

**IS THERE A NEXUS BETWEEN BUDGET TRANSPARENCY AND
SOUND FISCAL MANAGEMENT IN KENYA?**

A Dissertation

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ABSTRACT

Public finance reforms have been a key area of focus both locally and internationally. With implementation of several reforms in the public finance sector it was expected that there would be improved transparency and accountability levels in the public sector. Some of the immediate output in the field of public finance reforms include favorable changes in tax revenue collections, increased inflow of foreign grants and reduced budget deficits. The main aim of this study was to review the various public finance management reforms that have taken place between the years 2000 and 2017 in Kenya and thereafter determine whether these revenues enhancing public finance reforms have an impact on the public finance transparency and accountability levels.

The study employed time series techniques to examine the effect of public finance reforms on transparency and accountability. In this study, budget absorption was used as a proxy for the transparency and accountability levels while tax revenue, foreign grants and budget deficits were the explanatory variables of the study as proxies for public finance and fiscal reforms. The bounds test established presence of a long run relationship between the depended variable (budget absorption rates) and the explanatory variables namely: grants revenue, tax revenue and budget deficit. The disequilibrium in the short run model was corrected for rates between 71% and 100% which was indicative of the relative speed to which the long run equilibrium adjustments take place. Based on the long run regression results, it is therefore concluded that revenue enhancing fiscal management reforms in tax and grants had a positive impact on budget accountability and transparency. Based on the findings of the study, it is recommended that the national Government in Kenya should continue to implement the public finance reforms at the subnational level to improve budget transparency and accountability for the devolved units.

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GLOSSARY OF TERMS

BPS	Budget Policy Statement
BROP	Budget Review and Outlook Paper
CPI	Corruption Perception Index
GDP	Growth Development Product
IMF	International Monetary Fund
KNBS	Kenya National Bureau of Statistics
OAG	Office of the Auditor General
OBS	Open Budget Survey
OECD	Organization for Economic Co-operation and Development
MOF	Ministry of Finance
SSA	Sub Saharan Africa
IMF	International Monetary Fund

CHAPTER 1

INTRODUCTION

1.1. Background of the study

In political science, accountability can be defined as “ the requirement that public servants both inform the public about what they are doing and face sanctions when their activities do not conform to the law” (Githinji & Holmquist, 2012). This entails that management of public resources needs to be transparent and accountable since the power to manage resources by the executive stems from the delegated authority given to them by the citizens. For an effective public finance management that ensures transparency and accountability, there needs to be in place a basic framework which provides for a legal structure, clarity of vision and policies, defined roles and responsibility, strong monitoring and evaluation structures and access to information by the public to allow for independent scrutiny of the government (IMF, 2007).

In 2010, Kenya adopted a new constitution which brought with it an array of fundamental changes in management of public affairs including changes in public financial management. One fundamental change relates to the budget making process. Prior to 2010, the only forum the public and to a large extent the elected citizens participated - albeit passively - in the budget formulation process was when the minister of finance used to read the annual budget in parliament (Maina, 2003). Post 2010, Kenya implemented some major public financial management reforms which ensured that there is more transparency and accountability in the management of public finances (Muyonga, 2010).

It is argued that the successful establishment of a participatory budgetary process should enhance transparency and accountability, leading to better fiscal management and finally to improved economic growth of the country’s economy (Benito & Bastida, 2009). By agitating for the new constitution, Kenyan citizens were hoping to have a say in the how their country’s resources are allocated and managed thus ensuring that corruption is managed.

1.2.1 Problem definition

“The government sector should be distinguished from the rest of the public sector and from the rest of the economy and policy and management roles within the public sector should be clear and publicly disclosed” (IMF, 2007, p. 6). Government budgets are inevitably needlessly very complex due to the relative size of the bureaucracy as well as the numerous roles that modern governments undertake (Benito & Bastida, 2009). However, this needless complexity allows for hiding the true cost of the budget from the citizens, mostly for ulterior reasons (Bastida, Guillamón, & Benito, 2017). Benito et al. (2009), suggest that due to concerted citizen enlightenment undertaken by several non-governmental organizations, citizens have become more enlightened and demand more disclosure and participation in the uses of the state resources.

Citizen participation in the management of the state resources happens both directly (through proper channels of public participation enshrined in countries' laws) or through their elected representatives. Both processes try to ensure that the transparency in the budget process gives citizens more confidence in use of the state resources. Reforms in the public sector is a continuous process and with the goals being improvement of the government's fiscal position. Reforms are also aimed at improving the government's budget absorption rates by ensuring that the ministries and agencies are able to use their allocated resources efficiently and effectively (Hassan, 2018). Budget transparency and accountability is therefore essential to ensuring efficient and effective usage of public resources (Nicolas Van de Walle, 2018).

The study aims to establish whether there is link between the financial reform process that promotes budget transparency (as measured by budget absorption rates) and sound fiscal management. The study aims to assist policy makers in Kenya to ascertain if the public finance management reforms in budget transparency and accountability are yielding fruit as far sound fiscal management is concerned.

1.2. Statement of research objectives

The overall objective of this research is:

1. To examine the effect of fiscal management on budget transparency in Kenya.
2. To establish if the impact of tax revenue and budget deficit on budget absorption in Kenya.

1.3. Hypotheses of the Study

Based on the above research objectives, the following hypotheses guided this study:

1. There is no relationship between budget transparency and fiscal management in Kenya.
2. There is no impact on budget absorption due to changes in tax revenue and budget deficit.

1.4. Justification of the study

The study is useful to enable policy makers understand whether the various laws and regulations that are aimed at instilling best practice in the management of public resources are yielding fruit. It is expected that enhanced accountability shall lead to improved fiscal management. The study shall be able to advice on areas of further research to guide on specific policy recommendations in public financial management.

1.5. Organization of the study

Chapter 1: Introduction and background of the study

This chapter explains the motivation and relevance of the topic under review. It explains the key highlights of the public management reform that has been undertaken in Kenya and how these reforms are expected to lead to sound fiscal management within the public sector.

Chapter 2: literature review

This section reviews the empirical research that has been undertaken in public finance management reform, budget transparency and accountability and impact in the various sectors of the economy.

Chapter 3: Methodology

This chapter describes approach to the research in addition to specifying the data that has been used to analyze the relationship between budget transparency and accountability and sound fiscal management. Justification for selecting these data, limitations and shortcomings are provided.

Chapter 4: Discussion of results

This chapter shall provide an overview of the data analysis. The results analyzed include descriptive statistics, correlation, time-series diagnostics and estimated the long run and short run regression results. Interpretation and discussion of the findings of the study are done.

Chapter 5: Conclusion

This is the last chapter which summarizes the study findings and explains the relevance of the study to the targeted audience especially the policy formulators. Finally, the chapter end with a suggestion of areas of further research to augment findings of this study.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

One will not be wrong to assume that sound public financial management should lead to better management of resources, improved service delivery and improvement of the overall living standards for a country's citizens.

The Organization for Economic Co-operation and Development (OECD) states that “public financial management includes all phases of the budget cycle, including the preparation of the budget, internal control and audit, procurement, monitoring and reporting arrangements as well as external audit. The broad objectives of public financial management are to achieve overall fiscal discipline, allocation of resources to priority needs, efficient and effective allocation of public services” (OECD, 2002, p. 7).

Various initiatives have been put in place that aim to develop public finance management systems. Such initiatives include The Paris Declaration, Accra Agenda for Action, The Busan Partnership for Effective Development Co-operation and The Manila Consensus on Public Financial Management (de Renzio, 2009). The Manilla Consensus (2011) which is the latest initiative calls for:

- (i) More focus by countries on increasing and supporting PFM system and processes with aim of enhancing economic governance; and
- (ii) International coordination to organize and enhance a peer review mechanism and knowledge sharing with the purpose of enhancing PFM reforms.

There have been various triggers of public finance reforms such as budget challenges, pressure from donors, agitations from civil society and political pressure.

Kenya has undergone several public management reform processes including in the field of public finance management. The first Public Finance Management Reform (PFMR) strategy dubbed ‘Strategy for the revitalization of public financial management system in Kenya’ was intended to guide the PFM reform process for the period 2006 to 2012 (MOF, 2013). The strategy which was known as the Economic Recovery Strategy (ERS) was aimed to guide reforms in the public finance management sector which included strengthening the public financial management, public audit and public procurement legal frameworks, development and rollout of the integrated financial management information system (IFMIS), modernization of the tax administration, enhancement of the medium term expenditure framework development and training of staff for the preparation and implementation of the program based budget, among other key initiatives (MOF, 2013).

2.2 Overview on the Public Finance Management Reform Landscape in Kenya.

2.2.1 PFM reform prior to the promulgation of the 2010 constitution

The budgetary process in Kenya has undergone many changes since independence to date. In the 1970's the Kenyan government adopted the Program Review and Forward Budgeting (PRFB) which linked the national budget to the national development plans by formulating the public sector projects on a three year basis (Cheruyot, 2009). However, the major challenge of the PRFB was that the forecasted resources were not based on credible macroeconomic fundamentals and hence ministries were operating on resource uncertainties (Shah et al., 2007). This situation led to uncontrolled government spending which, coupled with the oil shocks between 1973 and 1979, had the Kenya's government spending reducing to just over 5% down from an average of 6% in the previous decade (Cheruyot, 2009)

In the 1980's, the government again changed its budgeting approach from the PRFB to the Budget Rationalization Program (BRP) with the aim of redirecting government policy and funding to areas perceived relevant to speedy growth of the economy (Shah et al., 2007). Additionally, the BRP was aimed at instilling fiscal discipline by trying to ensure that fiscal discipline is instilled within the government expenditure. The program continued to utilize the PRFB as the mode of change but incorporated a rigorous review of all projects and ensuring that only projects that have a direct impact on economic growth, generate revenue, poverty reduction and improve the balance of trade receive government funding (Kiringai & West, 2002). Unfortunately, due to some key inherent challenges the BRP failed its intended objective of being an effective tool to manage expenditure and instill fiscal discipline. Due to revenue challenges that was faced by the government during this period, the government resulted to cutting expenditure across the board and failed to priorities some key sectors over others. Additionally, poor and ineffective sectoral planning groups that were unable to clearly link between policy, planning and budgeting failed in their mandate. Finally, the budget structure and classification system was very ineffective and hence it was hard to assess the recurrent cost of developmental projects thereby making BRP fail in its initial goal of managing runaway government expenditure (Shah et al., 2007).

