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A Review of Economic Status and Public Sector Financial Management Reforms in Kenya

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Abstract

Practical concerns relating to successful public financial management ultimately determines whether or not there is good governance at all public sector institutions. Although there is growing literature on national public financial management in general, the researchers feel that less attention has been focused on the financial management reforms in Kenya. This paper, therefore, reviewed literature on public sector financial management reforms in Kenya, starting with the current economic status in Kenya. The exceptionality of this paper was the use of a significant body of literature focusing on 15 articles concerning the public sector financial management reforms and economic status in Kenya. The findings could assist in creating awareness on the main themes of public sector financial management reforms within the Kenyan public sector and help the national policy makers to develop measures of enhancing performance within the sector.

Keywords

public sector, New Public Management, public financial management, reforms, economic status, literature review

1. Introduction

Countries worldwide are experiencing external and internal pressures to restructure their public sectors in order to solve financial management problems, to raise public confidence in government, and to adapt to social and economic trends (Lynn, 1999, p. 302). Various reforms have occurred which can be viewed as a major policy shift in the manner in which governmental units exercise their financial management functions. Visser and Erasmus (2013, p. 15) argued that, in some countries, this change has given rise to the transformation of the whole public sector financial management. According to Tilley (2014, p. 65), this transformation has caused a permanent difference to strategy and culture, hence, enabling the necessary changes to systems and processes within the public sector financial management. Although there is growing literature on national public financial management in general, the researchers feel that less attention has been focused on the financial management reforms in Kenya. This paper, therefore, reviewed literature on public sector financial management reforms in Kenya, starting with the current economic status in Kenya for the period of 2007 to 2011.

Kenya's recently developed public sector performance contracting system is supposed to improve efficiency and accountability within the public sector. The first medium-term 2008-2012 of vision 2030, which articulates government's commitment to facilitating public sector growth through enhanced good governance, makes the study of public sector financial management reforms in Kenya important. The adoption of performance standards within the public sector in Kenya, aimed at integrating and aligning the Kenyan public sector's performance to vision 2030, has not yet achieved the traction required (Republic of Kenya, 2013, p. 34). Therefore, there should be clearly developed and enforceable strategic plans, such public financial management reforms strategies, and performance plans for the public sector in Kenya. These strategic plans would facilitate alignment of public financial management reforms directives within the public sector in Kenya with national development projects, which are linked to the Kenyan vision 2030.

In addition, the new public management paradigm is a reference to public sector reform by practitioners and academicians (Polidano, 1999, p. 3). Polidano (1999, p. 3) argued that the new public management reforms are a response to common pressures like deregulation of line management; conversion of civil service departments into free-standing agencies or enterprises; performance-based accountability, particularly through contracts; and competitive mechanisms such as contracting-out and internal markets (Polidano, 1999, p. 3). This New Public Management (NPM) aims at nurturing a performance-oriented culture that seeks to refurbish the process through which state corporations operate in order to increase efficiency, effectiveness, and encompassing client-oriented, mission-driven, and quality-enhanced management which are normally the private-sector management practice (Hope, 2012, p. 129). These reforms are intended to better serve the needs of both the government and the citizenry with improved delivery of public services in order to reduce poverty, improve livelihoods, and sustain good governance.

Guthrie and Olson (1999, p. 210) contributed to the New Public Management (NPM) debate by stating that an increasing notable element of NPM movement is the accounting-based financial management techniques that are being drawn in the pursuit of reforms. In other words, the New Public Financial Management (NPFM) reforms, which are advocated by the NPM movement, embrace the corporate financial management theories and techniques practised by the private-sector (Padovani, Yetano, & Orelli, 2010). Roberge and Jesuit (2012, p. 422) observed that new public management reforms' adaptability is not pre-ordained and varies across regions, states and communities.

