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Fiscal Decentralisation in Lesotho: A Closer Look at Intergovernmental Fiscal Transfers

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Abstract

The concept of fiscal decentralisation is explained to be central to all models of decentralisation of public services to subnational governments. Fiscal decentralisation is generally referred to as the transfer of budget powers in terms of revenue and expenditure from national to subnational governments. Although fiscal decentralisation aims to ensure local financial independence, subnational governments continually experience financial shortfalls. In this regard, intergovernmental fiscal transfers are considered to address the financial gaps and guarantee continuity of public service delivery at subnational spheres of government. To understand transfers, the paper reviews the concept of intergovernmental transfers and explores the nature of the Lesotho intergovernmental transfer system. The study on which the article is based adopted the convergent mixed methodology. The findings indicate that Lesotho uses transfers as the primary source of revenue for subnational structures. Therefore, Lesotho subnational governments depend on transfers as their sole source of revenue, and this constrains the capacity of subnational governments to deliver services. The country does not have an intergovernmental fiscal transfer framework designed to regulate and direct transfers between and among government spheres. The article, therefore, recommends a three-pronged framework that considers the development of a subnational financial management legislative framework that demarcates the subnational financial scope and guides the subnational financial practices and processes; a decision by the country on the degree of revenue devolution to activate local revenue generation; and developing an intergovernmental transfer system based on revenue generation capacity and spending needs of councils to ensure incentive compatibility and secure some degree of equity among districts.

Keywords: Decentralisation; fiscal decentralisation; subnational government financing; fiscal gaps, intergovernmental fiscal transfers.

Introduction

Intergovernmental transfer refers to a complex aspect of fiscal decentralisation by which funds are transferred from one government to another (Mohapi, 2023). Fiscal decentralisation that entails dispersing fiscal policy whereby subnational governments are given autonomy over fiscal decisions regarding revenue and expenditure in their territory (Otoo & Danquah, 2021). According to Atan and Esu (2021), fiscal decentralisation is the process of devolving fiscal responsibilities to subnational governments to stimulate service delivery and economic growth. Furthermore, fiscal decentralisation is a significant component of decentralisation with a determining effect on the success of the decentralisation process. Adamtey, Obeng and Sarpong (2020) argue that fiscal decentralisation is a prerequisite for the success of other

components of decentralisation (political & administrative) and for nations to achieve general objectives of decentralisation such as improved governance, accountability, citizen participation and efficiency in public service delivery.

Fiscal decentralisation is operationalised through several concepts such as revenue assignment, expenditure assignment, intergovernmental transfer/grants and borrowing (Atan & Esu, 2021; Park, 2022). In the same vein, Hobdari, Nguyen, Salvatore and Ruggiero (2018) contend that for fiscal decentralisation to be successful, it should be implemented as part of a comprehensive framework comprising four basic elements, namely, clarified spending responsibilities across government spheres; generation of local revenue to minimise fiscal gaps and increase fiscal responsibility; transfer system that encourages local revenue generation; and implementation of hard budget constraints. The central objective is to create autonomous and financially independent subnational governments that depend on locally generated revenue and minimal external financing. However, external financing through intergovernmental fiscal transfer is inevitable in decentralised systems. Smoke (2019) underscores the importance of how governments share income by explaining that the inevitable fiscal imbalances necessitate the role of transfers, while subnational government also needs to generate enough income to alleviate the burden on the national budget.

Intergovernmental transfers symbolise the vertical financial structure by which resources are shared between government spheres. According to Rutto, Minja and Kosimbei (2022), transfers are established on the rationale that local revenue is inadequate to support an effective delivery of subnational governments' mandate owing to the disparity between local revenue-generating capacities and spending needs. Therefore, the asymmetry between local revenue supply and expenditure needs is at the centre of intergovernmental transfers (Mohapi, 2023); hence, the primary objective of transfers is to complement local revenue and guarantee the availability of resources to manage fiscal gaps at subnational governments (Lual, 2018). National governments have inherent advantages for revenue generation given their productive revenue sources and administrative capacity, while subnational governments are tasked with the responsibility to provide multiple public services owing to their knowledge of local needs and preferences (Smoke, 2019). Consequently, it is a common challenge that subnational government financial resources and fiscal competencies do not match their responsibilities and are inadequate to support effective public service delivery (Adamtey *et al.*, 2022). According to Rutto *et al*. (2022), this mismatch between revenue supply and expenditure demands confers a balancing and permanent role of intergovernmental fiscal transfers.

In decentralised systems, both national and subnational governments are expected to provide public services, although revenue at the subnational level is often not sufficient for the provision of such services. While the vertical fiscal gap can be addressed by increasing revenue-raising powers of subnational government, transferring expenditure responsibilities to the national government or by transferring resources from the national government, increasing own-revenue for subnational government is often challenging (Rutto *et al.*, 2022). Moreover, Adamtey *et al.* (2020) explain that most of the subnational government expenditure is financed through transfers owing to local revenue generation challenges. The authors contend that the mismatch between revenue supply and spending demands is caused by limited local revenue base, lack of tax authority, lack of administrative capacity and poorly designed transfers (Adamtey *et al.*, 2020). The mismatch between revenue and expenditure between government spheres confers a balancing role to be assigned for intergovernmental fiscal transfers (Rutto *et al.*, 2022). To understand transfers, the article reviews the concept of

intergovernmental fiscal transfers and explores the nature of Lesotho intergovernmental transfer system. The theoretical basis of fiscal transfers and various objectives of transfers will be discussed. The aforementioned will assist in the development of a comprehensive intergovernmental fiscal transfer framework that encourages local revenue generation and effective service delivery.

Theoretical Perspectives

The theoretical base of fiscal decentralisation focuses on the analysis of the factors that impact its success, functional assignments principles and the optimal intergovernmental transfers design system (Mohapi, 2023). Intergovernmental transfers refer to a multidimensional aspect of fiscal decentralisation in which funds are transferred from one level of government to another to manage fiscal gaps (Leon 2019; Shotton & Gankhuyag 2019). According to Jha (2015), theories of fiscal decentralisation promote an understanding of the factors that determine the status of fiscal decentralisation, functional assignments and financial base principles and the optimal intergovernmental transfer design system. Park (2022) elucidates that theories demonstrate how fiscal decentralisation influences/determines the allocation of government resources. The literature identifies two theories of fiscal decentralisation as the first-generation theory and the second-generation theory, as presented in Figure 1 below. The first-generation theory adopts the traditional principles of welfare economics while the second-generation theory incorporates welfare economics together with public choice, political economy and institutional economics (Jha, 2015).