In the 1990's the government took another step to curb the high government expenditure and try to create stimulus for economic growth. This saw the introduction of a rolling public investment plan. The plan entailed profiling all the government investment projects and ranking them over the medium term against their detailed financing arrangements and disbursements. The purpose was curb investments in non-performing projects and redirect investments to high return investments. Similar to the previous two programs, the rolling public investment plan was a failure (Kiringai & West, 2002). The program did not only fail to curb expenditure, but it only created avenue for the introduction of new investment projects while the deserting the previous ones as white elephant projects (Shah et al., 2007).

Due to the above shortcomings, the government in 1997 held joint public expenditure review. The review noted that budgeting in Kenya “was held back by economic mismanagement, low credibility of the budget process, and low productivity in the public sector” (Cheruyot, 2009, 33). Shah (2007) argues that although the budget reform process was institutionalized, it was poorly executed and the review process was in most instances non-existing. There was little attempt at linking policies to plans and the budget practice was merely incremental-line budgeting that did not have any link to actual revenue generated by the government. Internal control systems as well as the accounting and reporting framework were very weak.

Following the outcome of the joint public expenditure review and being faced with low economic growth (1.3% GDP growth since 1990) and unsustainable public expenditure, the government, in 2001/2002 introduced the Medium Term Expenditure Framework (MTEF) approach (Cheruyot, 2009). MTEF aim was to link top-down policy planning with the bottom-up sector priorities and expenditure estimates, as well realizing that having a robust budget execution, monitoring and reporting is as important as budget development (Shah et al., 2007).

MTEF budget planning allows for wider consultations and strives to have a clear linkage between policy, planning and execution (Shah et al., 2007). Following the MTEF implementation, the Kenya government has undertaken various Public Expenditure and Financial Accountability (PEFA) assessment to gauge its progress in strengthening the PFM systems in the country. PEFA is an independent organization that undertakes an assessment of a country’s PFM system.

One of the first PEFA assessment was in 2009 where it reviewed the country’s public finance management systems from the period June 2004 to June 2009 (Hedvall, Steen, Ochieng, & Sharpley, 2009). The reported performance from the assessment were;

- a) Credibility of the budget – The budget releasers (revenue collection and distribution) have become more credible. However, improvement is needed in terms of accuracy, allocative efficiency and flexibility. The government is equally struggling in moving from incremental budgeting to program based budgeting.
- b) Comprehensiveness and transparency of the budget – The PEFA assessment has noted that the budget is not largely comprehensive and transparent. Even though the budget discloses funds allocated to various departments and agencies, most of the departments and agencies do not regularly report on the funds received. Furthermore, essential budget documents published in the government websites, analysis, compilation and overview is problematic hence making it very incomprehensive.
- c) Policy-based budget - The policy based budgeting process seems to be working relatively well. Sector groups and preparation of sector strategic papers is a remarkable improvement. However, a major

challenge remains in explaining the effects of the funding gaps in altering priorities. The assessment has noted that the government is working on implementing performance contracting and this will enable to link desired results with the available budgets.

- d) Predictability and control and budget execution – improved revenue collection and prudent management of local debt has led to improvement in budget predictability. Cash control has improved and more predictable and timely release of funds to budget holders has also been noted. However, the effectiveness of internal control environment needs improvement and especially in the implementation of audit queries by the Auditor General.
- e) Accounting, recording and reporting - It was noted that quite a number of initiatives are still underway and have not yet been fully concluded. The major one was the implementation of the integrated financial management information system (IFMIS). Together with the payroll systems dubbed the Integrated Payroll and Personnel Database (IPPD), it is expected that government accounting and reporting should be streamlined. However, the quality of the financial records needed improvement especially since the auditor general could not express an opinion due to the status of the financial reports.
- f) External Audit and Scrutiny – The efficiency of the Auditor General has improved with better organisation, increased training and the introduction of Computer Assisted Audit Software (CAAS) programs. The audit coverage had increased. However, there is weakness on the timely presentation of the audit report to the parliament and subsequent follow through by the legislators. Kenya National Audit Office (KENAO) equally did not have ability to enforce the implementation of its recommendations.

2.2.2 PFM reform after to the promulgation of the 2010 constitution

The adoption of the 2010 Constitution of Kenya, has set the stage for the overhaul and modernization of the country's legal and institutional structures of the public finance management system (Treasury, 2018). It is under this background that the national treasury developed, and is continuously implementing, the "Public Financial Management (PFM) Reform Strategy in March 2013" (Treasury, 2018) whose vision is "A public finance management system that promotes transparency, accountability, equity, fiscal discipline and efficiency in the management and use of public resources for improved service delivery and economic development" (Treasury, 2018).

The National treasury aimed at addressing the following weakness in the Public Finance Management System:

Areas in the PFM weakness	Identified weakness in the PFM	National treasury strategy
Strategic Planning and Budget Formulation	There is need to improve the quality of planning across sectors and institutions by integrating results framework and properly costing planning documents (MTP, sector and county strategies). These are well within the medium term fiscal framework, strengthening the link between these costed strategies, the MTEF and the budget	<ul style="list-style-type: none"> • Credibility of the budget will improve with better alignment between plans, appropriations and actual disbursements
Investment Programme Management	There is need to strengthen control and management of Kenya's investment programme by enhancing appraisal, selection and monitoring procedures over projects	<ul style="list-style-type: none"> • Efficiency in mobilization of resources will significantly improve leading to enhanced yields and greater stability in financing the budget at national and county government levels. • The capacity of OAG for audits, including financial, performance and Value for Money, will be significantly enhanced leading to timely and better quality audit reports
Efficiency in Budget Execution	There need to strengthen efficiency in budget execution by introducing quarterly cash planning and cash flow practices in MDAs and counties as provided in the PFM regulations, implementing comprehensive cash management reforms, strengthening commitment control and reporting, and enhancing in-year budget monitoring and reporting both at the national and county government level	<ul style="list-style-type: none"> • Budget execution at the national and county government levels will significantly improve, providing better predictability of exchequer releases and reductions in pending bills • Fully integrated PFM systems (including IFMIS and others) thus minimising manual operations and enabling more accuracy and timelines of reporting across all financial operations of MDAs and counties

Source: *The Strategy for PFM Reforms in Kenya (2013-18)* (Treasury, 2018, pp. 10–12)

The vision of the PFM reform strategy is the development of a “public financial management system that is efficient, effective, and equitable for transparency, accountability and improved service delivery” (MOF, 2013, p. 4). To achieve this vision, treasury is among other things being guided by the basic requirements of fiscal transparency as indicated in the IMF manual on fiscal transparency which are the establishment of clarity and roles within the PFM system, ensuring that the country uses an open budgetary process, ensuring all material information as to the formulation and spending of public resources is publicly available and finally ensuring integrity through effective oversight and safeguards (IMF, 2007).

To ensure that the government achieves its reform strategy and successfully implements the PFM Act, the ministry of finance developed the “Strategy for Public Finance Management Reforms in Kenya 2013 – 2018” (MOF, 2013). This PFM reform strategy has been drawn from article 201 of the constitution that deals with the principles of public finance. The reform principles include but are not limited to ensuring openness and accountability, enhancing an equitable society by establishing equitable taxation policies; ensuring value for money in the spending of public resources, and ensuring clarity in the reporting of the usage of public resources (MOF, 2013).

With the aim of ensuring that accountability and transparency is in the heart of public finance management, the new 2010 constitution also enshrines key offices such as the Commission on Revenue Allocation (CRA), the office of the Controller of Budget and the office of the Auditor-General (MOF, 2013). The establishment of these offices has managed to decentralize some key roles such as budgeting which used to be purely a treasury role but is now being managed by the office of the controller of budgets under article 228 of the new 2010 constitution.

Article 229 provides independence and protection to the auditor general. In contrast to the old constitution, the appointment of the auditor-general is not the prerogative of the president but it is rather done by the national assembly. He/she is also given tenure of office and he reports directly to parliament and not the executive (Kirira, 2012). This level of independence ensures that accountability of public resources is monitored by an independent oversight authority.

In summary, the main highlights of the PFM reform as high lightened in the new constitution dispensation are (Kirira, 2012);

- a) Budgets should contain the estimates of both revenues and expenditure analysed between recurrent and development expenditure. This should also be accompanied by an explanation on how any budget deficit shall be financed. There was no legal requirement for the secretary of finance to submit a plan on how to finance the budget deficit.

- b) The secretary of finance to submit to the national assembly estimates for the next year’s financial revenue and expenditure two months to the end of the current financial year. Additionally, the parliament finance committee shall scrutinise the budget before being table to the floor of parliament. This provision gives ample time for scrutiny of the budget by the legislature and hence ensures enhanced accountability and transparency in the budget process
- c) Supplementary estimates should not exceed 10% of the budget in the financial year and the national assembly must approve the appropriation bill for the money to be spent. The set limit encourages better planning by the respective ministries while also promoting efficiency. MDAs realise that it is not easy to get supplementary budgets approved and hence the need for them to be more prudent in their financial management.
- d) The new constitution provides the responsibility of financial control to the national treasury. This is in previous contracts to the previous constitution in which the role of the national treasury was not clearly defined.
- e) The comptroller of budgets (COB) is mandated to monitor the budget execution and report to the legislator on a quarterly basis. This is aimed at improving accountability and transparency in the budget process. To strengthen the above open budgetary process, the office of the COB must also produce a budget implementation report that details actual spending against the budget approved each year by parliament (Kinutia, 2017).
- f) The accounting officers for national public entities are now all accountable to the national assembly. To guide against misuse of public funds, holders of public or political offices are now held liable for losses or public funds or for the misuse of public funds contrary to the law.

Within the national government, the key roles of each of the key institutions in the PFM process as it relates to the budget formulation, implementation and monitoring processes are summarized in **Table 1** below:

National Assembly	Cabinet (Executive)	Controller of Budget (OCOB) & Auditor General (Monitoring)
<ul style="list-style-type: none"> • Reviews the Budget Policy Statement (BPS) and makes recommendations to National Treasury • Approves the Budget Estimates for National Government, Parliament and Judiciary Provides overall oversight at National Government level 	<ul style="list-style-type: none"> • Approves the Budget Policy Statement (BPS) and the Budget Review and Outlook Paper (BROP) • Reviews the Annual Budget Estimates for National Government 	<ul style="list-style-type: none"> • Continuous process of monitoring of resource use. • Prepare independent report on the use of the national resource

National Assembly	Cabinet (Executive)	Controller of Budget (COB) & Auditor General (Monitoring)
<ul style="list-style-type: none"> • Monitors budgets and public finances and related matters • Approves the Budget Policy Statement (BPS) and the Budget Review and Outlook Paper (BROP) • Reviews the Annual Budget Estimates for National Government 		

Table 1; Society for International Development (Public Finance Reforms in Kenya – Issues and Relevance under the Context of Devolution – page 13)

2.2.3 Impact of public finance management reforms on government fiscal position

The table below shows the impact of revenue due to public finance reforms that have taken place in the past 18 years.