However, Guthrie and Olson (1999, p. 210) summarized the new public financial management reforms across countries into four main areas. The first area involved changes to financial reporting systems, including the promotion of accrual-based financial reporting framework across all governmental units, as well as the state-owned corporations, and reliance on professionally set accounting standards. The second area related to the development of commercially-minded, market-based management systems and procedures to deal with pricing and provision of services with emphasis on cash management, including financing. The third area referred to the development of a performance measurement approach, focusing on techniques such as financial and non-financial performance indicators for all the governmental units including state-owned corporations. The fourth area concerned the decentralisation or delegation of budgets, coupled with the attempted integration of both financial and management accounting system and also with economic-based information sets. In addition, the final category of reforms involved changing to internal and external public sector audits, notably in terms of providing reviews of efficiency and effectiveness of public services (Hughes, 2003, p. 172). Hence, this paper reviewed the literature on the public sector financial management reforms in Kenya, focusing on these areas.

2. Methodology

A first general literature review resulted in 165 articles focusing on the widespread public management and the New Public Management (NPM) reform agenda. Three review rounds were performed, starting with a general, broad review for literature on public management by the researcher. The results of the first review were analysed and categorised into public management, public financial management reforms and public financial performance. The review process was further refined for a second round, in which the researcher analysed the literature of 130 articles on public financial management reforms according to the four major continents of the world, i.e., America, Europe, Asia, and Africa. The final review focused on the publications on public sector financial management reforms in Africa, narrowing down to the reforms within the Kenyan public sector. These resulted to a final review of 15 articles on economic status and public sector financial management reforms in Kenya.

The ISI Web of Knowledge, Google Scholar, and the search engine of the Durban University of Technology were used to identify articles and e-books. The researcher targeted the peer-reviewed articles, preferably published in ISI-ranked journals. However, an exception was made for articles in specialized public management journals because some of these journals are not ranked in the ISI index. The review also included unpublished or published work. Hence, the paper reviewed only those studies directly associated with economic status in Kenya and the public-sector financial management reforms. Monographs, unfortunately, could not be included in the search because the accessibility of many books is limited and their quality (e.g., through peer-review or publication by a scientific publisher) is less objectively evaluated.

In addition, the following keywords were used to find articles: “public sector”, “new public management”, “public financial management”, “reforms”, and “Kenyan economic status”. The paper included both theoretical and empirical evidence from exploratory and observational research, which included both quantitative and qualitative research designs. Therefore, as highlighted by Basak and Govender (2015, pp. 319-320), the study met all the five necessary elements of quality appraisal criteria for validity and trustworthy findings. The articles selected were significant, acceptable, reliable and empirically valid. In addition, each selected article had good research questions and theory.

3. Results

3.1 Economic Status of Kenya

According to Kiplagat, Wang and Li (2011, p. 2961), Kenya is located on the east coast of Africa. It lies on the equator and is bordered on the east by Somalia, Ethiopia is to the north, Sudan to the northwest, and Uganda directly to the west. The south-western border of the country is marked by Lake Victoria, and to the south is Tanzania and Mount Kilimanjaro, while the Indian Ocean lies to the south east. It is 582 646 km^2 and is the world's 47th largest country. Kenya has the most developed economy in Eastern Africa (Kiplagat et al., 2011, p. 2961). The authors observed that Kenya is also the economic, commercial and logistical hub of the entire East African region. According to them, the economy is heavily dependent on agriculture, which accounts for around 24% of GDP and 18% of wage employment in both agriculture and agro-based industries.

According to the 2009 Population and Housing Census, the population of the country stood at 38.6 million and was estimated to grow to about 41.4 million by 2012 (Ireri, 2014, p. 41). The census showed that the population was increasing by one million people per year and is anticipated to be at 46.7 million by 2017. The author also observed that the majority of the Kenyan population resides in the rural areas even though recent data indicates that there has been an increase in the rate of urbanisation, largely caused by increasing rural-urban migration and the rate of natural population increase in urban areas. Nearly 4 out of every 10 Kenyans live in poverty; maternal mortality is among the highest in Africa, with 488 deaths per 100 000 live births, secondary school enrolment is at a low 32 percent; and learning achievement levels are well below their potential and what is needed to fuel a modern market economy (Randa et al., 2013, p. 13). The authors argued that GDP growth, while solid, has yet to take off at the rapid, sustained rate needed to transform the lives of ordinary citizens.

The major economic sectors in Kenya include agriculture, trade and industry, transport and communication, energy, education, finance and insurance, hotel and tourism, amongst others (Word Bank, 2013, p. 4; Ministry of Devolution and Planning, 2014, pp. 5-15). According to the World Bank (2012, p. 2), since the 2008 crisis, Kenya has been growing at an average of 3.5 percent per year, well below the average for Sub-Saharan Africa (5.5 percent, excluding South Africa) and significantly slower than the East African Community (EAC) countries, some of which are among the fastest growing developing countries in the world.