In analysing the functional and revenue assignments to different government spheres, the first-generation theory concentrates on economic efficiency, macroeconomic stability and income redistribution (Yushkov, 2015). The first-generation theory is a traditional approach that postulates that government is a benevolent agent seeking to maximise the welfare of society (Park, 2022). The first-generation theory presumes a government that considers public needs and preferences in allocating resources, resulting in highly efficient service delivery (Mohapi, 2023). In this regard, the theory allocates macroeconomic stability and redistribution to the national government and tasks the subnational government with the allocative function (Jha, 2015). In general view, the theory prescribes securing efficiency and economic growth by decentralising the allocation function while centralising the distribution and stability function (Ozkok & Cutcu, 2021). Through the subsidiary principle, functions are allocated to the least centralised authority (Ejobowah, 2018; Logan, 2021), whereas taxing powers are centralised except for benefit tax, which is devolved to subnational spheres.

The prescriptions of the first-generation theory result in the mismatch between functional responsibilities and revenue assignment, creating economic disparity and fiscal imbalances. Intergovernmental transfers and grants are considered for correcting the inherent vertical and horizontal imbalances of the allocation methodology (Ejobowah, 2018). Moreover, the first-generation theory prefers minimal tax assignment and adoption of transfer to complement the revenue to maintain macroeconomic stability (Mohapi, 2023). Similarly, Jha (2015) argues that intergovernmental transfers have their roots in the first-generation theory as they emerge as a response to the description of the theory. Jha (2015) states that intergovernmental transfers are the response/solution to the inevitable/inherent fiscal imbalances resulting from the prescribed functional and revenue assignments among government spheres (Jha, 2015).
Complementarily, the second-generation theory adopts a broader view that considers multidiscipline to provide a more in-depth analysis of the concept of fiscal decentralisation (Valdalisi, 2018). In contrast to the first-generation theory, the second-generation theory views

government officials as selfish agents that often diverge from maximising society's welfare (Park, 2022). According to Arif and Chishti (2022), the second-generation theory promotes integration of fiscal decentralisation and institutions, and concentrates on institutional incentives that influence the behaviour of individuals as they interact within and across spheres of government. Although the theory supports the rationale for decentralisation of allocative function of the first-generation theory, it stresses the need for constructive revenue assignment to ensure that subnational governments generate enough local/own revenue to finance their mandate (Ejobowah, 2018). The theory advocates for self-sufficient subnational governments that can finance their mandates with their own revenue (Park, 2022).

In a general view, the second-generation theory subscribes to decentralisation of budget powers in terms of revenue and expenditure, a limited role to revenue-sharing and intergovernmental transfers (Jha, 2015). It is argued that transfers encourage subnational governments to adopt fiscal malpractices such as overspending and offloading the cost to the national government (Ejobowah, 2018), a practice that undermines macroeconomic stability. In this regard, Boardway and Shah (2007) explain that intergovernmental transfers/fiscal interventions are viewed as distortionary policies that encourage financial malpractices at subnational government, perpetuating their dependence on the national government. The design of the intergovernmental transfer system should, therefore, achieve the equalisation objective without diminishing the incentives of subnational governments to strive for prosperous economies (Jha, 2015).

Hard budget constraints are preferred over soft budget constraints to guarantee subnational government fiscal autonomy and minimal national government intervention. According to Ejobowah (2018), in hard budget constraints, institutions finance their mandate with their own revenue and manage deficits internally without considering external intervention, as they assume complete responsibility for their financial practices. While in soft budget constraints, institutions rely on external assistance and bailouts, especially from the national government. The hard budget constraints system is explained through government structures that promote and highly motivate public offices who prioritise economic prosperity through market and rule-based institutions (Mohapi, 2023).

Both the first-generation and second-generation theories subscribe to the relevance of intergovernmental transfer in decentralised systems. Complementarily, the second-generation theory introduces multiple factors in the analysis of transfers to secure an in-depth understanding of the concept. Accordingly, the second-generation theory promotes the primary objective of fiscal decentralisation by advocating for the creation of autonomous and financially independent subnational governments. The effort to consider the incentives generated by transfers on local tax generation is significant and impacts the success of fiscal decentralisation. If transfers disincentivise subnational revenue generation efforts, they may affect a decline in local revenue and accountability and discourage borrowing. In this regard, two sources of revenue for subnational governments (own revenue & borrowing) would be compromised. However, if transfers are designed in a way that they incentivise subnational government efforts, they would enable them to expand and explore broader investment areas for their economic growth.