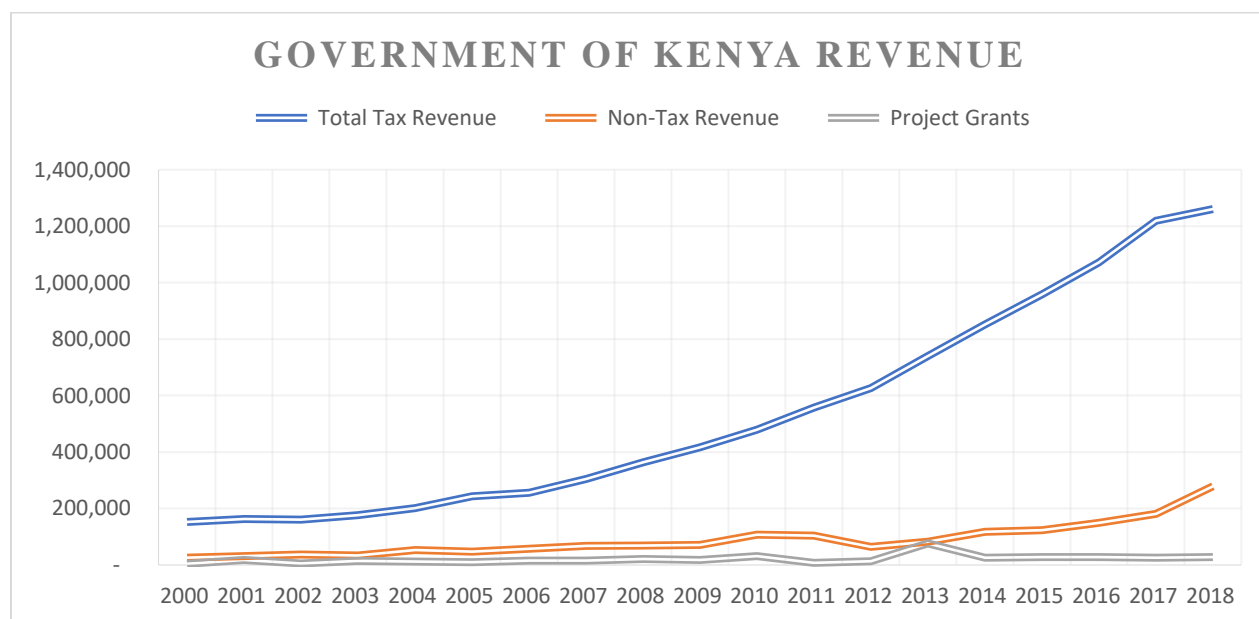


Table 2; The National Treasury of Kenya sector reports

From Table 2 above, it can be seen that the both the tax and non-tax revenues have been on an upward trend while the grant income has mostly remained unchanged. The tax and non-tax revenues are mostly affected by government policies and financial reforms while the grant income is managed by donors and hence may not be directly linked to government financial reforms.

It worth noting that tax revenues have increased since 2002 being the first time the opposition won the election and ushered in reforms in the country’s fiscal management. Additionally in 2010 after the advent of the new constitution, tax revenue grew far much more significantly further strengthening the argument that the financial reforms enshrined in the constitution seem to bear fruits.

2.2.4 Transparency international Index and financial reform

A review of Transparency International Index (TII) could be able to show if public financial management reforms have improved the transparency perception index. The Transparency International’s Corruption Perceptions Index (CPI) for Kenya “shows how transparent government is in managing public finance, and makes people aware of the levels of corruption in government as a whole, so that disciplinary sanctions can be taken” (Keita, 2014). The TI scores are from 0 to 100, with 0 indicating high levels of perceived corruption and 100 indicating low levels of perceived corruption (T.I, n.d.). The Kenya’s CPI index is shown below:

Year	2014	2013	2012	2011	2010	2009	2008	2007	2006
CPI Index	25 (145)	27 (136)	27 (139)	22 (154)	21 (154)	22 (146)	21 (147)	21 (150)	22 (145)

Table 3; Transparency International – Kenya CPI Scores

The Kenya’s CPI index above shows that the country’s CPI ranking has not materially improved since the implementation of the financial reforms in 2010. If transparency and accountability in the management of government resources had improved, we would have expected better management of resources would lead to improvement in the CPI Index.

2.2.5 Open Budget Survey (OBS) Ranking for Kenya

The open budget survey aims to analyze a country’s budget accountability systems and the effective of monitoring the budgetary process (IBP, 2018). The survey aims at analyzing the current system being used as opposed to what the laws that govern public finance management ought to be (IBP, 2018). Each country is ranked according to the level of budget accountability and these ranking can be accessed publicly.

The process of grading is 0-33 Weak, 34-66 Moderate and 67-100.

Year	Open budget Index (%)	Year	Open budget Index (%)
2017	46	2010	49
2015	48	2008	57
2012	49	2006	48

Table 4; OBS Index

From the review of the budgetary survey, there seems to have no material change in the open budget index score that the country has received over the past seven years. The average score is **48** which means the country's budgetary processes have remained moderate even with the implementation of public finance reforms.

2.2.6 The role of the supreme audit institution (SAI)

The Office of the Auditor-General (OAG) is the Supreme Audit Institution (SAI) of Kenya and is entrenched in Article 229 of the Constitution of Kenya. The new constitution, in a departure from the previous one, provides the Auditor General security of tenure for eight years and the president does not have the authority to remove him/her from office. Article 220 (6) of the Kenyan constitution requires the Auditor General to audit all accounts of the government, i.e. both the national and county government and to confirm if the public money has been applied lawfully and effective way.

In its undertaking of the audit, the OAG shall report any instances of non-compliance to the PFM legal provision as well non-compliance to other laws and regulations. The OAG shall also report on how the public institutions are demonstrating value-for-money in their usage of the public resources (OAG, 2012). Article 229 dictates that the Auditor General shall undertake the audit within six months after the end of the financial year and submit the audited report to the National and the relevant county assembly for debate. However the Auditor General has experienced both human resource and financial capacity challenges which has led to delay in the issue of audit reports (Treasury, 2016).

The Auditor-General's second mandate of confirming of the public money is a new mandate enshrined in the new constitution. The aim is to ensure that the OAG reports as to whether public resources have been spent economically, effectively and efficiently). The OAG shall report as to whether the respective government entity has met the goals and objectives set for their respective programme or project (OAG, 2012).

Audit Opinion from the supreme audit agency

The annual audit reports are prepared by the office of Kenya's Auditor General's office is a key resource. The audit opinions provide an indication as to the level of accountability by public organizations. Unqualified audit opinion means that the respective ministry, department and agency represent and fair view of the organization's financial position. Management's responsibility is to ensure that the organization has sound internal control processes and sound fiscal management policy. Devoid of this and not being able to provide adequate supporting evidence and explanation on how they have spent their respective budgets, the auditor general qualifies the accounts.

Year	Qualified opinion	Unqualified opinion	Adverse opinion	Disclaimer opinion
2013/2014	50%	26%	16%	9%
2012/2013	50%	12%	13%	25%
2011/2012	51%	6%	10%	33%
2010/2011	-	33%	-	67%
2009/2010	No audit Opinion Issues			
2008/2009	No audit Opinion Issues			
2008/2007	No audit Opinion Issues			
2007/2006	No audit Opinion Issues			
2006/2005	No audit Opinion Issues			

Table 5; Kenya Auditor General Office Reports

The table shows that that the auditor general had previously not been issuing audit opinions on the state’s financial audit reports. However, Article 229 of the Constitution of Kenya obligated that the auditor general issue audit opinions on its audit findings. Even though the percentage of qualified and adverse opinions, as shown in table 5, have not reduced, the unqualified audit opinions have more than doubled which may mean that prudence in the management of public financial management is improving.

2.2.7 The performance management process

Most of the countries in Sub-Saharan Africa (SSA) are confronted with challenges in service delivery (Margaret & Nure, 2006). To counter this challenge the Kenyan government has implemented various reforms in the Public Sector. It can be argued that one of the most radical reforms implemented by the Kenyan Government is the Economic Recovery Strategy for Wealth and Employment Creation (ERS) 2003-2007. In this policy, “the government accords high priority to economic recovery and improving the performance of public service to deliver results to the people” (Margaret & Nure, 2006).

To achieve, monitor, review and enhance the performance delivery in the public service as set out in the ERS, the government introduced performance contracting. A performance contract can be defined as “an agreement between two parties that clearly specify their mutual performance obligations, and the agency itself” (Margaret & Nure, 2006). The Ministries, Departments and Agencies (MDAs) are required to develop Specific, Measurable, Accountable, Realistic and Time bound (SMART) strategic plans and set targets. Subsequently, plans are derived from the set targets and how to measure and monitor and review the plans are agreed upon. Finally, an independent individual or institution undertakes a performance appraisal to identify if the set goals have been met. Interventions for future improvements are agreed and the process is repeated the following year (Margaret & Nure, 2006).

The constitution currently provides for three independent bodies to review how the respective MDAs are meeting their set objectives/priorities. The Office of Auditor General is required to confirm if the public money has been applied lawfully and in effective way. This entails reporting as to whether the respective MDAs have met the set goals and objectives set for their respective programme or project (OAG, 2012). The Public Service Commission (PSC) under Article 10 and Article 232 has a constitutional mandate to promote national values and principles of governance (PSC, 2016). Among the nine thematic areas that the PSC reviews, is the report on the economic review of resources and sustainable development (PSC, 2016). The review of both the OAG and the PSC reports shows if the ministries reviewed observe fiscal responsibility by economically, effectively and efficiently meeting their set goals.

2.3 Theoretical Framework: PFM

Given that societal needs are inherently greater than the available resources, public finance management is critical for the effective management of public resources in the most equitable way (McKinnon, 2004). As shown in the diagram below, public finance systems has various level (Witt & Müller, 2007).