According to the Ministry of Planning (2012, pp. 8-9), the main sources of economic growth in Kenya for the last five years from 2007 to 2011 were transport and communication, wholesale and retail, manufacturing, education and financial intermediation sectors. Table 1 showed that the wholesale and retail sector had the greatest growth with an average of 7.2%. The transport and communication sector showed an average growth of 6.7%, followed by financial intermediation sector at an average of 6.2%. The educational sector indicated an average of 5.0%, followed closely by the manufacturing sector at an average of 3.9%. On the other hand, as shown on Table 1, the agricultural and the tourism sectors have showed mixed results over the same five-year period.

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Table 1. Economic Sectors' Performance in Kenya

Year	2007	2008	2009	2010	2011
Hotels and restaurants	16.3	-36.1	42.8	4.2	5.0
Tourism	16.4	-19.2	0.2	17.9	32.8
Wholesale & retail trade	11.5	5.1	3.9	8.0	7.3
Transport and communication	15.1	3.1	4.0	6.9	4.6
Financial intermediation	6.5	3.1	4.6	9.0	7.8
Education	3.7	5.8	6.3	4.5	4.9
Building and construction	6.9	8.3	12.4	4.5	4.3
Manufacturing	6.5	3.8	1.3	4.4	3.3
Agriculture	2.3	-5.4	-2.6	6.4	1.5
Energy	5.1	0.2	0.8	5.2	5.4

Source: Kenya National Bureau of Statistics (KNBS) website (2014).

This Table represents % growth of economic sectors' performance in Kenya for the period of the study from 2007 to 2011.

Nevertheless the Gross Domestic Product (GDP) growth over the five-year period from 2007 to 2011 has indicated a steady growth from the lowest figure of 1.5% in 2008 to 5.8% in 2010 and maintaining it at 4.4% in 2011 (Ministry of Planning, 2012, p. 49). However, according to Randa et al. (2013, p. 3), average annual growth in Kenya was 4.4 percent in the period 2008-2013, which was much lower than in Uganda (5.6 percent), Tanzania (6.6 percent), Rwanda (7.3 percent), and the Sub-Saharan Africa average as a whole (5.5 percent). However, the authors argued that macroeconomic conditions continued to improve, as the economy of Kenya entered the third year of relative stability in 2014, with single-digit inflation and a stabilized exchange rate.

As shown on Table 2, inflation showed an unsteady downward trend over the five year study period, with the highest rate of 16.2% in 2008. According to the Central Bank of Kenya (2014), the weighted average commercial banks' lending rates have been increased from 13.32% in 2007 to 20% in 2011. The corporation tax rate, according to Deloitte and Touche (2011, p. 17), for the years of income from 2007 to 2011 have remained at 30% for resident corporations and 37.5% for non-resident corporations. However, some state-owned corporations are exempted from corporation tax, according to the Republic of Kenya Income Tax Act (Republic of Kenya, 2012, pp. 157-165).

Kenya has one stock market, the Nairobi Stock Exchange (NSE), where the debt securities of the listed corporations, such as bonds and preference shares, are bought and sold. The market has increased in activities over the past periods, attracting even state-owned corporations, which are partially owned by the government (Randa & Gubbins, 2013, p. 15). The authors argued that the securities' market is booming with securities' prices rising strongly in the past. Table 2 shows stable average market capitalization over the five-year period of the study, with a high growth of 40% recorded in 2010, driven by strong performances across all sectors of the economy in the same year. Nonetheless, the NSE index showed some slight decline, but with an increase of 1186 points (36.5%) in 2010. The stability of the stock exchange is believed to allow listed corporations, both private- and state-owned, to have an option of raising external finance through the stock market. Hence, the stock market activity may have an impact on debt-financing decisions of corporations, including listed state-owned corporations.