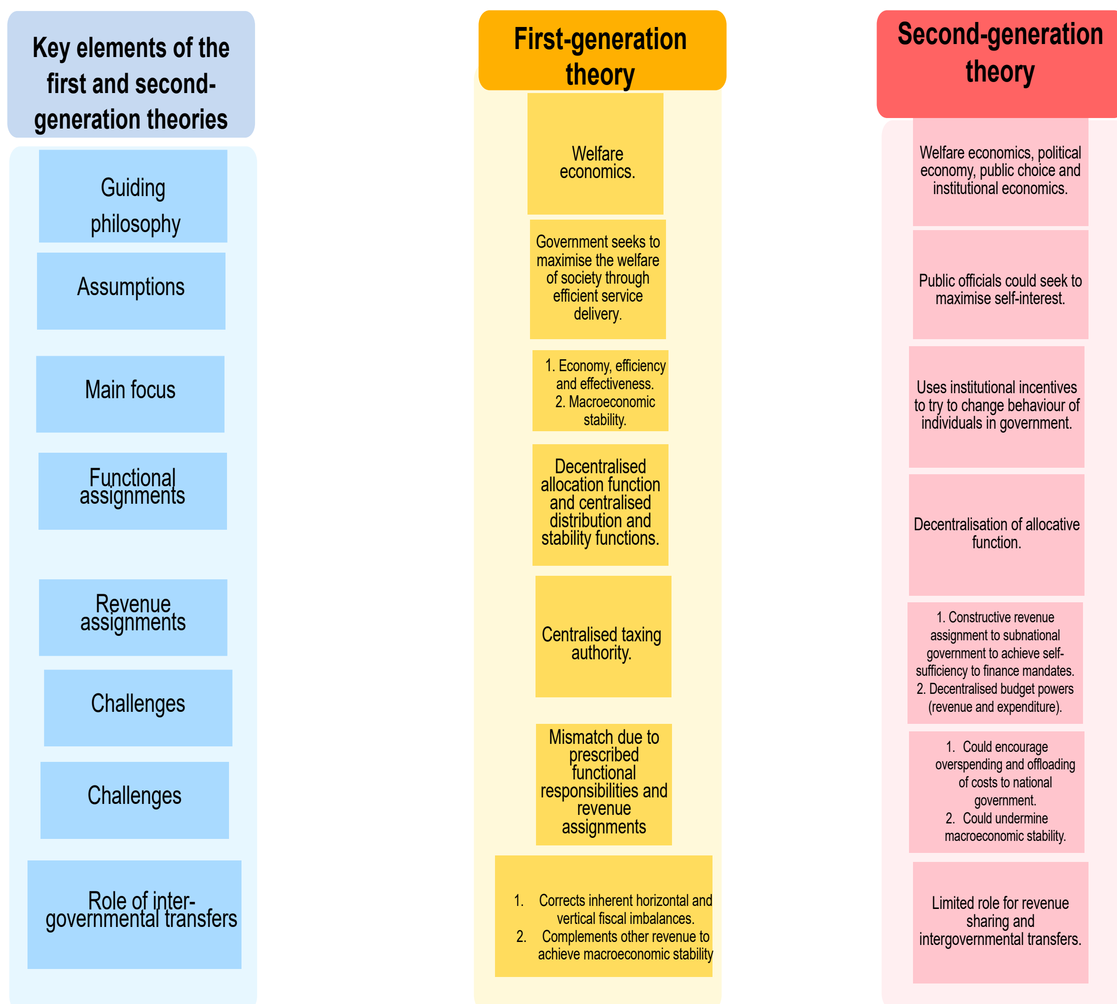


Figure 1: Intergovernmental transfers: theoretical framework

Source: Authors' creation informed by literature in section 2

The literature provides the following objectives for engaging transfers.

Objectives of intergovernmental fiscal transfers

Intergovernmental transfers are a permanent feature of fiscal decentralisation that plays a significant role in subnational financial performance. The foundation of intergovernmental transfers is the disparity between expenditure needs and revenue supply (Shotton & Gankhuyag, 2019). Therefore, the primary objective is to complement revenue supply to manage fiscal imbalances between and among spheres of government (Lual, 2018; Hobdari *et al.*, 2018). In this context, transfers serve as a strategy for financial supply to manage the fiscal gaps and guarantee sustainable service delivery and macroeconomic stability (Mohapi, 2023). Intragovernmental transfers, therefore, complement local revenue.

The intergovernmental fiscal transfers system has become an area of interest to strengthen subnational fiscal operations and outcomes (Lewis & Smoke, 2015). Irrespective of intensive debate, there is no consensus among scholars regarding the design of an optimal intergovernmental transfer system; rather, objectives are highlighted as one critical factor to determine the design of transfers (Rutto *et al.*, 2022). Adamtey *et al.* (2020) support that the

objectives of transfers should determine the structure of the design within a country context, given the limited local revenue and absence of best practice design. Boardway and Eyraud (2018) posit that the design of the intergovernmental transfer system assumes a critical position in guaranteeing that decentralisation is associated with successful macroeconomic outcomes. Therefore, the intergovernmental transfer system must have the following basic pillars: transparency of allocation, predictability of the amounts available to subnational spheres and local autonomy of decision-making on resource utilisation (Adamtey *et al.*, 2020). The literature identifies multiple worthwhile objectives that contribute to the drafting of transfer systems design. These include correcting vertical and horizontal imbalances, equalisation (Adamtey *et al.*, 2020), addressing spill overs or externalities between governments (Rutto *et al.*, 2022) and promotion of national standards (Al-Samarrai & Lewis, 2021). The objectives of transfers are subsequently discussed next.

Transfers for addressing the vertical fiscal gap

Subnational financial systems are characterised by revenue shortfalls; whereby subnational government collects less revenue than they spend on their responsibilities. Shotton and Gankhuyag (2019) assert that in most decentralised systems, the expenditure needs of subnational government exceed revenue supply. This mismatch between revenue supply and expenditure responsibilities is termed the vertical fiscal gap (Boardway & Eyraud, 2018). This refers to a financial structure in which national government revenue surpasses the spending needs, while subnational government spending needs surpass the available revenue, causing fiscal imbalances (Hendricks, 2014). Transfers are, therefore, designed to bridge the fiscal gap with the intention to ensure that subnational expenditure responsibilities are approximately equivalent to revenue supply.

Transfers for addressing the horizontal fiscal gap/equalisation

Subnational governments have different access and ability to generate revenue owing to their territorial location. Horizontal fiscal gaps refer to financial disparity among subnational governments at the same sphere of government (Al-Samarrai & Lewis, 2021), caused by their different abilities to raise revenue and their different needs as well as different costs of providing public services (Boardway & Eyraud, 2018). Broardway and Eyraud (2018) explain that the equalising transfer is used to address the discrepancies in revenue-generation abilities among subnational governments with the intention to promote equity and efficiency in service delivery. The primary objective of equalisation fiscal transfers is to ensure that all citizens across the country have access to similar services with similar costs regardless of their location (Lual, 2018, p. 12).

Transfers for correcting externalities

Transfers are also considered when the activities or services of one subnational government generate spill-overs, either as a benefit or a cost beyond its territorial boundaries. It is a situation where subnational government citizens enjoy the benefits of services that originate from their neighbouring governments without bearing the costs of such services (Jha, 2012). Boardway and Eyraud (2018) explain that when externalities arise, transfers are developed as a means of compensation to address the impact of externalities.

Transfers for supporting the national standard

According to Boardway and Eyraud (2018:21), intergovernmental transfers may also be used to promote the implementation of national policies at the subnational level. The intention is to encourage subnational governments to prioritise spending on programmes that support national interests that would not be prioritised at the local level without the transfer (Mohapi, 2023). The rationale for the transfer is to achieve optimal distribution.