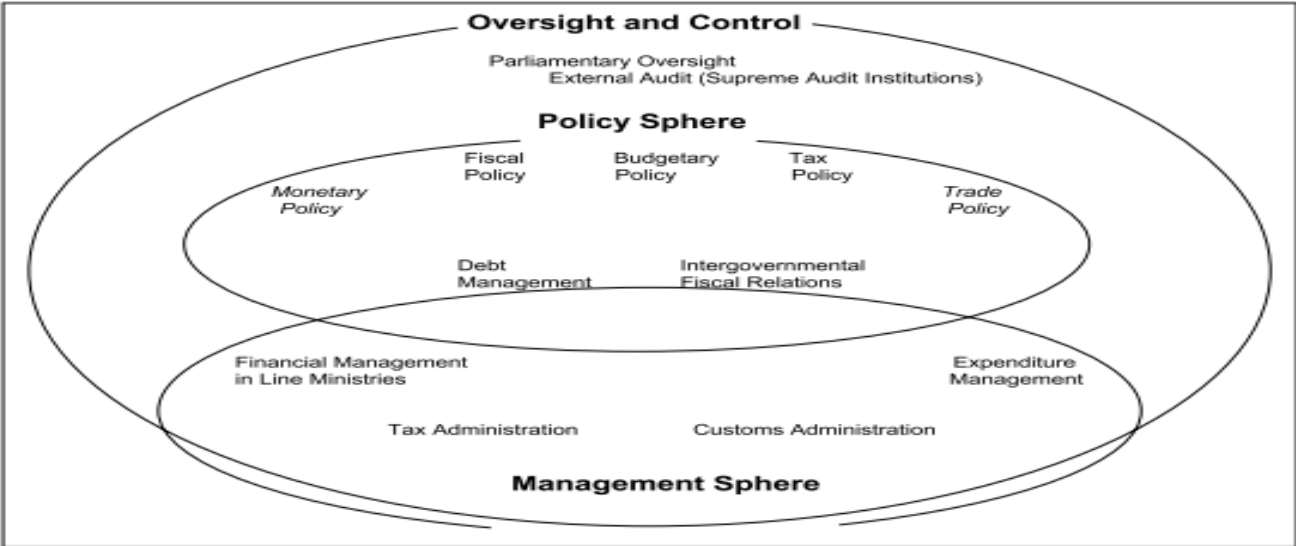


Figure 1. Public finance system and its subsystem Source:(Witt & Müller, 2007)

Transparent, efficient and effective management of country’s resources allows for buy-in by the citizens hence leading to a more just and prosperous society (Witt & Müller, 2007). Figure 1 above depicts that for an efficient public finance management system, it is paramount that the government’s policy in centrally interlinked to it management of public resources as well ensuring a robust oversight of the effective and transparent usage of the resources by the state.

Witt and Muller (2007) describe the Public Finance Management System as:

1. Policy sphere – The government policies that are linked to public finance policy include trade, tax, budget, fiscal and monetary policies. Effective trade policies have a direct impact on the customs revenue. Formulating fair, efficient and effective tax policies enables the country to attract investment and increase its fiscal and monetary positions.
2. Management Sphere – The aim of the management sphere is the effective implementation of the set government policies. Additionally, in the course of implementing the set policies, ministries and agencies should ensure they do so while enhancing transparently and accountability of their respective ministries and agencies.
3. Oversight and control – A good financial system ensures proper segregation of duties and the capacity for a third party to independently detect and verify any deviation from the set public financial system governance structures. This is achieved through both internal and external auditing.

Implementation of PFM reforms has been quite a tedious one with various models being implemented across various periods. Over the decades various models have been developed and utilized in the endeavor of improving the public finance management systems. In the developing countries, most of these reforms have been implemented with the support of different donors.

In the seventies and eighties, New Public Management (NPM) approach was adopted by various developing countries following the successful implementation of this approach by other developing countries at that time such as New Zealand (Pretorius & Pretorius, 2009). By fostering discipline in government through strategic planning and managerial accountability, NPM was aimed at enforcing better proficiency in the management of public funds (Keita, 2014). One of the biggest drawback of the NPM model in public finance management is the lack of a clear relationship between emphasis laid on NPM and the overall macroeconomic performance level including fiscal performance (Hood, 1995).

In the mid-nineties, after a realization that NPM was not as successful as had been anticipated, there came the Public Expenditure Management (PEM) approach which was aimed at considering all actors in the budgetary making process (Pretorius & Pretorius, 2009). Among the various challenges with the PEM approach is the realization that budgeting process is more of a political process and not only a technical process hence expenditure prioritization becomes quite challenging, there is a risk that the PEM process has risk of focusing on short-term and medium term objectives and distracts from the long term developmental goals and PEM has a risk of setting ambitious expenditure targets that may not have been fully costed leading to unsustainable levels of expenditure (Fozzard & Foster, 2001)

Other approaches developed in the arena of public finance management are politically economy model (emphasizes a country's political context), the Platform Approach (sequencing of PFM reforms) and the

Strengthened Approach (analysis of the relationship and roles of the various PFM reform stakeholders) (Pretorius & Pretorius, 2009). All the aforementioned approaches are reforms on the expenditure management process. Other approaches such as the tax revenue administration models have been applied towards the management of government revenues.

“Political accountability is a relational concept that describes how one entity is answerable to another in a specified manner that can be enforced” (Nicolas Van de Walle, 2018). Public financial management uses the principal-agent relationship in determining who and how the public resources are managed. It goes without saying that the citizens demand an efficient and effective ways of managing their resources to better improve their daily lives.

Historically, budgetary institutions are the key pillar to responsible, responsive and accountable public governance (Shah et al., 2007). The challenge has been the failure of the government to be more transparent and involve the citizens in the budgetary process. Therefore, most of the reforms undertaken by the developing countries have been geared towards strengthening government’s accountability to its citizens and hence improving the level of transparency and efficiencies (Shah et al., 2007).

Modern Public Finance Management (PFM) stems from the adoption of new public management principles. Modern public financial management is a core principal aimed at ensuring that the principles of transparency, accountability, effectiveness, efficiency and good governance are enshrined in public finance management (Keita, 2014). Transparency (Benito & Bastida, 2009) argues, promotes fiscal discipline since politicians are incentivized to spend the public resources diligently due to the fact that citizens are more aware on the government’s fiscal position. They equally suggest that transparency and accountability play a key role in resolving fiscal imbalances within the economy.

Some scholars argue that for budgets to become an effective tool for development, accountability measures must be reinforced within the public expenditure system (Nicolas Van de Walle, 2018). The question that begs to be answered is how best to enforce accountability within the budget process. The Manual on Fiscal Transparency (IMF, 2007) is a guide for national governments on how best to implement Standards and Codes for fiscal transparency. Each country may refer to the guide to assist in the development of laws and regulations that aim to ensure transparency and accountability in the country’s fiscal management.

Some scholars argue that there is no proven direct link between participatory open budgetary and transparency initiatives and improved wellbeing of the citizens (Carlitz, 2013). It is suggested that it is important to ground the budget related transparency changes to clearly defined theories of change (Carlitz, 2013). Others researchers argue that it is very difficult to judge whether the open budgetary and transparency initiatives deliver the desired effect (O’Faircheallaigh, C., Wanna, J. and Welle, 2009).

Public finance management is a critical tool in the implementation of the government policy (Leruth & Paul, 2007). Additionally, it is argued that a well-functioning PFM system leads to better use of donor aid especially those targeting the poverty alleviation strategies as well as the improvement of the country's macroeconomic fundamentals. Several studies such as Acemoglu and Johnson (Acemoglu & Johnson, 2005) Prakash and Cabezón (Cabezón & Prakash, 2008) have identified that SSA faces institutional constraints in the implementation of a robust PFM system. Some of the major institutional constraints include issues such as having over ambitious budgets that are not aligned to the available revenues, poor chart of accounts that poses difficulties in expenditure analysis and management and the overreliance on donor commitments in the country budgets which most of the time do not tally with the actual donor funds received (Cabezón & Prakash, 2008). Institutional capacity including of human capital and technology in SSA has also been noted as one of the main contributors of weak a public finance management systems including the absorption of foreign aid (Brautigam & Knack, 2004).

According to a 2010 Harvard Kennedy School study, PFM reforms in Africa have improved in the past decade in areas of budget preparation but is lagging behind in the development of a strong and robust PFM legal framework (Andrews, 2010). The main reason for the improved PFM environment can be largely attributed to the importance given by the development agencies such as the World Bank and the IMF in governance and public sector reform as well as the financial support provided to the Africa countries to drive reforms in this areas (Andrews, 2010).

According to Cheruyot (2009) the policy objectives set to be achieved through governments budgets are;

- a) Fiscal discipline: Which involves making a decision on revenue, expenditure, debt management and how the government intends to finance it polices
- b) Allocation efficiency: This requires coherent linkages between policy, planning and spending. Resources should be allocated to key priority arrears to deliver sustainable economic growth.
- c) Operational efficiency: This relates to the value-for-money received from each coin spent by the government in its endeavour to deliver on its priorities.

Budget transparency may be defined as the act by governments in making accessible all relevant budgetary information to the public in a timely and accurate manner (Fölscher, 2014). Budget transparency is also defined as “the full disclosure of all relevant fiscal information in a timely and systematic manner” (OECD, 2002, p. 7). Some researchers also argue that sound decision is actually promoted with greater transparency and accountability in budget reports (Keating, 2001). Budget transparency is necessary to promote responsibility of the various individuals within the budget making and execution process. Transparency

ensures that there is full disclosure between the budgetary figures and the national accounts and hence preventing logrolling and reciprocity in the planning and spending of public funds (Hagen, 2007).

The idea of the “governors and the governed” is based on the fact that the public delegates the power to determine the use of their resources (government revenues) to their leaders (elected and non-elected). The delegation of these powers to the leaders creates two challenging issues i.e. the principal-agency relationship and the common pool problem (Hagen, 2007). It is mostly due to these two factors that some research has shown that governments (agents) tend to make budgetary information unnecessarily complex and difficult to decipher in order to avoid scrutiny of their actions by their citizens (principals) (Benito & Bastida, 2009). Moreover, Keating (2001) argues that in today’s democracies, citizens are very enlightened and are very much interested in results and outcomes of the specific policies that the leaders implement. In fact, Benito and Bastida (2009) suggest that there could be a strong relationship between transparency in the budgetary process and voter turnout.

