INSTITUTE OF ECONOMIC AFFAIRS

THE BUDGET FOCUS

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BUDGETING FOR THE NATION

Issues of public finance management and expenditure have always attracted public interest. However, this quest has been frustrated by an information drought which has only succeeded in alienating the public further from this important subject. It is in response to this that the Institute of Economic Affairs (IEA) has designed a Budget Information Programme (BIP) which, apart from mobilising public and professional input into the Budget, also undertakes to monitor expenditure. The Budget Focus is one product of this programme.

In this inaugural issue of the Budget Focus, we take a look at two important aspects of Kenya's public finance. Part I is an overview of Kenya's budget practice and process while Part II examines the new budgeting approach recently introduced, the Medium Term Expenditure Framework (MTEF).

If the budget is supposed to be used as an instrument for stimulating or inducing growth, then Kenya's budgetary process, especially in the last decade, has been a serious failure. Measured by the declining GDP annual growth rates (averaging about 2%) and the increasing incidence of poverty, the budget has failed to respond to the development challenges of the country.

Aggregate fiscal discipline, resource allocation based on strategic priorities, and efficient and effective use of resources - three important standards against which to measure the budget - have been sorely lacking. Kenyans, despite paying high taxes (27% of GDP) have rarely gotten value for their money. Budget deficits have become endemic leading to expensive domestic debt strategy which the government pursues and which end up depressing production. National development goals have not been attained. Disproportionate spending in recurrent and development expenditures still obtains. Public resource misuse is the still rampant as the annual reports of the public audit institutions show.

The reasons for the 'budget failure' in Kenya are to be found largely in the inappropriate

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institutional and legal arrangements that govern the process. The budget is cast, and conducted, as a technocrats (Executive) project on which the public has little input to make. In fact even Parliament plays largely a ceremonial or rubber stamping role having either been disabled by law (e.g. the scrapping of Estimates Committee) or political manoeuvring (unconstitutional expenditures have been made that ignores provisions in the law that require parliamentary approvals). The provincial administration has had inordinately large influence on the district allocations being, as they are, signatories to the district cheques and chairmen of the District Tender Boards.

Further, the Budget is not clearly linked to the planning process and approved policies. Policies are agreed upon without reference to their costing to the exchequer. The mismatch between expenditures and revenues are unending which leads to mini-budgets and supplementary budgetary estimates. Not all expenditures are included in the Printed Estimates (PE) which gives room for parachuting projects. Unconstitutional expenditures have been undertaken – thanks to a weak legal and institutional framework. Parliament's ability to scrutinise expenditure is greatly limited largely because of the institutional structure of the House's operation part of which include the absence of the Estimates Committee.

Through all the stages in Kenya's budgeting-formulation, enactment, implementation, monitoring—it is clear that serious loopholes exist. At the formulation stage, the budget is largely an exclusive and opaque process in which Treasury plays a predominant role. Public participation in the identification of priorities for allocation is woefully low despite attempts at district focus strategy. This approach completely distorts the priorities. The sheer length and language of the budget itself is too complicated for ordinary comprehension which further alienates Kenyans from the budget.

The scrapping of the Estimates Committee and other revision of the Standing Orders over time, have also greatly constrained Parliament's ability to exert itself substantively in the budgetary process. Consequently, the Executive literally ambushes Parliament with the tax and expenditure proposals which MP's encounter for the first time when the financial statement is read by the Minister for Finance. The 7 continuous days allocated for debate and subsequent 3 days for suggestion on amendments are scarcely sufficient to thoroughly digest the budget. Unlike other Bills of the House, the Finance Bill is not referred to a special committee—The Finance Committee—but is handled by the Committee of Ways and Means which is a committee of the Whole House– a rather unwieldy arrangement.

The implementation of the budget is an Executive task and this stage is confronted by serious problems: political intervention in the allocation of resources and sluggishness in the disbursement of allocations to the districts. These remittances are at times distorted and projects that do not appear either in the PE or Public Investment Programme (PIP) are sneaked in. As a result of the 'alien' nature of projects there also tends to be little public enthusiasm in their implementation.

Monitoring is weakened both by the fact that there are no internal mechanism for continuous monitoring and also that the external auditors are not only late in their audit but they also lack teeth to take corrective / punitive measures on the basis of their audit reports. Thus Controller and Auditor General (CAG), Auditor General Corporation (AGC), Public Accounts Committee (PAC), Public Investment Committee (PIC) are largely academic and post mortem institutions which provide little remedies for public expenditure excesses.

HOW DO WE BUDGET?

Through the Planning and Budget Cycle (PBC), the Kenya budgetary process seeks to provide the interface between budgeting and planning. Using expenditure ceilings provided by the Ministry headquarters, district departmental heads are expected to identify specific district levels activities to help realise the objectives of the National Development Plan. The PBC, basically transforms the contents of the National Development Plan into specific plans and programmes for implementation. This it does by producing:

- ? ? 3 year Programme Review and forward budget at district, ministerial and parastatal levels.
- ? ? 3 year Public Investment Programme (PIP) at the national level.
- ? ? Annual Annex (AA)

The Forward Budget (FB) is a three-year rolling plan, which is produced between July and December and is aimed at rationalising delivery within expenditure ceilings set by the Treasury. The FB establishes clear priorities for the allocation of recurrent and development resources. The end of the Forward Budget results into the publication of approved estimates and development expenditure.