Table 2. Macroeconomic Performance Indicators in Kenya

Year	2007	2008	2009	2010	2011
Gross domestic product (GDP) (%)	7.0	1.5	2.7	5.8	4.4
Inflation rate (%)	9.8	16.2	9.2	4.1	14.0
Commercial banks lending rates (%)	13.32	14.87	14.76	13.87	20.04
Corporation tax rate (%)	30	30	30	30	30
Nairobi Stock Exchange (NSE) index	5445	3521	3247	4433	3205
Market capitalization (Kshs. Billion)	851	854	834	1167	868
Overall domestic credit (Kshs. Billion)	671	827.4	978.3	1300	1500
Outstanding public debt (Kshs. Billion)	715.5	748.5	889.9	1100	1300

Source: Kenya National Bureau of Statistics (KNBS), Central Bank of Kenya (KCB) and Capital Markets Authority (CMA) websites (2014).

This Table represents macroeconomic performance indicators in Kenya for the period of the study from 2007 to 2011.

The banking sector in Kenya has undergone noteworthy transformation over the last decade or so (Randa et al., 2013, p. vii). The authors argued that these reforms have improved the resilience of the sector to domestic and international shocks. They also noted that the state presence in the sector has been shrinking, and with it the share of non-performing loans in bank portfolios. Randa et al. (2013, p. vii) also argued that Kenyan banks are doing better than their counterparts in Sub-Saharan Africa in terms of the share of lending to small and large corporations, including state-owned corporations.

Though the weighted average of commercial banks' lending rates have been increasing over the study period, from the lowest of 13.32% in 2007 to 20.04% in 2011, the overall domestic credit has been grown by 124%, from Kshs. 671 Billion in 2007 to Kshs. 1.5 Trillion in 2011 (Central Bank of Kenya, 2014). On the other hand, the outstanding debt of the government has also increased by 82%, from Kshs. 715.5 Billion in 2007 to Kshs. 1.3 Trillion in 2011. These figures indicate that debt financing in Kenya has been increasing over the five-year study period, both within the public and the private sectors. Hence, the economic status in Kenya has indicated some improvement over the years and this improvement is as a result of the major public-sector financial-management reforms being undertaken by the government.

3.2 Public-Sector Financial-Management Reforms in Kenya

Since 1997, the government of Kenya has been implementing public sector reforms aimed at strengthening government finance and accounting functions to improve public-sector financial management, accountability, and transparency of public funds (Diamond & Khemani, 2006, p. 116). Nevertheless, Bagaka (2009, p. 188) argued that a look at Kenya's reform initiatives since the mid-1980s found that more emphasis has been placed on efficiency and economy and less attention has been given to social equity. Coleman (2013, p. 81), on the other hand, reported that Kenya's macroeconomic performance improved considerably in the period of 2004-2007, with real GDP growth averaging 6 percent per year. Coleman (2013, p. 81) argued that this was achieved through the implementation of sound public financial management reforms, along with a favourable external environment. Coleman (2013, p. 81) noted that the support of the Poverty Reduction and Growth Facility (PRGF) programme, under the International Monetary Fund, ensured significant progress in structural reforms in Kenya, including reforms in the financial sector and in public-financial management and governance.

According to Marwa and Zairi (2009, p. 36), the public sector reform, referred to as the Civil Service Reform Programme (CSRP), was first launched in Kenya in the early 1990s to improve efficiency and productivity within the governmental units. Marwa and Zairi (2009, p. 36) noted that the government created a steering committee on the Civil Service Reform Programme (CSRP) at the national, provincial and district levels and in each ministry with a national secretariat as its operational arm. The public-sector reform agenda was planned to be implemented in phases. The first phase of the reforms, which focused on containment, was implemented during the period of 1993 to 1998. The second phase was embarked on immediately during the period of 1998 to 2001, focusing on performance improvement within the Kenyan public sector. Finally, the third phase, focusing on refinement, consolidation and sustenance of reforms, was to be implemented during the period of 2001 to date.

Key reforms that were initiated in phase one were policy shifts in the areas of staffing, civil service organisation, pay and benefits, personnel management and training, financial and performance management (Deloge, 2009, p. 3). According to Deloge (2009, p. 3), other reforms included the local government reforms, public expenditure reform, state corporations reform, judiciary and legal sector reforms. Phase one of the reforms were, therefore, an attempt by the government to implement the new public-sector financial-management reforms within the public sector in Kenya. According to Sawe (2007, pp. 2-3), phase one involved a move from a hierarchical type of organizational structures to more flexible and professionally-oriented structures, followed by the decentralization of Finance Ministry's core functions to Provinces and Districts, as well as, lower operational levels. These helped to ensure effective service delivery and privatization and commercialization of a number of activities previously performed by the Finance Ministry. The first phase further focused on identification and improvement of potential areas for revenue collection to supplement predicted shortfalls in ex-chequer releases and enforcement of target setting in ministerial operations or activities.