The principal-agency problem within the budgeting process is not only between the citizen and their leaders but also between the ministries themselves. This is specifically true if one is to analyze the relationship between the Ministry of Finance (MoF) and the other Ministries, Departments and Agencies (MDAs). The MoF provides, through budgetary allocations, funds to MDAs to implement a set of programs and activities. Due to information asymmetry the MoF is not able to ascertain with certainty whether the allocated budget can be efficiently and effectively absorbed by the MDAs or whether the intended outcome can be achieved by the planned programs and activities (Leruth & Paul, 2007).

Accountability on the hand can be defined as “the obligation to render an account for a responsibility conferred. It presumes the existence of at least two parties: one who allocates responsibility and one who accepts it with the undertaking to report upon the manner in which it has been discharged” (Wilson, 1975, p. 9).

In its endeavor promote integrity and accountability, the Organization for Economic Co-operation and Development (OECD) advises governments to implement clear accounting policies, robust internal control environment, undertake period external audits and institute a robust legislative scrutiny and oversight (Wehner & Renzio, 2011). Setting measurable performance targets can lead to enhanced accountability. Performance management targets are usually set in program based budgeting which most governments adopt. Moreover, majority of governments require head of Ministries, Governments and Agencies to sign performance contracts that enable their performances to be measured against set qualitative and quantitative targets (Therkildsen, 2001). Interestingly, increased accountability and a high level of fiscal transparency seem to have a direct correlation with sound fiscal management in strong democracies (Wehner & Renzio,

2011). The data seems to suggest in democracies, in the issue of the principal-agency problem, the more accountable and transparent the agent is to the principal, the greater the chances of the agent retaining its leadership role.

In most budget making process, the lack of budget transparency due to information asymmetry poses the risk of corruption and bad governance which most economist treat as rent that is captured at the expense of the principal. Rent leads to low outputs in as far as the use of finances are concerned and more often than not the principal has a post-event analysis tool such audit to identify the low exogenous use of the resources (Leruth & Paul, 2007). Some research has also shown there is a strong and direct correlations between the level of transparency and good governance (Islam, 2003).

2.4 Empirical Literature

There is limited research undertake to empirically analyze the link of public finance management reform and economic development. Some international development agencies have commissioned some studies to try to establish such a link but the research has been inconclusive mostly due to the difficulty in developing monitoring and evaluation indicators (Pretorius & Pretorius, 2009).

Using 16 indicators, Renzio & Dorotinsky (2007) analyzed the progress in the quality of PFM Systems by tracking progress in the quality of PFM systems in fifteen heavily indebted poor countries (HIPC) from 2001 and 20016. The study used a model benchmark for the public finance systems. The study noted a significant correlation between the current level of PFM development and government commitment to reform with the improvement in PFM systems.

Paolo de Renzio (2009) undertook a cross-country PFM comparative performance analysis using different budget dimensions defined by the PEFA methodology. The analysis established that there is a direct correlation between the PEFA scores and country's income and population size. The study notes that an improvement in the country's fiscal position mostly relates to strong public finance management system. However, the major weakness in the study was the controversial methodology used of converting the letter scores to numerical, a process that is considered arbitrary and may lack objectivity.

In their attempt to assess if there is a relationship between budget transparency, fiscal institution, and political turnout, Benito and Bastida (2009), noted that a strong correlation between political turnout and budget transparency. Budget transparency enables voters to objectively analyze the performance of the political leadership and they can make informed decision during voting. The study notes that lack of transparency leads to confusion and voter apathy since citizens feel that they have little say in how their fiscal resources are being used to their benefit (Benito & Bastida, 2009).

2.5 Chapter Summary

The literature seems to suggest that the central objective of public financial management is to enhance budget transparency and accountability so as citizens can have confidence in the management of their resources. By achieving this objective, it is argued that the government aims to ensure that it achieves a high budget absorption rate.

The Kenyan government has implemented numerous public finance management reforms since independence. The reforms are aimed at ensuring that public resources provide social benefit to the citizens. However, since gaining independence, the major reforms in public financial management have been witnessed after Kenya adopted a new constitutional dispensation in 2010.

The constitution not only ushered in a new era in governance and social justice, it also introduced major reforms in public finance management especially within budget transparency and accountability and sound fiscal management. The government ministries, agencies and departments are required to continuously report to parliament on their requirement and usage of public resources. Parliament has also been capacitated to set debt limit for purposes of managing government budget deficit. Additionally, the constitution empowers the legislator to review both government borrowings and donor funds. The supreme audit institution has been given a clear mandate and protection in the constitution to be able to strongly monitor the usage of public resources and to report continuously to parliament.

The next chapter aims to provide empirical evidence to analyze if the reform in the budget accountability and transparency measures has led to better fiscal management.

CHAPTER THREE

METHODOLOGY

3.1 Introduction

This chapter describes the research design and methodology that was employed in establishing the relations between budget transparency accountability and sound fiscal management. Sections covered under this chapter include the research design, theoretical framework, empirical model specification, target population, sampling for the study data collection instruments and data analysis. As discussed in the introduction and literature review budget transparency /accountability is also determined by various other variables some of which is also considered during analysis.

3.2 Research Design

According to Kothari, (2004) a research design is a plan that directs the researcher on how to collect, measure and analyze data. In order to understand how some probable variables affect budget transparency and accountability in Kenya, the study adopts a non-experimental research design using quantitative data. Similarly, by the nature of need to establish how some variables affect budget transparency and accountability, this study was explanatory since no variables were controlled for.

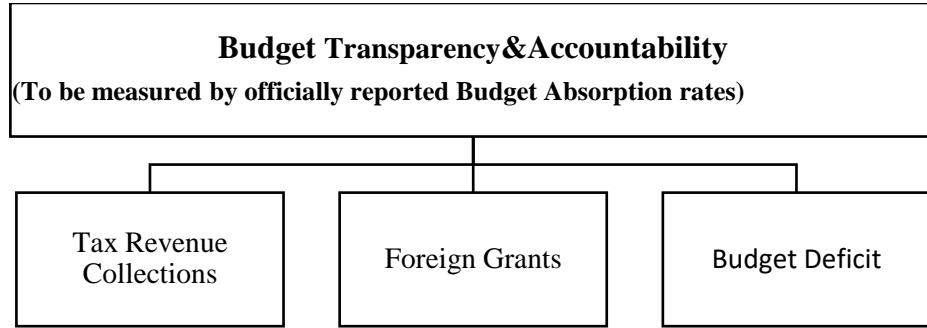
3.3 Research Data and Sources

The study on the relationship between budget transparency and sound fiscal management applied secondary data on budget deficit, revenue collection and expenditure levels which were obtained from the national treasury reports and economic survey reports published by the Kenya National Bureau of Statistics (KNBS). In circumstances where some specific variables were not available, they were complemented by data from the World Bank data bank. The ratio of budget deficit to GDP was derived by dividing the annual budget deficit by the level of GDP as at that particular year. The study employed semi-annual time series data from 2000 to 2018. The choice of the data period was limited by the availability of data.

3.4 Analytical Framework

The relationship between fiscal reforms and budget transparency and accountability are presented in the flowchart in Figure 3.1

Figure 3.1: Budget absorption and fiscal reforms



3.5 Empirical Model

This research models the relationship study of budget transparency and sound fiscal reforms is presented in the model shown in equation 3.1.

$$BT\&A = f(Defcit, TaxRev, Frgs,)..... (3.1)$$

Equation 3.1 is expanded into equation 3.2 below as;

$$BT\&A_t = \beta_0 + \beta_1 Defcit_t + \beta_2 TaxRev_t + \beta_3 Frgs_t..... (3.2)$$

Where *BT&A* is Budget Transparency and Accountability indicator measured by officially reported Budget Absorption rates; *Defcit* Is Budget Deficit; *Rev* Is Revenue Collections; *Frgs* Is Foreign Grants. The relationship of fiscal reform outcomes and budget absorption was analyzed under three models. Model one includes; budget deficit, tax revenue and foreign grants as the independent variable. However, in order to address challenges of multicollinearity, model two included tax revenue and foreign grants as the only independent variable as shown by equation 3.3, while model three included budget deficit and foreign grants as shown in equation 3.4.

$$BT\&A_t = \beta_0 + \beta_1 TaxRev_t + \beta_2 Frgs_t..... (3.3)$$

$$BT\&A_t = \beta_0 + \beta_1 Defcit_t + \beta_2 Frgs_t..... (3.4)$$

3.5.1 Budget Absorption Rate as a proxy for budget transparency

Budgetary absorption data represents the efficiency and effectiveness to which a country is able to spend its budget allocations (IMF, 2007). New public management perspectives emphasize value for money and

transparency in the usage of public resources (Keita, 2014). Budget transparency and accountability policies support better fiscal outcomes and more responsive, impactful and equitable public policies (OECD, 2002). From the analysis above, we note that budget absorption rates can be used a proxy measure for budget transparency and accountability. Therefore, for the purpose of the research, we use the reported budget absorption rates for the half year periods 2000-2018.

Budget absorption is measured as a ratio of reported expenditure divided by budget allocation. Budget absorption can be treated as a proxy of budget transparency since based on the Kenya Auditor General's report (OAG, 2014) institutions with high budget absorption are more transparent since they have a higher rate of completeness in reporting of their expenditures. The auditor's report also site a lower absorption is often associated with institutions that incur expenditure is an unprocedural and in less transparent manner hence leading to misappropriation of public resources.

3.5.2 Tax Revenue Collections

Tax revenue collection is measured as absolutes number as reported in official government reports. Budget financing is largely from tax revenue collections. This is an activity undertaken by the national treasury but delegated to its sole revenue administration authority, The Kenya Revenue Authority (KRA). Revenue collection runs from 1st July of every year to 31st June of the subsequent year. While investigating public expenditure (absorption rates) and the role of development partners Neil and Kirira (2009), acknowledged how new reforms including reforms in fiscal transparency and accountability have caused a rise in the internally generated revenue. They also found out how sector coordination difficulties are partly to blame for the low performance within the public sector as measured by the budget absorption rates. Some recent studies in South Africa have underscored the need for a distinction between revenue overruns and planned budget surplus. This is particularly due to the fact that revenue over-runs have occurred bot in times of deficit and surplus budgets.

