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Governance Challenges in Public Expenditure Management in Kenya

The concept of governance covers the social, economic, corporate, political and cultural aspects of how power is exercised in an organization or society. The common principles in the exercise of power include: accountability, transparency, openness, participation, performance, fairness, predictability, legitimacy and voice. Some of these principles overlap and are interrelated. The concept of governance can thus be applied at different levels of society or institution. It is widely acknowledged that good governance plays an important role in the development process. Through research, it has been established that improved governance has a large positive effect on development outcomes.

This policy brief discusses a framework through which the concept of good governance can be understood and applied in Public Expenditure Management (PEM) and then uses the framework to analyse and identify the key governance challenges in PEM in Kenya.

Public expenditure management is a key policy instrument for influencing how public resources are allocated and used towards realizing public policy goals, namely: growth, stability, and equity and poverty reduction. In PEM, macroeconomic stability is maintained by ensuring fiscal discipline while the other goals (growth, and equity and poverty reduction) are impacted upon directly through the way public resources are allocated and utilized.

The 1997 Public Expenditure Review (PER) report was one of the early attempts at assessing systems of public expenditure management in Kenya. The report noted improvements in macroeconomic stability in the four years up to 1997, but concluded that the composition and trends in public expenditure management was at variance with public policy goals, especially growth and poverty reduction. The review noted that there was a big divergence between the budget and its implementation. Public expenditure allocations did not reflect policy priorities, and the government had adopted informal fiscal management systems that led to an accumulation of pending bills. Weak systems of expenditure control bred corrupt practices. Due to intermittent commitment, it was not until 2000 that reforms were initiated in PEM. The annual reports on government accounts by the Controller and Auditor General continued to reveal massive corruption and wastage. Based on these reports covering the period between 1990/91 and 1996/97, the Center for Governance and Development (CGD), estimated that the government had

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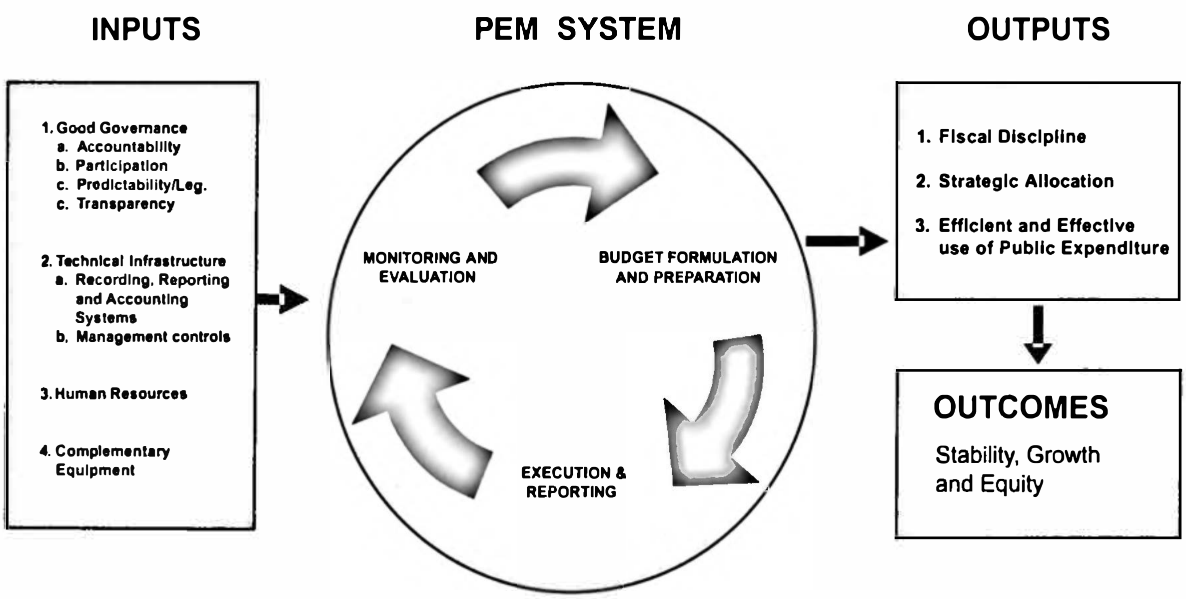
lost about US$ 4 billion through fraud and wasteful spending by paying for non-existent items or goods, irregular payments and un-surrendered or uncollected revenue. Due to weak governance systems, in the last two decades, Kenya has been rocked by two major scandals, the 'Goldenberg Scandal' and the 'Anglo-leasing Scandal'. The genesis of Anglo-leasing scandal could be largely explained by the lack of transparency and accountability in the procurement of security-related goods and services. Reports by the Kenya Anti-Corruption Commission (KACC) reveal cases of enormous corruption within the public sector. For instance, in 2005/06, KACC was undertaking investigations in cases of corruption estimated at about Ksh 75.1 billion (including Anglo-Leasing type of contracts). Good governance in PEM ensures that public policy goals are not subordinate to private interests, and limits the extent to which public offices are used to extend personal wealth and power at the expense of the public.