The discussion on the objectives of transfers reflects the primary rationale for engagement of intergovernmental fiscal transfers to support decentralisation. Irrespective of the objective of the transfer, they all involve a flow of resources from national to subnational government. In this regard, transfers have redistribution implications. Therefore, governments adopt different strategies in implementing transfers. Intergovernmental fiscal transfers are implemented in several strategies such as shared taxes, grants, subsidies and subventions (Rutto *et al.*, 2022). The main types of intergovernmental transfers are revenue sharing, a general-purpose grant and several specific-purpose grants (Lewis, 2023), hence classified as revenue-sharing and grants (Shotton & Gankhuyag, 2019). According to Mohapi (2023), grant transfer refers to financial support from the national government to the subnational government for a general purpose (unconditional grant) or a specific purpose (conditional grant). Contrarily, in revenue-sharing transfer, the subnational government receives a share of revenue that is generated from its territory by the national government (Mohapi, 2023).

Grant transfers

Intergovernmental grants are classified based on their objective and allocation method (Lewis, 2023). Grants transfers are classified as conditional, unconditional and performance-based grants (Shotton & Gankhuyag, 2019). Conditional grants have restrictions that compel the receiver to utilise them for specific forms of spending, whereas unconditional grants (general-purpose grants) allow the receiver to decide on spending areas (Lago, Lago-Penas & Martinez-Vazquez, 2022). Grant transfers are subsequently defined next.

Conditional grant transfer

Conditional grants, also referred to as earmarked or specific-purpose grants (Lewis, 2023), are defined as transfers with attached restrictions on their utilisation. Mohapi (2023) defines conditional transfers as restricted and earmarked financial support to promote subnational government spending on national priorities. The transfer comes with detailed guidelines and expected outcomes to ensure efficiency.

Unconditional grants

Unconditional grants are designed as general budget support to enable subnational governments to finance their mandate (Shotton & Gankhuyag, 2019). Unconditional grants focus on equalising fiscal capacities of subnational governments (Lewis, 2023) and preserve subnational government autonomy while boosting inter-jurisdictional equity (Rutto *et al.*, 2022). The grants affect redistribution with the intention to boost the fiscal capacity of subnational governments (Clemens & Veuger, 2023, p. 11). Therefore, the rationale is to provide stability over the course of the budget cycle (Lewis, 2023). The grant ensures efficiency, fairness and flexibility, and enables subnational governments to address local preferences (Rutto *et al.*, 2022).

Performance-based grant

Performance-based grants are designed to encourage good performance and can either be conditional or unconditional (Shatton & Gankhuyag, 2019, p. 33). The grant aims to promote accountability by designing transfers based on the output or performance of subnational government in a particular area of interest. Therefore, performance-based grants link grant finance with service delivery performance.

Revenue-sharing

Revenue sharing involves the national government allocating a fraction of the national collection of a certain revenue to the subnational government (Rutto *et al.*, 2022). The shared revenue includes revenue collected from national tax and non-tax revenue (natural resource-based) for reducing vertical fiscal gaps (Lewis, 2023). The allocation of revenue-sharing transfer is based on the principle of derivation (Shatton & Gankhuyag, 2019; Lewis, 2023) and on equal per capita as part of redistribution (Boardway & Eyraud, 2018). That is, the national government transfers a share of revenue to a specific subnational government as a fraction of revenue collected from that subnational government's territory.

The foregoing discussion indicates the necessity for the permanent role of transfers in a fiscal decentralisation framework. Subnational governments need predictable and adequate transfers, calling for objective criteria and transparency in designing transfers (Smoke, 2019). According to Bird and Smart (2001), the performance of transfers is best viewed through the incentives they create for national and subnational governments. Smoke (2019) explains that central to intergovernmental transfers is the relative importance of the intended goal, the incentives and conditions attached to the transfer. In addition to funding expenditure, transfers establish incentives and accountability mechanisms that influence the fiscal management, efficiency and equity of service delivery and promote government accountability (Bird & Smart, 2001). It is, therefore, necessary to design an intergovernmental fiscal transfer system to support an efficient implementation of fiscal decentralisation.

Next, the discussion on the intergovernmental fiscal transfer system is described within the context of Lesotho.

Lesotho’s Intergovernmental Fiscal Transfers System

The foundation of Lesotho's decentralisation is rooted in the Constitution. Section 106 of the Constitution, Act 5 of 1993, makes provision for the establishment of authorities in urban and rural areas to enable communities to develop themselves (Lesotho, 1993). The section is operationalised through an Act of Parliament, the Local Government Act of 1997. The Local Government Act of 1997 is the principal legislation for the functional and management of decentralised structures. The National Decentralisation Policy of 2014 defines Lesotho as a democratic state with a multi-party system at all spheres of government, headed by the King (Lesotho, 2014). The country has two tiers of governance, namely, the national government and local government. Section 3 of the Local Government Act of 1997 provides for the creation of a four-level decentralised system, namely the District Council, the Municipal Council, the Urban Council and the Community Council. The establishment of a four-tier decentralisation system is catered under section 3 of the Local Government Act of 1997 as District Council, Municipal Council, Urban Council and Community Council. As detailed in the National

Decentralisation Policy of 2024, Lesotho has ten District Councils, a Municipal Council, 11 Urban Councils and 64 Community Councils (Lesotho, 2014).

The Local Government Act of 1997 identifies transfers as the source of subnational funding. Section 55 of the Act states that local authorities may apply for the allocation of grants under the terms and format determined by the Minister of Local Government and Chieftainship. After the evaluation, recommendations for approval and allocation of grants are made to the Minister of Finance. Mohapi (2023) explains that transfers are administered through a budget process in which subnational governments receive grants in the form of quarterly warrants as part of their approved annual budget to finance their operations. The Ministry of Finance allocates an annual budget to subnational governments through the Ministry of Local Government as transfers from the national government (Ministry of Local Government and Chieftainship, 2014). The allocation reflects the national government as the primary financier for subnational governments through intergovernmental transfers in the form of grants. Lesotho fiscal decentralisation is defined as an 'intergovernmental transfers system' (Nyane, 2016), as transfers are the only active revenue source for subnational structures.