The PIP is a ministerial review of all on-going projects. It categorises projects into "core", "high priority" and "other".

The AAs are produced at the district levels under the co-ordination of the District Development Officer for submission to the (former) Ministry of Planning and National Development. They contain three forms.

- ? ? Form A is a summary of the projects completed in the immediate past financial year and their recurrent cost implications.
- ? ? Form B consists of the Annual Work Programme, indicating funding allocation and expenditure for immediate past financial year, funding requirement for the new financial year, estimated funding needs for the next 2 financial years and a Forward Budget proposal to the end of the project.
- ? ? Form C contains proposals of new development projects.

The budget path/cycle consists of four stages which include:

?? Formulation

Broadly speaking, the preparation of the Kenyan budget begins in July of every year. This is preceded by a detailed analysis of the present and medium term domestic economic situation as well as developments and expectations in the world economy. The release of the Economic Survey that precedes the budget lays the background of the Kenyan economy against which the budget is to be prepared.

At the helm of the budgetary process is the Budget Steering Committee (BSC) chaired by the Minister for Finance (MOF) and draws membership from MOF, Ministry of Planning and National Development and the Central Bank of Kenya. The BSC's main task is to review of all macro-economic and sectoral performance and make projections for the coming year.

The BSC produces the Budget Out-turns which forecast levels of revenue, grants, expenditure, debt servicing and internal and external borrowing needs. A distinction is subsequently made between "imperative" (which include debt obligation) and "discretionary" expenditure. Imperative expenditure are those commitments which government, even for its own credibility, is compelled to honour whereas discretionary expenditures are those commitments government regards as optional.

The production of the draft budget is preceded by the production of the PIP – supposedly a product of all-level consultation right from the sub-locational. It is compiled from the district AAs and the ministerial and parastatal FB.

FB preparation begins in July when the Treasury circular conveying budget ceilings on the basis of the out-turns of the BSC, is released to Ministries and parastatals. The ministries in turn communicates their budget ceilings to the district heads each of whom is required to submit the departments FB to the District Developing Officer (DDO) by mid-August. The DDO in consultation with the DDC compiles the district's AA which is sent to the Ministry of Planning and National Development and the parent ministries headquarters. Parastatals FBs are submitted during the last two weeks of August to the Director of Government Investments and Public Enterprises (DGIPE) with accompanying comments from the parent ministries.

Once ministries and parastatals have submitted their FBs to the MPND, work on the draft PIP commences in September (note that at Ministry level the budget is co-ordinated by a Budget Committee chaired by the Permanent Secretary and whose membership include the Principal Finance and Establishment Officer (PF -EO).

Upon completion of the draft PIP and FBs, the Estimates Working Group (EWG), a committee of

Treasury's Budgetary Supply Department, scrutinises the proposals to ensure their conformity with the expenditure ceilings and the overall guidelines issued by MOF. The Budgetary Procedures Group, chaired by the Director of the Budgetary Supply Department, receives the report of the EWG to review the ministries' proposals to ensure they follow the macro level constraints and priorities.

These two closely inter-linked processes occur between October and November after which they are released to ministries and parastatals. In December the Approved Recurrent and Development Forward Budget are published and the preparation of Draft Estimates commences.

In January the Treasury issues circulars to ministries informing them of the ceilings. Sometime in February parastatals forward proposals for the draft estimates to their respective ministries and the DGIPE which examines the proposals and re-submit back to ministries in May. The ministries approve and dispatch approved budget to parastatals before June. In April the Draft Estimates are presented to the Budgetary Procedure Group and to the BSC for approval. Then the Minister places the proposals before the cabinet to seek government approval before tabling them in parliament.

?? Enactment

The presentation of the budget speech is accompanied by the tabling of the Appropriation Bill and the Finance Bill. The Appropriation Bill contains the estimates of recurrent expenditure and development estimates; while the Finance Bill outlines the legal changes effected in that financial year (in a number of pieces of legislation) to help realise the objectives and measures of the budget.

Whereas, constitutionally, the measures announced in the budget cannot have effect until approved by Parliament, this process is normally long. To avoid a government shut down parliament, at the beginning of the financial year, authorises by vote on account, the appropriation of funds required for the purpose of meeting expenditures necessary to carry on the services of government (Sec. 101). However, this vote does not exceed in total one half of the sums included in the estimates or expenditure for that year laid before Parliament.

The supplementary/revised budgetary estimates are presented to Parliament as the Supplementary Appropriation Bill by about March every year. Supplementary estimates are supposed to be a response to deficits that occur in the budget as a result of emergencies or inability to have forecast correctly in the Budget out-turn. The estimates are also presented to effect allocation of funds between votes. Whereas the Minister presents the Bill to Parliament for approval, in reality the expenditures appearing in the supplementary estimates have already been incurred. The presentation is merely intended to formalise it.