When the new government came to power in December 2002, good governance was identified as one of the three pillars of the Economic Recovery Strategy for Wealth and Employment Creation that was unveiled in 2003. According to the Strategy (ERS), most of the problems bedevilling Kenya and its people arose from the many years of bad governance and poor economic management. Improving governance has thus remained one of the key reform challenges for the government.

Governance Principles in PEM Cycle

The public expenditure management cycle consists of three main stages, namely; Budget formulation and preparation; Budget Execution and Reporting; and Monitoring and Evaluation. The idealized PEM cycle is presented schematically in the figure below. There are four important inputs to the PEM. These are: good governance, technical infrastructure, human resources and complementary equipment. The inputs give the PEM system its dynamic nature—as and how information is processed, goals are set and public resources are deployed and utilized in the realization of development



goals. The outputs of the PEM system include: manageable fiscal deficits reflecting fiscal discipline, strategic allocation of resources based on priorities, and efficient utilization of public resources. Governance in PEM is mainly concerned with the management practices and decision making processes and how they enhance or inhibit good governance especially with regard to application of fundamental principles: accountability and performance, transparency, predictability and participation.

Accountability requires that public officers are responsive and answerable. Effectiveness in accountability requires that performance measures are established and oversight mechanisms are effective to ensure that standards are met and maintained.

Participation is key both in Budget formulation, and monitoring and evaluation. Involvement of stakeholders is important in identifying priorities as well as appraising performance and getting feedback on policy implementation.

Predictability requires a sound legal framework for public expenditure management as well as administrative regulations that provide clarity of roles and responsibilities for the different players with the PEM cycle. The legal and administrative framework should be applied uniformly without fear or favour.

Transparency ensures that information is available on government processes, budgets and performance and thus supports accountability. Good governance, therefore, enhances transparency, accountability, participation and predictability in the planning and budgeting processes. These practices have strong implications for the realization of the goals of efficient allocation (allocation of public resources according to national priorities), efficient (least cost) and effective (realization of the outcomes) use of public expenditures while at the same time ensuring aggregate expenditure discipline that is supportive of macroeconomic stability.

Participation in the planning and budget process has improved in the recent years through annual public sector hearings during the budget formulation and preparation process. In addition, the Ministry of Finance requests and receives pre-budget submissions from key stakeholders. Participation in the 'bottom up' process that requires the incorporation of grass-root inputs has, however, lagged behind.

Reforms in Kenya's Public Expenditure Management

The recent improvement in development outcomes is to a large extent attributed to improvement in public expenditure management. The government has strived to maintain macroeconomic stability, improve strategic allocation of public resources and promote efficient use of public resources through introduction of results-based management systems. However, there is a lot of scope for improving and deepening the reforms.

Budget formulation and preparation

The adoption of the Medium Term Expenditure Framework (MTEF) budget

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process in 2000/01 marked an important step in enhancing governance in PEM. The process has undergone various reforms to make it relevant and more effective. The current process has five distinct characteristics: A Ministerial PER process; medium term framework; a top-down fiscal framework; a 'bottom up' process of preparing sectoral budgets for achieving sector policies and targets; and a bidding process for reconciling the 'bottom up' and 'top-down' processes.

Participation in the planning and budget process has improved in the recent years through annual public sector hearings during the budget formulation and preparation process. In addition, the Ministry of Finance requests and receives pre-budget submissions from key stakeholders. Participation in the 'bottom up' process that requires the incorporation of grass-root inputs has, ho wever, lagged behind. The District MTEF Committees that are supposed to provide forums for participation in the budget preparation process at the district level have not been fully institutionalized at the sub-national level. The African Peer Review Mechanism (APRM) process established that outside Nairobi, citizens had limited information about development programmes. Even for devolved funds such as Constituency Development Fund (CDF) and Local Authority Transfer Fund (LATF), it was felt that they are less transparent and participatory in the management.