Intergovernmental transfers dominate subnational finances (Smoke, 2019), forming the cornerstone of subnational government financing and determining the success of fiscal decentralisation (Rutto *et al.*, 2020). Lewis (2023) highlights that transfers are the most important source of revenue for subnational governments in developing countries. Lesotho is not an exception, as the entire budget of the Lesotho subnational government is financed through intergovernmental transfers. According to Mohapi (2023), subnational government budget is provided under the national government as transfers because subnational governments do not have authority to collect and expend revenue. The author argues that the provision deters subnational governments from exploring initiatives to strengthen local revenue collection to improve service delivery (Mohapi, 2023).

Rutto *et al.* (2022) assert that generally, subnational governments in Africa collect little revenue compared to their functional responsibilities, creating dependency on transfers and ultimately the failure of decentralisation programmes. The failure is explained through multiple challenges, including limited local revenue streams, absence of tax authority and weak administrative capacity, the concentration of locally generated revenue in the larger urban areas and poorly designed transfers and grants (Adamtey, 2020).

Sefeane (2020) explains that even though there are potential revenue sources at local spheres, Lesotho local authorities are not able to generate significant revenue because the function remains the responsibility of the national government. The National Decentralisation Policy details that the annual revenue collection for some local authorities amounts to USD$303.70, the amount equivalent to a councillor's one-month allowance (Lesotho, 2014). Kali (2020) accentuates that local authorities continually experience insufficient resources owing to the absence of authority to develop a budget and mobilise resources. According to Sefeane (2020), subnational governments depend on the national government to finance their budget owing to the absence of a fiscal decentralisation framework. 'Nyane (2019) concludes that the dependency on the national government affects the management of revenue sources and expenditure at subnational spheres.

Intergovernmental fiscal transfers are used for various objectives and mostly for addressing subnational financial challenges (Rutto *et al.*, 2022). The design of an intergovernmental transfer system, therefore, plays a significant role in ensuring that national interest is

considered in decentralised systems (Boadway & Eyraud, 2018). According to Dougherty, Nebreda and Mota (2024), when transfers are adequately designed, they can improve accountability, efficiency and local service delivery. The authors also caution that poorly structured transfers may result in detrimental outcomes such as misallocation of resources, dependency and fiscal disparities among subnational structures (Dougherty *et al*., 2024). In this regard, intergovernmental transfers assume the role of an important policy instrument for influencing subnational financial management systems (Rutto *et al.*, 2022). Smoke (2019) argues that it is critical to establish the effect of fiscal decentralisation on the economy, as subnational governments are central in the delivery of public services. The specific focus on the intergovernmental fiscal transfer system is to enhance subnational fiscal operations and outcomes to realise decentralisation objectives (Lewis, 2023). Lual (2018) avers that transfers should complement local revenue for addressing fiscal gaps. Boardway and Eyraud (2018) contend that the transfer system cannot be designed independently; it should be contemplated in the context of a broader decentralisation framework which covers multiple policies such as taxation, spending assignments, borrowing controls and institutional arrangements. The next section presents the research findings on intergovernmental transfers as one of the research themes that emerged during the study.

Research Findings

The study's research findings, specifically the section of the study relevant for this article (intergovernmental transfers) are presented next. The study adopted the convergent mixed-methodology, wherein data were collected through a questionnaire and interviews. The findings from data collected from questionnaires are presented first, followed by findings of data collected through interviews.

Findings of the Data Collected Through the Questionnaire

Intergovernmental transfers are an element of fiscal decentralisation (Rutto *et al*., 2022). Furthermore, Dejene Mamo (2020) postulates that in accordance with decentralisation theorem by Musgrave and Oates as well as Pigouvian theory of subsidies, the division of government functions and financial relations among the three spheres of government is concerned with "the rational assignment of taxation, expenditure responsibilities and intergovernmental transfers to different tiers of government" (Dejene Mamo, 2020, p. 8). This section thus presents the reporting and analysis of data on intergovernmental transfers, collected through questionnaires. The questionnaire consisted of closed-ended questions, where respondents had to select answers as follows: 1=Agree, 2=Partly Agree, 3=Disagree and 4=Totally disagree. 44 participants completed the questionnaire. The positions of the respondents were: Senior Accountant (6), Assistant Procurement Office (2), Assistant Administration Officer (5), Assistant Human Resource Officer (1), Accounts Clerk (11), and Councillor (19).

Descriptive statistics were applied to analyse the data. To reflect data distribution, summary statistics were presented using central tendency and dispersion. These include the calculation of the mean to identify the average/ common pattern and the standard deviation to indicate the data distribution. The aim was to determine the spread of the data around the mean. If the spread is small, it shows that all responses are closer to the mean, resulting in a smaller standard deviation. Conversely, a greater spread with a larger standard deviation means that the data are far from the mean. The standard deviation, therefore, enabled the researcher to

use the distribution value to assess the outliers in the data and identify potential issues that might be caused by the outliers.

The results relevant to this article are presented next.

Table 1: Reporting and analysis of findings from data collected through questionnaires: Intergovernmental transfers

INTERGOVERNMENTAL TRANSFER					
Questions	**Agree**	**Partly agree**	**Disagree**	**Totally disagree**	**Interpretation**
Q4.1 Transfers for addressing asymmetry between revenue and expenditure.	39%	16%	25%	20%	55% of the respondents agree that councils receive transfers to manage the financial gap between expenditure and revenue, while 45% of the respondents disagree.
Q4.2 Grant transfers for local development.	75%	25%	0%	0%	All the respondents acknowledge existence of intergovernmental transfers.
Q4.3 Sharing locally collected revenue.	0%	39%	16%	45%	61% of the respondents do indicate that councils do not receive a share of revenue originating from their territory.
Q4.4 Authority to determine the use of transfer funds.	52%	36%	7%	5%	88% of the respondents are of the view that local authorities have autonomy on how to spend the funds transferred by national government.
Q4.5 Availability of transfer system regulations.	50%	27%	0%	23%	77% of the respondents concur to the availability of regulatory framework to guide the transfer system.
Q4.6 Suitability of transfer system as a funding strategy.	41%	43%	11%	5%	84% of the respondents believe that the transfer system is the most effective funding strategy for councils.

An overview of the findings from data collected through questionnaires will follow the presentation of data collected through interviews.