3.5.3 Budget Deficit

Budget deficit is the difference between actual expenditure and allocated budget. For purposes of the study, the budget deficit numbers are logged. Budget deficit occurs when government revenue falls below government expenditures at a particular period of time. Budget deficit has the potential of enabling a country tap into borrowing funds with the intention of growing the overall economy since the local generated revenue is not sufficient to address the government's developmental objectives (Winnnyrose, 2014). However, as Moraa (2014) observes, budget deficit financing should be accompanied by greater budgeting discipline that will reduce wastage in government expenditure and resultant rising national debt. Reduced wastage of public financial resources leads to greater budget transparency and accountability (absorption rates). In a budget deficits and macro-economic performance analysis in Kenya, it was

concluded that budget deficits has an impact on macro-economic variables such as private consumption and investment, money supply (M3), as well as real GDP growth rate all of which have an impact on budget absorption rates (Kosimbei, 2009).

3.5.4 Foreign grants

This refers to Official Development Aid (ODA) which are financial resources from foreign donors. Foreign aid represents a key fiscal source for most countries in Sub-Saharan Africa, Kenya included, which are characterized by low savings and a thin tax base (Njeru, 2004). Foreign grants, even though budgeted are not consistent in their receipt due to the governance and transparency concerns from the donors. Njeru (2004) argues that an increase in foreign grants stimulates economic development by a higher proportion than increase in domestic revenue. This is achieved through the increased absorption rates for the readily available financial resources. This would imply that due to higher level of budget scrutiny, budget transparency and accountability, donors' funds have higher budget absorption rates. According to Njeru (2004), bilateral and multilateral donors suspended their funding to Kenya in 1993 after which the government adopted conservative fiscal and monetary policies. Part of such policies included reducing the number of civil servants employed by the government, in other words such measures caused a reduction in the absorption rates.

Table 4.1: Definition and Measurement of Variables

Variable	Measurement	Symbol	Expected relationship
Dependent Variable: Budget Transparency and Accountability			
Budget Absorption	The Budget absorption will be measured as a ratio with a maximum value of 100. For ease of measurement absorption will not be categorized as recurrent or development but rather as total combine expenditure.	$BT\&A_t$	
Independent Variables: Fiscal Management			
Budget Deficit	Budget deficit is measured at intervals of six months (bi-annual every financial year)	$\beta_1 Defcit_t$	Negative
Tax Revenue Collections	Revenue collection will be measures as absolutes number as reported in official government reports	$\beta_2 TaxRev_t$	Positive
Foreign Grants	Foreign Aid is mainly denominated is foreign currency, but the study will consider the equivalent of the local currency	$\beta_3 Frgs_t$	Positive

3.6 Model Estimation and Diagnostics

The data analysis followed the conventional time series data analysis. The processed involved stationarity test, cointegration analysis and the estimation of the long-run and short-run regression models There is also

a demonstration of the causal relationship between budget absorption and the other independent variables of the model using the Granger causality test.

3.6.1 Unit Root Testing

The performance (behaviour and properties) of a series is highly influenced by how stationary or otherwise the series is. For instance, persistence of shocks is infinite for non-stationarity series. Achievement of non-stationarity avoids spurious regressions whereby two variables will show very high levels of R^2 even where any relationship doesn't exist. Lack of stationarity also disqualifies the standard assumptions for asymptotic analysis. This means that the usual t-ratios don't follow a t-distribution and therefore it's not possible to test for hypothesis.

Testing for unit roots is done using the Augmented Dickey Fuller (ADF) test to ensure the regressed parameters meet the linear regression assumptions. The ADF is preferred over the basic auto regressive unit root test to allow for a more general autoregressive moving average (ARMA (p, q)). The ADF is easy to apply since it also eliminates any possible autocorrelation in the error terms.

In order to test for unit root, the null hypothesis assumes that the time series has a unit root, which occurs when the test statistic is less than the critical value. In case the critical value is greater than the test statistic the null hypothesis is reject meaning that the time series is stationary.

3.6.2 Cointegration and Long run Estimates

“Cointegration tests analyse non stationary time series processes whose variance and means vary over time. The method allows you to estimate the long run parameters or equilibrium in systems with unit root variables” (Stephanie, 2016). For instance, cointegration exists if a set of I (1) variables can be modelled with linear combinations that are of I (0). Cointegration among variables indicates the existence of a stable long run relationship, where the means and variances of the variables remain stable regardless of time (Riba, 2016).

Some of the popular tests of cointegration include: Engle-Granger, Philips-Ouliaris and Johansen test and the Auto Regressive Distributed Lag (ARDL) technique. Engle –Granger method first constructs residual based on static regression. The residuals are then tested for presence of unit roots using ADF or a similar test. If the time series are cointegrated then the residuals will be practically stationary (Stephanie, 2016). However, this method could lead to different conclusions which can be corrected by Johansen test. Johansen test improves on the Engle granger test by avoiding the issue of choosing a dependent variable as well as avoiding occurring when errors are carried from one step to the next. This test can detect multiple cointegrating vectors. In testing the level of the relationship and due to the small sample size used, the Auto Regressive Distributed Lag (ARDL) of Pesaran et al. (1996, 2001) technique was employed. This approach

is consistent with the application of the ARDL technique on smaller time series (Refer to Narayan and Smyth, 2004 with 31 observations; Tang and Nair, 2002 and Narayan and Narayan, 2004 with 29 observations; Enisan and Olufisayo (2009) with 24 observations and Alhassan and Biekpe, 2016 between 18 and 21 observations) compared to the 38 observations used for this research.

The long run relationship of underlying variables is detected through the F-statistic (Nkoro & Kelvin, 2016). If the F statistic exceeds the critical value band, there is existence of a long run relationship. This approach identifies the cointegrating vectors in case there are multiple cointegrating vectors.

$$D(\ln(BT\&A_t)) = \beta_{01} + \beta_{11}\ln(BT\&A_{t-1}) + \beta_{21}\ln(DfR_{t-1}) + \beta_{31}\ln(Rev_{t-1}) + \beta_{41}\ln(Frgs_{t-1}) + \beta_{51}\ln AiA_{t-1} + \sum_{i=0}^p a_{1i} D(\ln(BT\&A_{t-i})) + \sum_{i=0}^q a_{2i} D(\ln(DfR_{t-i})) + \sum_{i=0}^q a_{3i} D(\ln(Rev_{t-1})) + \sum_{i=0}^p a_{4i} D(\ln(Frgs_{t-1})) + \varepsilon_{1t} \dots \dots \dots (3.5)$$

While testing for cointegration, the F-statistic is compared with the lower and upper bound critical value to accept or reject the hypothesis. The critical values are determined at 1%, 5% and 10% levels of significance.

H_0 : No Long run Relationship exists(F-sta<CV)

H_1 : Long-run relationship exists (F-stat \geq CV)

Following results from the cointegration analysis the long run estimate will be given by the following regression model;

$$\ln(BT\&A_t) = \beta_0 + \sum_{i=0}^p a_{1i} \ln(BT\&A_{t-i}) + \sum_{i=0}^{q1} a_{2i} \ln(DfR_{t-i}) + \sum_{i=0}^{q2} a_{3i} D \ln(Rev_{t-1}) + \sum_{i=0}^{q3} a_{4i} (\ln(Frgs_{t-1})) + \varepsilon_{1t} \dots \dots \dots 3.6$$

3.6.3 Short Run Error Correction Model (ECM)

From the analysis of the long run estimate, the data suggests a long run relationship between variables under consideration as stipulated by theory (Nkoro & Kelvin, 2016). As stated earlier the mean and variances are constant and not depending on time. That notwithstanding most empirical researches have shown that the constancy of the mean and variances are not satisfied in analysing time series variables (Stephanie, 2016). At times most cointegration techniques are wrongly applied, estimated and interpreted. One of the said techniques is the Auto Regressive Distributed Lag (ARDL) technique. Studies have shown that adoption of ARDL cointegration technique does not require pre-tests for unit roots as the case for other techniques. The long run relationship of underlying variables is detected through the F-statistic (Wald Test). If the F statistic exceeds the critical value band, there is existence of a long run relationship. This approach identifies the cointegrating vectors in case there are multiple cointegrating vectors. The error correcting estimates for the long run equation are given as shown in equation 3.7.

$$\ln(BT\&A_t) = \beta_0 + \sum_{i=0}^p a_{1i} \ln(BT\&A_{t-i}) + \sum_{i=0}^{q1} a_{2i} \ln(DfR_{t-i}) + \sum_{i=0}^{q2} a_{3i} D \ln(Rev_{t-1}) + \sum_{i=0}^{q3} a_{4i} (\ln(Frgs_{t-1}) + aECT_{t-1} + \varepsilon_{1t}) \dots \dots \dots 3.7$$

ECT_{t-1} Signifies the error correction term. According to Abdalla et al (2018), the error correction model tells us the degree to which the equilibrium behaviour drives short run dynamics. The equilibrium relationship in turn will have implications for a short run behaviour, whereby one or more series move to restore equilibrium. The error correction coefficient should be negative (0-1) and significant and determined through the t-statistic and p-value. Cointegration Coefficient values of closer to -1 are considered to be more significant.

3.6.4 Causality

Causality is closely related to the idea of cause-and-effect. A variable X is causal to variable Y if X is the cause of Y or Y is the cause of X (Emam et al., 2018). According to Emam et al (2018) Causality is measured by that Granger cause test. The method is probabilistic and uses empirical data sets to find patterns of correlation. Granger causality does not test a true cause-effect relationship but establishes if a particular variable comes before another in the time series and therefore a most appropriate term might be preceding. Statistical software simplifies the process of Granger cause test by selecting the number of lags from as programmed by the statistical software.

The null hypothesis in the Granger-cause test is that the independent variable does not Granger cause the dependent variable in the first regression and that the dependent variable does not Granger-cause independent variable in the second regression, as depicted below, where 3.84 is the criteria for F value to test which hypothesis is accepted as is globally verified and p-value greater than 0.05 results in the acceptance of the null:

$H_0: X_1$ does not cause X_2 (F-stat < 3.84)

$H_1: X_1$ Causes X_2 (F-stat \geq 3.84)

3.7 Data Limitation

Some of the challenges faced in analysis the data for this study include:

Different publication in Kenya report different figures of the same variable, for instance the figures reported by national treasury differ from those reported by the Kenya national Bureau of Statistics. The same reports also different with those of other organisations such as from the Controller of Budget, Central Bank of Kenya, World Bank among others.