There have been improvements in transparency, especially with regard to information availability. For instance, the Ministry of Finance provides budget documents on its website. These include the Budget Outlook Paper, Budget Strategy Paper, the MTEF Sector Reports, and Quarterly Budget Reviews. However, a limited number of citizens have access to Internet or are computer literate. This underscores the need to strengthen sub-national systems, including the District Information Dissemination Centers (DIDCs) that have not received equal attention. Budget formulation has been made more transparent through the public expenditure review process. However, despite line ministries preparing the Ministerial Public Expenditure Reviews (MPERs) that inform the budget, these are hardly published for public consumption and the process is not institutionalized across the government.

There have also been efforts towards enhancing budget transparency by adoption of international budget classification systems, which ensure improved disclosure of fiscal information, scrutiny and analyses. Thus, while the budget classification has remained mainly based on the traditional administrative classification with some economic classification, there is need for a strong programme and regional orientation to support results-based management and fiscal decentralization process. It is not clear whether the Official Secrets Act (CAP

187), which provides for the preservation of state secrets by public officers hampers public access to information. However, the government is now working on a Freedom of Information Policy that will culminate in the development of a legal framework to enhance public access to information and transparency.

Also expected to enhance transparency and participation in PEM is the Fiscal Management Bill 2006 that aims at strengthening legislative oversight over the budget process. In addition, it provides for the establishment of the Fiscal Analysis and Appropriations Committee. However, the bill in its current form does not provide for effective participation or involvement at the early stages of formulation, which include PER processes and preparation of budget outlook papers.

Matters of budget preparation and execution used to be contained in the Government Financial Regulations and Procedures (GFRP) 1989. These are now outdated as reforms have been undertaken to strengthen the legal framework for PEM. For instance, matters related to Audit are now covered under the Public Audit Act 2003, and execution and reporting under the Government Financial Management Act 2004. Likewise, procurement issues now fall under the Public Procurement and Disposal of Assets Act 2005. However, budget formulation and preparation still lacks a clear legal framework, 'though it may be considered as an executive amendment to the Programme Review and Forward Budget procedure'.

There is thus need to strengthen the legislative framework for budget formulation and preparation, which currently relies on release of Treasury Circulars. This will enhance predictability and accountability in budget formulation as it would set the budget formulation timetable as well as specify clearly the roles of different players in the budget formulation process.

Execution and reporting

The budget is executed through the release of funds by the Treasury to the spending agencies. Spending agencies are responsible for disbursement of funds to contractors and suppliers. At the spending agency level, the execution process involves the following steps: commitment of funds; verification (once approved, the spending agency can place an order or enter into contract); delivery of goods and services; and payment. This stage in PEM is where good governance is even more key, as the avenues for corruption or misuse abound, especially in the procurement and supply of goods and services. Service delivery points have also been recognized as points where corruption occurs.

Predictability in budget execution and reporting has been enhanced with the strengthening of the legal framework, especially the enactment of Public Audit Act 2003, Government Financial Management Act 2004 and Public Procurement and Disposal of Assets Act 2005. The Government Financial Management Act 2004 provides the legislative framework for management of public financial affairs, including reporting by accounting officers. The Public Procurement and Disposal of Assets Act 2005 establishes the framework for streamlining the procurement system. As part of its operationalization, Public

Procurement and Disposal Regulations 2006 were developed and came into effect from 1st January 2007 through a Gazette Notice. Although it is too early to assess the effectiveness of this legislation, it provides for the creation of an autonomous Public Procurement Oversight Authority (PPOA), whose functions include, among others, ensuring compliance and monitoring performance of the procurement system, and covers security-related procurement.

Independent oversight institutions such as corruption control agencies, external auditing agencies and parliamentary oversight committees may help ensure enhanced transparency and accountability. In this regard, strengthening of such institutions is important in enhancing governance. The enactment of the Anti-Corruption and Economic Crimes Act 2003 leading to the establishment of the Kenya Anti-Corruption Commission (KACC) to fight corruption should be seen in this light.

There have also been efforts to strengthen the Kenya National Audit Office (KNAO) to clear the backlog of audits of Central Government, Local Authorities and Semi-Autonomous Government Agencies. The establishment of KACC was an important step in the fight against corruption. However, there have been serious challenges in addressing past corruption cases through investigation, prosecution and recovery. Strategically, there has been more focus on establishing and strengthening preventive mechanisms, e.g. the inclusion of security related procurements under the Public Procurement and Disposal of Assets Act. However, progress towards establishment of supportive pieces of legislation such as the Proceeds of Economic Crimes and Anti-Money Laundering Bill has been slow.