Reporting and analysis of findings from data collected through interviews

Interviews were conducted with management teams of councils to collect data on their perceptions of the practicality of subnational financial management as well as the status of fiscal decentralisation and intergovernmental relations. The interviews were conducted at the participants' council offices. In addition, in-depth interviews were held with district council management teams and chairpersons of the council finance committee at their respective offices as well. The number of interviews conducted was informed by the principle of saturation. Saturation was, therefore, reached after 26 interviews. The participants are leaders in the local authorities who have financial decision-making powers. Consent was obtained from the participants to take extensive notes and record the interviews. The recordings were transcribed as the first step of the analysis process. The adopted data analysis method was thematic analysis.

The questions in this section aimed to collect data about the formula for allocating financial resources and methods of sharing revenue. The goal was to understand the intergovernmental transfer system and its objectives. The questions included the following:

1. *Do subnational governments receive transfers as grants and revenue sharing from the national government?*
2. *Is there a regulatory framework for governing the transfer systems?*
3. *Please explain the current intergovernmental transfer system.*

The general view among respondents was that the transfer system is the most suitable funding model for councils and is currently the sole source of income. The majority of the respondents also acknowledge the absence of a regulatory framework to govern the transfer system. As presented by Mohapi (2023), the following are dominant direct quotations by the participants:

> *"We receive transfers from the national government as grants to finance our budget. The national government provide grants for daily operations of council and for capital projects."* (Procurement Officer)

> *"Transfers are the sole source of revenue for councils and come as grants. We do not share any revenue with the national government as we receive funds like all other government departments"* (District Council Secretary)

> *"We use grants to finance our activities and do not engage in revenue sharing. All the revenue collected at district level is deposited to the consolidate fund to finance the entire government budget at national and subnational level."* (Finance Manager)

The following are quotes in response to the question about the transfer system and council authority in utilising the transferred funds:

> *"Grants are distributed through the budget formula whereby councils receive quarterly warrants depending on their approved annual budget."* (Community Council Secretary)

> *"We annually receive grants transfers through four quarter warrants like other national government department/ministries. The transfers that do not come as quarterly warrants are those from development partners. The financial support from development partners also come as grants through the Ministry depending on the conditions of the support."* (Procurement Officer)

"Quarterly warrants are released to council for operations and capital projects depending on the approved budget. The usual argument is that the approved annual amount, which determines the number of quarterly warrants, is influenced by the council's consumption rate of the previous financial year budget, whereas the consumption rate is also influenced by various factors that are external to the control of councils, such as the timely release of warrants." (Finance Manager)

"The consumption of grants is determined by the annual budget policy that is developed by the councils." (Procurement Officer)
"In both operations and capital initiatives, councils make priorities on the preferred activities to be financed in a financial year." (Community Council Secretary)

"We decide on how the transfer funds are used. Even with the grants from the development partners, we are guided to focus on certain areas, but ultimately, we decide on the projects that should be financed in those areas. For instance, the UNDP supported councils with funds to improve employees' skills through training. The respective councils decide on the areas on which they train their staff." (Finance Manager)

"Councils determine the use of the budget because budget policy is developed on the basis of local needs, and the transfers are made in line with the budget." (Administration Manager)

"Councils are allowed to manage their expenditure by using the transfer funds to finance their local development plans although the expenditure is regulated through national government financial policies" (Town Clerk)

"The transfers and other financial operations at subnational government are guided by the Public Financial Management Accountability Act." (Procurement Officer)

"Councils use national government policies; we are directed to always engage national government policies in every case where we do not have regulatory frameworks." (Senior Legal Officer)

"The budget requests, approvals and expenditure of the grants are guided by Public Financial Management and Accountability Act." (Finance Manager)

In line with Thapa, Rahman, Were, Wamai and Galárraga (2024), the respondents argued that transfers are the best funding model for Lesotho. They provided their explanations as follows:
"Transfers are needed to support local development, but they need to be more predictable and rational to have impact on local development." (Town Clerk)

"The government has to assist councils with grants, especially those in remote areas because most of us in the rural area have multiple challenges." (Community Council Council)

"Although depending on grants is not enough for us to operate effectively, government has to design transfer system to support local service delivery so that we can achieve equitable development." (District Council Secretary)

"The transfer system is a good way of financing council but needs to be improved, especially the budget cuts. The councils in the hard-to-reach areas have more challenges than in urban and easily accessible areas." (Community Council Secretary)

"The Ministry of Finance transfers funds to the Ministry of Local Government and Chieftainship as per approved annual budgets and the Ministry transfers the funds to district councils. The District Council, on behalf of all councils in the district, administers the funds. However, there is no formula for sharing the budget among councils in the district. Each district designs its suitable way depending on their needs every time they receive the budget." (District Council Secretary)