Different variable are reported over twelve periods but on different months. For instance, the fiscal year runs from 1st July to 31st June of the subsequent year. However, measurement of GDP growth rates and other macro variables follows a calendar year reporting (January to December of every year). This makes it difficult to relate different economic and financial variables.

As earlier discussed Kenya has undertaken a series of public financial reforms, however it's observable that it was until early 2000 when proper public financial reporting was adopted. This has result to lack of continuous and consistent data over long periods to allow for comprehensive study on how the variables at hand relate with one another.

CHAPTER FOUR

DISCUSSION OF RESULTS

4.1 Introduction

This chapter gives an overview from the analysis of Government of Kenya Fiscal Data from 2000 to 2018. The results discussed include the descriptive statistics, correlation, the unit root test, cointegration and the long run and short run regression results. The chapter also covers a discussion on Granger causality analysis.

4.2 Descriptive Statistics

Table 6 show a summary of the descriptive statistics for this study. As seen in the table 6, the logged half yearly tax revenue has the highest magnitude as compared to the other explanatory variables. This is followed by budget deficit, non-tax revenue and then grants. Therefore, the tax revenue stands out as the most sensitive variable on a half-year basis. The standard deviation shows budget absorption to be portraying the lowest variation from one half to the other half. This can be explained by the fact that other factors held constant availability of financial resource will lead to a normal absorption rate through the financial year. Tax revenue ranks second in deviation which can be explained by the fact tax collections are driven seasonal factors. For instance, corporation income taxes are paid on quarterly basis depending on the date of the end of the financial year of the corporate. Also, the varied expenditure by the government leads to variation in collection of tax revenue resulting from government expenditure. Similarly, budget deficit has the greatest variation. This observation can be explained by the fact that there is a tendency to spend more resources in the second half of the financial year as compared to the first one. Most government entities rush to clear allocated budget in order to guarantee more allocations in the subsequent periods.

Table 6: Descriptive statistics

VARIABLES	N	Mean	Median	Min	Max	S.D.	Kurtosis	Skewness	Jarque-Bera
Ln(budget deficit)	38	11.40	11.40	10.07	12.93	0.764	2.054	0.146	3.22
Ln(tax revenue)	38	12.27	12.27	11.20	13.38	0.745	1.569	0.0514	14.42
Ln(grants)	38	9.082	9.082	7.442	11.16	0.689	4.136	0.257	3.70
Ln(budget absop)	38	4.348	4.348	4.254	4.432	0.0480	2.559	-0.334	1.04

Grants revenue equally has high variation which can explained by the fact that grants revenue is not within the control of the government but rather on donor determination on compliance levels by the national government.

The measure on skewness and kurtosis shows how well the data is spread around the mean. The summary table show that skewness ranges between -0.334 and 0.257 which lies within the normal range since they are close to zero. All the explanatory variables have a positive skewness indicating that they are spread to the right tail unlike budget absorption which has a negative skewness value.

Normal distributions have an accepted benchmark for kurtosis of 3. High values depict a peaked distribution which also represents the volatility of the data.

Budget absorption has a kurtosis value of 2.5 which is closer to the accept benchmark of 3. This implies that it has a steep peak. Grants revenue has a value of 4.136 which is more than three and therefore portrays a steeper peak and also it is also an indication of outliers. The other variable have kurtosis measures of between 2.05 and 1.57 which represent a more flat peak.

4.3 Correlation and Multicollinearity

Table 7; Measurement on correlation matrix

	Budget absorption	Budget-deficit	Tax-revenue	Grants
Budget absorption	1.0000			
Budget-deficit	0.1282	1.0000		
Tax-revenue	0.3806	0.9450	1.0000	
Grants	0.2417	0.5523	0.5218	1.0000

Table 7 show a matrix on the correlation value for the four variables included in this study. As seen in the table there is presence of a strong correlation between budget absorption and tax revenue. Budget deficit ranks the least with regard to its correlation with budget absorption. From our analysis tax revenue has the strongest correlation with depend variable. While the budget deficit depicts the weakest correlation. Overall since all correlation value are positive it depicts direct relationship.

However, it is also worth noting that there is high correlation between budget deficit and tax revenue at 0.9450. High levels of correlation between the explanatory variables will lead to existence of multicollinearity. In order to solve this problem, three different regression models were estimated. The first Model (Model 1) doesn't account for the multicollinearity and includes all the three independent variables. Model 2 and 3 considers the strong correlation between budget deficit and tax revenue, hence Model 2 includes budget deficit without tax revenue while Model 3 includes tax revenue without budget deficit. All three models have budget absorption as the depended variable.

4.4 Unit root test

Table 8 show a summary of the ADF test results which were performed at both level I(0) and at first difference I(1). At level I (0), it is only grants revenue which is has unit root at 1%, 5% and 10% significance levels.

Table 8; ADF Test Results

			CV 1%		CV5%		CV10%	
	t-stat 1(0)	t-stat 1(1)	1(0)	1(1)	1(0)	1(1)	1(0)	1(1)
Budget absorption	-2.385	-3.740	-3.682	-3.689	-2.972	-2.975	-2.618	-2.619
Budget deficit	2.474	-4.199	-3.696	-3.709	-2.978	-2.983	-2.620	-2.623
Tax revenue	1.835	-5.349	-3.696	-3.709	-2.978	-2.983	-2.620	-2.623
grants	-6.571		-3.668		-2.966		-2.616	

CV-Critical Value

Note: We reject the null hypothesis when the t-statistic is greater (in absolute terms) than the estimated statistic at the different levels of significance.

			CV 1%		CV5%		CV10%	
	t-stat 1(0)	t-stat 1(1)	1(0)	1(1)	1(0)	1(1)	1(0)	1(1)
Budget absorption	-2.385	-3.740	Reject	FTR	Reject	FTR	Reject	FTR
Budget deficit	2.474	-4.199	Reject	FTR	Reject	FTR	Reject	FTR
Tax revenue	1.835	-5.349	Reject	FTR	Reject	FTR	Reject	FTR
grants	-6.571		FTR	FTR	FTR	FTR	FTR	FTR

FTR (Fail to Reject) = Unit Root

Reject=No Unit Root

4.5 Cointegration

The bounds test sought to test if there is existence of a long run relationship. Table 9 show that the F statistic are greater than the upper bound critical values for models two and three. This is proof of existence of a long run equation. However, this is not true for Model 1 which is contrary to our expectation of where we assumed a reduced budget deficit and increased tax revenue will have a long run impact on budget transparency and accountability.

Table 9: Bounds Test Result

	F-Statistic	CV (2.5%)		CV (5%)		CV (10%)	
		I(0)	I(1)	I(0)	I(1)	I(0)	I(1)
		4.41	5.52	3.79	4.85	3.17	4.14
Model 1	3.81	FTR		FTR		FTR	
Model 2	7.67	Reject		Reject		Reject	
Model 3	6.18	Reject		Reject		Reject	

CV is Critical value, FTR –Fail to reject the null hypothesis of no long run relationship.

4.6 Regression Results

4.6.1 Long run estimates

Table 10 show the summary of long run estimates where by grants revenue has a positive impact on budget absorption. Model three shows that there is a positive and significant impact of grants revenue on budget absorption. This indicates that increases in grants enhances budget absorption. The positive impact of grants on budget absorption is two way, first the direct impact of increasing available budgetary resources available for government consumption and secondly because of government counterpart funding to match the foreign grants. This finding is in agreement with other empirical studies from other jurisdiction. For instance, in a study by Muda (2007) on the factors influencing absorption, it was established that budgeting time did not have any effects on budget absorption. However budget surplus and local own-source of revenue had some effect on budget absorption. When multicollinearity is accounted for (Models 2 and 3), tax revenue and budget deficit have positive coefficients with tax revenue being significant for model one. This indicates that increases in tax revenue and budget deficit leads to an increase on budget absorption. This relationship can be attributed to the recent public finance reforms which on one side has led to increased revenue collection while on the other hand it has put stringent controls on utilization of public resources.

Availability of tax revenue remains a paramount condition for the sustaining recommended absorption rates. While investigating public expenditure and the role of development partners Neil and Kirira (2009), acknowledge how new reforms and institutions have caused a rise in the internally generated revenue. They also found out how sector coordination difficulties are partly to blame for the low performance within the public sector. Different ministries pursue their mandates separately leading to sub optimal budget absorption even when financial resources are available. However, the estimated effects are only marginal (0.4% for tax revenue and negligible for budget deficit). However, model two shows that tax revenue has a positive impact of 0.6% on budget absorption.

Table 10: Long Run Coefficients

	Model 1	Model 2	Model 3
Constant	-1.002285***	-0.943231***	-1.047039***
<i>Standard Errors</i>	(0.275038)	(0.222343)	(0.324649)
<i>T-Ratios</i>	-3.644172	-4.242225	-3.225139
Tax Revenue	0.052634**	0.006068	
<i>Standard Errors</i>	(0.024434)	(0.022574)	
<i>T-Ratios</i>	2.154167	0.268798	
Budget Deficit	1.94E-08		-5.68E-08
<i>Standard Errors</i>	(2.07E-07)		(1.30E-07)
<i>T-Ratios</i>	0.711237		-0.425710
Grants	0.012976	0.067114	0.087064**
<i>Standard Errors</i>	(0.037494)	(0.050056)	(0.037195)
<i>T-Ratios</i>	0.34608	1.340764	2.340732

Note: *** and ** denotes significance at 1% and 5% respectively.

4.6.2 Short run estimates

Analysis under this section follows the fact that the test on cointegration has proved presence of a long run relation between the variables under study. The short run estimates include the error correction term which represents the speed of adjusting to the long run equilibrium from the short run. In the short run tax revenue and budget deficit have a direct relationship with budget absorption. The impact of budget deficit on absorption is however very minimal with a direct impact of less than 0.005% on budget absorption. The Impact of tax revenue ranges from 4.2% to 0.6% positive increase in budget absorption due to a unit per cent increase in tax revenue. Grants revenue has both a direct and inverse relationship with budget absorption. A unit per cent increase in grants revenue will cause a change of between 0.14% to -0.8% to budget absorption.