In PEM, controls are put in place to help management control the organization. However, management is able to circumvent those controls and misuse public resources. The enactment of the Witness Protection Act 2006 provides the framework for witness and whistleblower protection. The Public Officer Ethics Act 2003 requires that government officials declare their wealth annually as a way of deterring accumulation of corruptly-gotten wealth. However, the impact of the wealth declaration process has been hampered by lack of public access to the declarations of assets made by public officers.

In 2000, the government started introducing the Integrated Financial Management Information System (IFMIS) aimed at integrating budget preparation, execution, control and financial accounting and reporting in one system. IFMIS is expected to enhance information flow and, therefore, transparency in PEM. However, progress has been slow.

Accountability and performance have been enhanced by introducing a results-based management system that includes the Rapid Results Initiative (RRI) and performance contract system. The system could be improved through an appropriate legal framework and should be anchored in the budget cycle, rather than operate parallel to the annual budgetary process.

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government agencies. The absorption rate has been estimated at 33-40 per cent, especially with regard to Overseas Development Assistance (ODA). Fast tracking the External Resources Policy should help enhance transparency, predictability and accountability in management of external resources.

Monitoring and Evaluation

Monitoring usually involves collection of relevant information on execution and implementation of public expenditure programmes and projects. Evaluation, on the other hand, relates to using monitoring and other information available to make improvements on expenditure management. It provides the feedback loop from M&E to plan formulation whereby past experience can be used to inform and improve, use and allocation of public resources. Therefore, monitoring and evaluation should provide information on whether the goals of PEM are being realized. Some of the key tools for M&E include: public expenditure reviews, client surveys, expenditure tracking surveys, and cost-benefit analysis

The Monitoring and Evaluation function within PEM management in Kenya has not received adequate attention despite efforts to establish strong M&E systems since the early 1980s. As part of institutionalization of the M&E system, the government established the Monitoring and Evaluation Directorate in the Ministry of Planning and National development to spearhead the process. In addition, Central Planning and Project Monitoring Units were established in all ministries to support project monitoring function. The M&E directorate has co-ordinated the preparation of Annual Progress Review (APRs) and Medium Term Reviews (MTRs) on the implementation of the Economic Recovery Strategy. However, there exists some key challenges, namely:

- The M&E function is not well integrated in the PEM cycle and is not institutionalized within the legislative framework governing PEM. In addition, the production of the annual and medium term progress reports are not clearly synchronized within the budget cycle. The PER process that precedes the preparation of Ministry budgets runs parallel with the APR and MTR process. Proper institutionalization of these processes will enhance transparency, accountability and predictability of the M&E within the PEM system.

- The M&E system is yet to be fully extended to the district level. Most of the indicators are output rather than efficiency-oriented. As a result, the system does not promote the practice of collecting data on unit cost or least time incurred to provide a service or output. In addition, there is need to extend the indicators to the non-traditional areas such as governance.

Policy Recommendations

The government's reform agenda in Public Expenditure Management is broad. The greatest challenge is to undertake the reforms to their conclusive end. There is, thus, need for clear prioritization and monitoring and evaluation of PEM reforms.

Legal framework for budget formulation and preparation: There is need to develop a sound legal framework for budget formulation and preparation. This should be harmonized with the draft Fiscal Management Bill 2006.

Performance based budgeting: To facilitate performance-based budgeting, there is need to build output and performance-based data, and clearly anchor the process within the PEM system. In addition, performance orientation requires that chief executives are given some flexibility in budget execution while not undermining accountability. This is an important area of policy research.

Parliamentary committees: To improve on the oversight role of parliamentary committees such as the Public Accounts Committee and the Public Investment Committee, capacity of parliamentarians needs to be enhanced in the ongoing reforms to establish a parliamentary budget office. Parliament should enhance working relations with Treasury to ensure that House Committees' recommendations are used for the purpose of improving Public Expenditure Management.

Government Financial Statistics 2001: One of the public finance reforms is the adoption of the international budget classification system that will facilitate improved disclosure of fiscal information, scrutiny and analysis of fiscal decisions on allocation of expenditure, the fiscal risks and impact on the economy. Although the traditional administrative classification is more useful for the purpose of control of budget by the administrative units, it is limiting in terms of information and transparency, especially if one needs to analyze the budget to understand the purpose of expenditure and geographical location.

International Benchmarks: The government should speed up the implementation of the Public Financial Management Reforms. By June 2007 a total of 10 benchmarks had been reached covering budget formulation, execution and auditing, and reporting.

About KIPPRA Policy Briefs

KIPPRA Policy Briefs are aimed at a wide dissemination of the Institute's policy research findings. The findings are expected to stimulate discussion and also build capacity in the public policy making process in Kenya.

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