Phase two of the reforms witnessed a series of ministerial and segmental initiatives that led to the launch of governance reforms; justice, law and order-sector reforms; judicial reforms; capacity building and training; e-governance; Results-Based Management (RBM); participation in quality awards and reintroduction of performance contracts (Marwa & Zairi, 2009, p. 36). While remarkable progress in entrenching the public sector reforms' agenda has gained momentum in Kenya, there still remains room for improvement and much more remains to be done especially in the area of enhancing performance within the governmental units (Marwa & Zairi, 2009, p. 36). Few African nations, such as Botswana and Ethiopia, have recorded major strides towards the realization of objectives of public sector-reforms, while several others, including Kenya, were struggling and had only recorded modest success (Marwa & Zairi, 2009, p. 36).

However, Njeru (2013, pp. 1-50) looked at the Kenyan public-sector financial management reforms from a constitutional dispensation and political perspective, and categorised the process into four phases. The four phases were made up of President Kenyatta regime, President Moi regime, President Kibaki regime and the new constitution era.

3.2.1 Public-Sector Financial-Management Reforms in the 1970s

The Kenyatta era began immediately after the Kenyan independence in 1963. The independence Constitution (1963) divided public-sector financial-management powers among the three branches of the government; the executive, the parliament and the judiciary, but the executive soon moved to accumulate more influence than the other two (Njeru, 2013, p. 2). The executive, under a strong presidency, led the budget process, with more powers from the Constitution (1963), which prohibited Parliament from introducing bills related to money or making any amendments to increase taxes or expenditure. The fiscal structure and institutions of public-sector financial management were intended to give the executive and ruling elite maximum control. The tax system established by the colonial government was retained in Kenya with minor changes introduced to remove obviously racial connotations and the preferences bestowed on the white settler community. Therefore, under Kenyatta regime, the Treasury, under the direction of the presidency, became the lead public-sector financial-management agency as Parliament's finance function was reduced to one of ceremonial approval. The senior public servants became significantly powerful on technical and policy issues, especially the Treasury, which became very influential assuming control over all public financial resources (Njeru, 2013, p. 2).

3.2.2 Public-Sector Financial-Management Reforms in the 1990s

During President Moi's era, there was a slight improvement on the public-sector financial-management practice, allowing the parliament to approve taxes, rates and expenditure proposals, though merely as a formality, since any member of legislature, who opposed the finance bills, would be reprimanded (Njeru, 2013, pp. 2-3). Thus, despite the initial constitutional authority granted to Parliament to scrutinize and approve the national budget, the legislature was effectively ignored by the executive, and the Treasury took the lead role in public-sector financial management. In addition, there was a systematic erosion of the Office of the Controller and Auditor General arising from transfers of key officers, a situation that diluted its capacity to audit public-sector financial reports and led to accumulated audit arrears. These resulted to gross abuse of public office and mismanagement of finances that culminated in mega scandals (Njeru, 2013, p. 3).

3.2.3 The Current Public-Sector Financial-Management Reforms in Kenya

Prior to 2003, the year Kibaki regime assumed power, Kenya faced serious weaknesses in the area of public financial management practice, which culminated in a number of notorious scandals, such as Goldenburg and Anglo-Leasing scams (Hedvall, Steen, Sharpley, & Ochieng, 2009, p. 12). Since then, a number of key reforms were initiated, which aimed at improving public-sector financial management and fiscal transparency. To improve public-sector financial management, key reforms were involved in changing the public-financial management legal framework. First, the Government Financial Management Act (2004) was legally enacted and addressed some urgent public financial management issues, mainly in accounting, by the introduction of the accrual-based financial reporting system. The second legal change was the introduction of the Public Procurement Act (2003), which established the modern procurement processes and standards within the public sector. Thirdly, the Public Audit Act (2003) was also introduced to establish the independence of the National Audit office (Hedvall et al., 2009, p. 12).