Table 11: Short Run Estimates

	Model 1	Model 2	Model 3
D(Budget Absorption)	0.304179	0.602777**	0.128540
<i>Standard Errors</i>	(0.251363)	(0.225916)	(0.239269)
<i>T-Ratios</i>	1.210117	2.668144	0.537222
D(Tax Revenue)	0.042007*	0.006243	
<i>Standard Errors</i>	(0.023223)	(0.023602)	
<i>T-Ratios</i>	1.808866	0.264505	
D(Budget Deficit)	0.000001**		0.000001***
<i>Standard Errors</i>	(0.000000)		(0.000000)
<i>T-Ratios</i>	2.700149		4.029454
D(Grants)	0.001425	-0.019599	-0.008253
<i>Standard Errors</i>	(0.012012)	(0.013795)	(0.012019)
<i>T-Ratios</i>	0.118588	-1.420742	-0.686685
CointEq(-1)	-0.798088***	-1.028823***	-0.711887***
<i>Standard Errors</i>	(0.194874)	(0.222484)	(0.178112)
<i>T-Ratios</i>	-4.095411	-4.624252	-3.996845
F-Statistic	5.361763	3.504160	6.004565
Prob>F	0.000437	0.006218	0.000201
R-Squared	0.777042	0.603732	0.796042
Adj R-Squared	0.632119	0.431442	0.663469
DW	2.499585	2.027837	2.388404

Note: ***, ** and * denotes significance at 1%, 5% and 10% respectively.

In the short run, tax revenue and grants have an inverse relationship with budget absorption while budget deficit affect budget absorption positively. Table 11 also includes the cointEq coefficient for the three models. The negative sign on the cointEq coefficients is prove of its significance. The cointEq coefficient show the speed at which the long run disequilibrium is corrected. Model 2 which excludes budget deficit from the regression is corrected at the fastest rate followed by model one which considers all the variables and then Model 3 which excludes tax revenue from the regression at 103%, 79.8% and 71% respectively. Since these rates of correction are relatively high this is an implication of the delayed adjustment within the period especially for models 1 and 3.

It can also be seen from Table 11 that the model has relatively high values of R-Squared and adjusted R-Squared of between 43% to 79% hence a good predicative power for the three models. The Durbin Watson values also is in the range of 1.5 to 2.5 which is a sign of normality in the model.

Further diagnostic test done include the cumulative sum of recursive residuals (CUSUM) and the CUSUM of square (CUSUMSQ). The two tests were performed to establish the three models are of a good predictability due to stability of the parameters. Nevertheless its notable that model one which does not provide for multicollinearity is not stable. Plot graphs on CUSUM and CUSUMSQ are presented in the annex. The regression was not subjected to heteroscedasticity test since this is not a common problem for times series data like the case for this study.

4.7 Causality

To establish the relation between budget absorption and the other explanatory variables the granger test was used and the result are shown in table 12. From the results, it can be observed that budget deficit, granger causes budget absorption. Similarly, tax revenue and grants revenue does not granger cause budget absorption.

Table 12: Granger Test Results

Null hypothesis	F-statistics	Probability	Test	Result
Budget deficit does not Granger cause Budget Absorption	4.25	0.016	Reject	Budget Deficit causes Budget Absorption
Tax revenue does not Granger cause Budget Absorption	0.10	0.95	FTR	<u>Causality Rejected</u>
Grants does not Granger cause Budget Absorption	0.405	0.75	FTR	<u>Causality Rejected</u>

Null hypothesis: when F-test <3.84 and p-value >0.05, FTR-Fail to Reject

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

Chapter five provides an over view and recommendations as established from chapter four on analysis. This study sought to investigate the relationship between budget transparency and accountability as anticipated under the fiscal management reforms undertaken in Kenya.

The study on how public finance reforms have impacted budget transparency and accountability confirms that resource mobilization variables have played a key role in explaining the levels of budget absorption. Tax revenue plays the greatest positive role in influencing the absorption rates while grant revenue plays a varied but positive role on budget absorption. Non-tax revenue was found to be highly correlated with the other variables and was therefore dropped from the regression analysis.

Regarding budget deficit, it has been shown that there is a very minimal but positive relationship between increased budget deficits and budget absorption. Lack of financial resources to implement appropriated budget does not necessary lead to reduced budget absorption at the same time. As discussed earlier, public finance reforms were mainly targeted towards increased budgetary resource mobilization and therefore key resources areas were mainly tax revenue and other public financial resources. It is also notable that donor grants were pegged on certain deliverables as far as budgetary reforms were concerned. This explains why grants revenue just like tax revenue is a key driver of budget absorption. Most donor grants are pegging to some counter art funding by the Government of Kenya which imply both tax revenue and grants revenue will have similar impact. However, grants revenue are not continuously available in the budget calendar of the government. Grants are availed once donor are convinced that a minimum criterion has been met by the government.

5.2 Summary of key findings of the study

This study focused to establish if public finance reform in tax revenue and other resource mobilization areas have an impact on budget absorption over the periods 2000 to 2018. The study employed time series cointegration techniques to explore the long run properties of the determinants of budget absorption in Kenya. In this study, reported budget absorption rates presented the level of transparency and accountability. This test confirmed existence of a log run relationship as presented under the bounds test. Specifically, tax revenue and grants were observed to have significant positive effect on budget absorption. The adjustment from disequilibrium in the short run ranged between approximately 71% and 100% which was indicative of the relatively high speed with which an adjustment to long run equilibrium occurs.

The results also shown presence of unilateral causality from budget deficit to and budget absorption. It can, therefore, be concluded that there is an impact on budget accountability and transparency as a result of fiscal management. Most key areas which were being targeted by public finance reforms were mainly on public resources mobilization.

5.3 Recommendations

The aim of this study was to establish if public finance reforms had an influence on the level of accountability and transparency in the management of public finances. As a result, the study focused on how various public resources variables affected the levels of budget absorption. It was expected that with the achievement of the expected outcomes from the public finance reforms there would be improved accountability and transparency as well as increased levels of budget absorption.

Having established that public finance reforms have an impact on the transparency and accountability levels, it is highly recommended that the government of Kenya should continue with the current reforms and reach the newly created sub national government entities. This is because reforms have largely been implemented at the national government level which is independent of the 47 subnational government entities that were established in 2010.

Also, more focus should be put to ensure public finance reforms raise more tax revenues and attract foreign grants both of which are key drivers of budget absorption.

Relevant areas of study in this thematic area should investigate whether public reforms have contributed to growth in public resources such as tax and non-tax revenues. Similar studies could be done to establish the relationship between changes in public resources (revenues) and the GDP economic growth. Such studies could complement the current study in establishing the broad effectiveness of public finance reforms and how they are contributing to economy.

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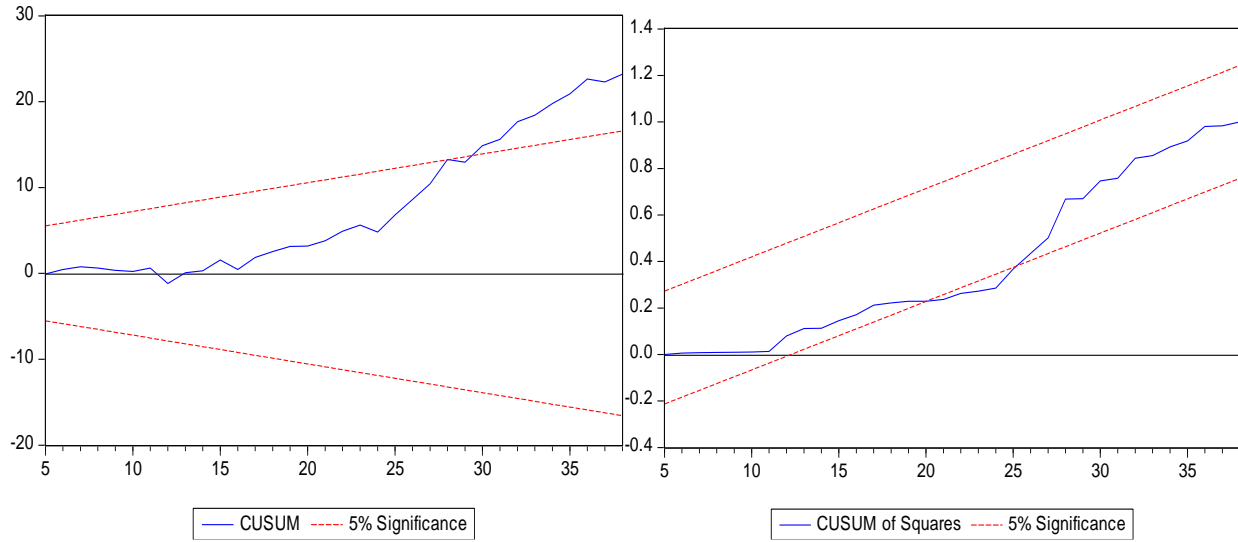
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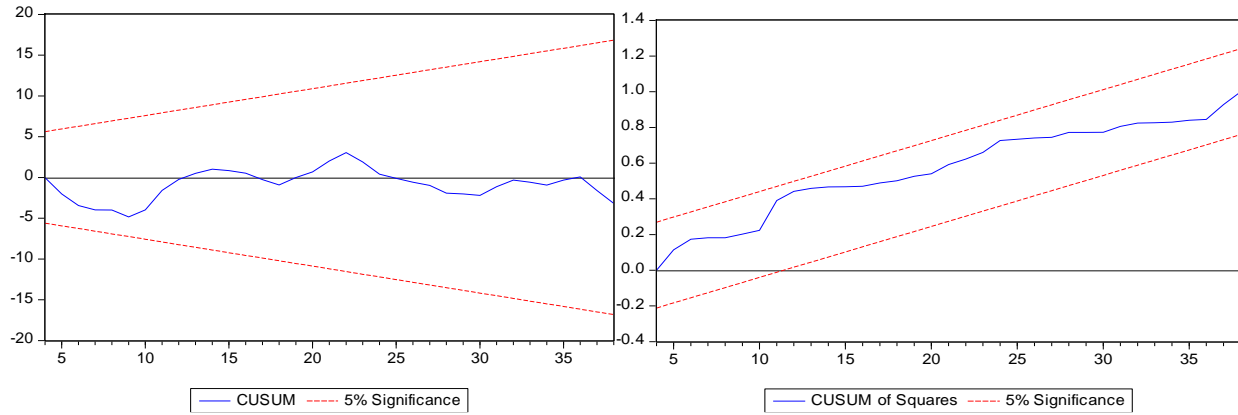
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Annexes

Model 1



Model 2



Model 3