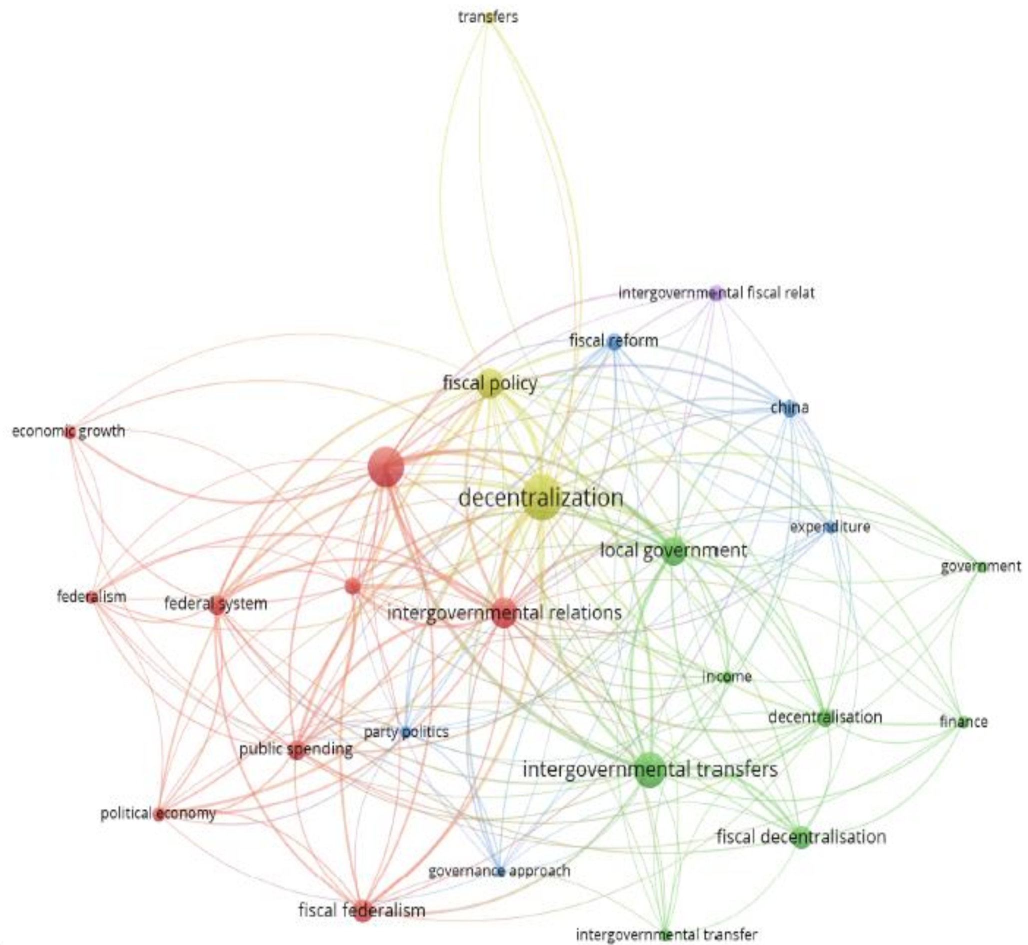
The foregoing responses by the various respondents paint a picture of sole reliance on transfers by the subnational government sphere of Lesotho. Ogweno and Semedo (2025) caution that when the subnational sphere of government is heavily reliant on transfers from the national sphere, fiscal discipline by subnational spheres only improves when they have increased borrowing and taxing autonomy. Similarly, Abidar, Ed-Dafali and Kobiyh (2025) underscore the importance of having an effective transfer system which aims to reduce dependence on transfers from the national sphere through the effective use of resources to bolster the revenue generation capacity and autonomy of subnational governments. In this regard, it is important to note that neither a formula nor legislation exists in Lesotho for revenue sharing to manage transfers.

Despite the respondents being in support of transfers as methods for financing service delivery, the researchers do not recommend the current transfer system. However, the criticism of the dependence of subnational spheres of government on transfers from national spheres does not in any way discredit the value of intergovernmental transfers in the mix of financial resources for subnational spheres. In this regard, Yu and Kwan (2024) found that "increased resources to local administrations from intergovernmental transfers and economic development may discourage public servants from deviating from their stated career motivations, that is, engaging in corruption" (Yu & Kwan, 2024, p. 749). The authors' emphasis is, therefore, explained by Lual (2018), who contends that transfers ought to complement local revenue to address the inevitable fiscal gaps. The current dependency on transfers from the national government in Lesotho renders subnational governments vulnerable in terms of independence and autonomy. In accordance with the second-generation theory as described earlier, only minimal national government intervention to promote accountability is recommended (Martinez-Vazquez *et al*., 2016).

Vos viewer bibliometric networks

In further linking the findings of the study to existing literature, the Vos viewer application, an application used in qualitative research was used to construct and visualise bibliometric networks from 195 sources (published between 2010 and 2025), downloaded from the Scopus database using the search terms: *fiscal decentralisation*; *intergovernmental*; *fiscal transfers* to create a network visualisation of keywords. The network visualisation is presented in Figure 2. The visualisation shows the association strength of the terms. Four clusters emerged from the analysis of the sources. The clusters emanate from the analysis of the sources and shows strongly related interconnected keywords. The clusters are provided in Table 2, together with the key terms from each cluster and explained further below:

Figure 2: VOS viewer network visualisation



Source: Scopus database

Table 2: Network visualisation clusters

Cluster	Items
Cluster 1	1. Fiscal decentralisation; 2. Fiscal federalism; 3. Intergovernmental relations; 4. Economic growth; 5. Political economy; 6. Public spending; and 7. Tax system.
Cluster 2	1. Decentralisation; 2. Finance; 3. Fiscal decentralisation; 4. Income; 5. Intergovernmental transfers; and 6. Local government.
Cluster 3	1. China; 2. Expenditure; 3. Fiscal reform; 4. Governance approach; and 5. Party politics.
Cluster 4	1. Decentralisation;

Cluster	Items
	2. Fiscal policy; and 3. Transfers.

Source: Scopus database

Cluster 1 highlights, among others, that fiscal decentralisation takes place within the context of intergovernmental relations which has an impact on economic growth and public spending, which is mainly funded through taxes (see Abidar *et al*., 2025; Ogweno & Semedo, 2025). **Cluster 2** further emphasises the importance of fiscal decentralisation, within which intergovernmental transfers to the local sphere of government take place. **Cluster 3** accentuates lessons that can be observed from countries such as China in terms of their implementation of fiscal decentralisation and fiscal reforms (see Yu & Kwan, 2024). **Cluster 4** shows the importance of promulgating fiscal policies to enable the implementation of fiscal decentralisation (see Ogweno & Semedo, 2025).

General assessment on intergovernmental fiscal transfers

The feedback from the respondents affirms the necessity of intergovernmental fiscal transfers as a source of income for subnational governments. Grant transfers are explained as the sole income for Lesotho subnational governments. There is no revenue-sharing formula and legislation for managing transfers, resulting in total dependency on the national government for budget and regulatory frameworks. Data collected through questionnaires and interviews support the implementation of a transfer system for subnational government. This system is to ensure equitable development across the country. Similarly, Yu and Kwan (2024) highlight that intergovernmental fiscal transfers were instituted in China during the country's fiscal reforms in 1994, and aimed to raise fiscal capacities at the local sphere of government as well as reduce regional income disparities. Furthermore, Martínez-Vázquez, Sanz-Arcega and Tránchez-Martín (2024:3) proffer that "dealing with decentralised fiscal governance implies solving four basic challenges in intergovernmental fiscal relations design: the problems of expenditures and revenue assignments, the implementation of an efficient and effective intergovernmental transfer system, the design of fiscal and borrowing rules, and the validation of formal and informal institutional arrangements and political institutions enabling fiscal decentralization to work." The design of an intergovernmental fiscal transfer system has significant incentives and consequences. This is confirmed by previous authors (Kasumba-Ddumba & Mubangizi, 2022; Dougherty *et al*., 2024) who explain that the strategic design of a transfer system is a significant element that guarantees that fiscal decentralisation translates into tangible benefits for all spheres of government. Recommendations are presented next.