Since there was also a limited availability of fiscal information, the Kibaki regime also embarked on an introduction of a strengthened monthly expenditure return process, improvement in reporting on the semi-autonomous government agencies and extra budgetary fund (Hedvall et al., 2009, p. 12). The regime established the publication of a quarterly budget review on the Ministry of Finance website and replaced the computerization legacy systems gradually by modern-integrated financial management information systems within all the government units. The treasury also implemented strict limitations to tax expenditures through tightened legal framework and improved controls at the Kenya Revenue Authority (KRA), improved cash management by releasing cash-based on cash-flow projections from the ministries and other governmental units and strengthening accountability within the governmental units by reducing the discretionary power of treasury to make budgetary changes.

Further, to improve budget realism, there was an improved fiscal framework, which emphasised greater reliability on macro-economic forecasts, improved revenue projections and realistic ceilings for budget preparations based on the Medium-Term Expenditure Framework (MTEF). The Medium-Term Expenditure Framework encourages wider consultation during budget preparation, including consultation of civil society groups (Hedvall et al., 2009, p. 12). The Kibaki regime also implemented public-sector financial-management administrative reforms which included outlawed political fund-raising events, establishment of the ministerial code of conduct, simplifying licensing regimes for businesses and the introduction of performance contracts for all semi-autonomous government agencies and the state-owned corporations (Hedvall et al., 2009, p. 12). Many of these changes were incorporated into the Fiscal Management Act of 2009 and later incorporated in the Kenyan current Constitution (Njeru, 2013, p. 4).

The provisions of the Kenyan new constitution enabled the transfer of key public-sector financial-management responsibilities from the executive to the parliament (Njeru, 2013, p. 5). In addition, some of the regulatory institutions have been established and new independent constitutional offices introduced by separating the control function of the Controller and Auditor General (CAG) into two, i.e., the Controller of Budget (CB) and the Auditor General (AG). The new Constitution extended the role of the Controller of Budget (CB) to supervise budget implementation and report on a quarterly basis to Parliament.

The new constitution also changed the functions of the Treasury and, as a result, most of the functions of the Secretary of Finance (formerly the Minister for Finance) and the Principal Secretary (formerly the Permanent Secretary, Treasury) were relegated to legislation. The other major changes in the new constitution are fiscal decentralization, with county governments authorized to decide on how to use their budgetary allocations, and the establishment of the Commission for Revenue Allocation. The Commission for Revenue Allocation is authorised to supervise the allocation of revenues between national and county governments and advise the legislature. Further, to consolidate fiscal decentralization, the new Constitution established a Senate and county legislatures as key institutions on matters of county public-sector finance (Njeru, 2013, p. 5).

In addition, the reform agenda of state corporations, under the umbrella of public-sector reforms programme in Kenya, have witnessed five state-owned corporations being privatised, and several more, from hotels to banks, have been scheduled to be privatised too (Seymour, 2011, p. 45). Seymour (2011, p. 45) noted that it is not just politics that is getting in the way, but many of Kenya's state-owned corporations are in considerable debt, which reduces their value in the process of privatisation. It is, therefore, important to note that the public-sector financial management reforms in Kenya has been in progress in decades and is targeting improvement on performance within the public and private sectors.

4. Conclusion

The aim of the study was to review literature on public-sector financial management reforms in Kenya, starting with the current economic status in Kenya for the period of 2007 to 2011. The literature review revealed that the Kenyan economy is on a positive track and the government has embraced the public-financial management reforms within its governmental units. The review also showed that the public-sector financial management, which involves government budgeting, financing, expenditure management, accountability, financial reporting and auditing, has been undergoing some considerable reforms over the last decades. The public-sector financial management reforms have been embraced by all institutions of the government. Furthermore, the public-sector financial management reform agenda has focused mostly on improving efficiency and accountability within the governmental units, including state-owned corporations. The reformists believes that by way of enhanced economic or market-based management, such as market-based debt-financing decisions, the efficiency and accountability of the governmental units, which have been in question for a while, will be improved. Therefore, it is supposed that this restructuring, combined with improved economic performance, will translate to better financial performance within the Kenyan public sector.

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