Recommendations

The recommendations and strategies for enabling the country to develop a comprehensive intergovernmental fiscal transfer framework are first depicted in Figure 3, followed by an explanation of the figure:

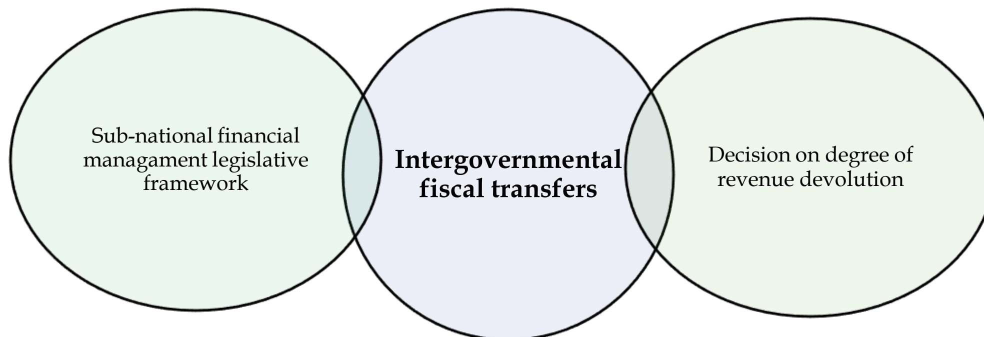


Figure 3: Recommendations for a comprehensive fiscal transfer framework in Lesotho. Source: Authors' creation

Firstly, it is recommended that the country develop subnational financial management legislative frameworks that demarcate the subnational financial scope and guide the subnational financial practices and processes.

Secondly, the country needs to determine the extent of revenue devolution to motivate local revenue generation. The decision on the degree of revenue devolution will enable the development of a revenue management framework for subnational governments. The framework will manage the sources of revenue generation and reduce dependency on national transfers. Thirdly, the proposal is to develop an intergovernmental transfer system framework. The framework would assist in designing a transfer system suitable for the country, considering the revenue generation capacity and spending needs of councils. The intention is to ensure incentive compatibility and secure some degree of district equity.

An explanation of how the three elements depicted in Figure 3 above, that is, intergovernmental fiscal transfers, sub-national financial management legislative framework and the decision on the degree of revenue devolution overlap and intersect, follows below.

Smoke (2015) alludes that the design of intergovernmental transfers depends on the financial management capacity of sub-national governments. Similarly, Dejene Mamo (2020) posits that when a grant system is designed to incentivise local governments that can exploit their revenue potential, this could support greater local revenue collection. In this regard, legislation and regulations for either performance-based or compliance-based measures, such as a requirement to meet standards in pursuance of good governance and fiscal discipline can be put in place (Smoke, 2015). This would highlight the intersection between intergovernmental fiscal transfers and financial management legislative frameworks. In this way, transfers are ultimately used to improve and to incentivise prudent public financial management and service delivery at the local sphere of government (Kasumba-Ddumba & Mubangizi, 2022). Key examples on the African continent are Kenya and Uganda, wherein transfers to local governments are linked to good fiscal practices (Hobdari *et al.*, 2018).

The degree of revenue devolution is also often dependent on management capacity and whether there are strong legislative frameworks in place or not. This indicates the intersection between legislative frameworks, intergovernmental fiscal transfers and decisions on the degree of revenue devolution. It is also worth noting that developed countries, such as the United Kingdom, also link greater revenue devolution to sound fiscal management and political stability. For example, devolution in Northern Ireland was delayed due to political instability (Vértesy & Gyakovácz, 2023). Ayres (2025) states that capacity and resilience building should be the cornerstones for decentralisation and devolution. Furthermore, "local institutions should be empowered with resources and tools, including appropriate legal frameworks, strategic and accountability frameworks, to shoulder the responsibilities associated with taking many of the decisions locally which are currently reserved to Westminster" (Ayres, 2025, p. 4). Ayres (2025) further cautions that although there are benefits for pursuing fiscal devolution, such as increased efficiencies and enhanced accountability, the success of its implementation lies in a "wider political system and the quality and capacity of local institutions".

It is also important to have legislation at the national government level that governs intergovernmental fiscal relations amongst the various spheres of government (Abuselidze, 2021), indicating the intersection between legislative frameworks and intergovernmental fiscal transfers. This is due to that, sub-national governments that have adequate legislative frameworks on fiscal management and management capacity, tend to reduce their dependence on transfers as they can deal with more responsibilities about revenue devolution (Chigumira, Chipumho & Mudzonga, 2019; Ng'ang'a, 2024; Oduol, 2023). This

Conclusion

Fiscal decentralisation has a determining factor on the success of the decentralisation process. Intergovernmental transfers are critical revenue sources for subnational governments owing to multiple revenue generation challenges, such as limited revenue sources and the absence of taxing authority at the subnational government level. It is believed that Lesotho needs to consider policy decisions about fiscal decentralisation, as it is apparent that there is a need to explore stable and reliable sources of revenue for Lesotho's subnational structures. The discussion shows that local authorities depend on transfers, and these constraints constrain their ability to deliver services. The theories of fiscal decentralisation highlighted the importance of attending to fiscal gaps through transfers. Central to fiscal transfers is the need to address fiscal gaps and achieve identified objectives without disincentivising local revenue generation; hence, the objectives are identified as significant factors determining the design of intergovernmental transfers. The development of the intergovernmental fiscal transfer system depends on other fiscal decentralisation factors such as revenue assignment; hence, there is a need to develop the system in contemplation of the various financial factors that have a role in the subnational financial management system. Lesotho can ensure success of its fiscal decentralisation by developing supporting financial legislative frameworks to address various factors that impact subnational government financial performance such as taxation and intergovernmental fiscal transfer.

Declaration

- The authors have read the paper and approve that it be published.
- The article is based on the completed thesis of the primary author: Mohapi, T.J. 2023. *Fiscal Decentralisation: Domesticating a Methodology for Lesotho*. University of South Africa.

Conflict of interest

The authors declare that there is no conflict of interest.

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