The preparation if the supplementary estimates begin in October when the Treasury issues circulars on budget ceilings to ministries, which proceed to submit proposals to Treasury by November. The EWG subjects these proposals to scrutiny and review. Upon approval by the government the Supplementary Appropriation Bill is presented to Parliament and approved estimates printed in March.

To respond to emergencies such as drought or outbreak of epidemics ministries may urgently require more money than had been allocated to them by Parliament. The ministries may also need to make adjustments/realignment to the voted allocations.

To enable ministries to do these Sec. 102 of the Constitution allows for the establishment of the Civil Contingencies Fund which allows Treasury to authorise ministries to use the fund for emergency interventions which, however must finally be reflected in the supplementary estimates which parliament endorses - more often retroactively. The ministries upon receiving the allocation make remittances to the funds to replenish the stock.

?? Implementation and Monitoring

Upon the enactment of the Appropriation Act the office of the AG must ensure that all proposed withdrawals from the Consolidated Funds are authorised by law and approve them. This is the control function of the CAG which is rarely exercised.

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KEY INSTITUTIONS IN KENYA'S PUBLIC FINANCE

District Development Committee (established under Office of the President)

Duty: Mobilise public participation in identifying priorities

Product: District Annual Annexes

Composition: Chaired by DC, Members include departmental heads

Performance: Dominated by provincial administration and public input generally ignored

Ministry of Finance (a constitutional office)

Duty: Prepares ceilings, annual Estimates and makes allocations and disbursements

Product: Public Investment Programme (PIP), Forward Budgets & Annual Printed Estimates

Performance: Allocations sometimes done arbitrarily, PE produced timely, AIEs abused, disparities in PIP and PE, no link between budgeting, policy and plans, pending bills, huge deficits

Parliament (established under Chapter 3 of the Constitution)

Duty: Authorise government revenue and expenditure proposals and audit expenditures

Product: Finance, Appropriations and Supplementary Appropriation Acts and PAC and PIC Reports

Performance: Has never failed to pass the Bills; lacks amendment powers, lacks capacity to scrutinise proposals due to weak committee system; has no role in external debts issues, generally weakened by constraints of institutional structure and law

Public Accounts Committee (PAC) (established by Standing Order No.147)

Duty: To examine accounts showing the appropriation of the sum voted by the House to meet the public expenditure and other such accounts laid before the House

Composition: Opposition Chairmanship, not more than 10 MPs nominated to reflect the relative majorities of parties provided ruling party does not have a majority of more than 2.

Product: PAC Report

Performance: Good Reports annually but no prosecutorial powers

Public Investment Committee (PIC)(established by Standing Order No.148)

Duty: To examine the Reports and accounts of the public investment

Composition: As in PAC above

Performance: As in PAC above

Controller and Auditor General (established by Section 105 of the Constitution)

Duty: To approve all government withdrawals and audit government expenditures

Product; CAG Report to be submitted to PAC

Performance; Good annual Reports, Audit late by about 2 Financial years, no prosecutorial powers, does not report directly to parliament.

Auditor General (Corporations)- (established in 1985 under Exchequer and Audit Act)

Duty; audit government public investment

Product: Report to be submitted to PIC

Performance: Good annual reports, no prosecutorial powers, lack of expertise to audit technical government investments, understaffing, weak legal grounding, under-funding, Executive influence in staffing and funding

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Once funds are disbursed to ministries the Permanent Secretaries become the Accounting Officers in charge of all monies allocated to the ministry. Authorities to incur Expenditure (AIEs) are issued directly to the district heads copies of which are supplied to the District Treasury and the Paymaster General. The AIEs to the districts must be sent by 1st July and the District Commissioner is expected to inform the OP by 31st July of the ministries, which have not issued theirs.

Kenya's financial year closes on the 30th of June and the district financial accounts are finalised for submission to the AG within 4 months after June. The Controller and Auditor General's office executes its constitutional role of auditing government accounts within 9 months of the end of the financial year and submits this report to the MOF who constitutionally is required to transmit it to Parliament within seven days. If he doesn't then the CAG directly submits his report to Parliament but this provision is to be found not in the constitution but in the Exchequer and Audit Act.

THE MEDIUM TERM EXPENDITURE FRAMEWORK

Introduction

The link between policy, planning and budgeting has not been an easy one to establish. The absence of a clear symmetry between these three important and related functions of the government constitutes one of the greatest weaknesses in Kenya's public finance management. Budgeting, policy and planning have not been conducted in an entirely integrated and comprehensive manner which has resulted into inconsistencies and incoherencies in Kenya's development platform.

The need of integrating these processes has now evidently become apparent to the government. In his Budget speech the Minister announced that as part of an economic framework designed to "effectively translate long term strategies into medium term operational plans for effective implementation", the government will "during the 1999/2000 embark on the formulation of the first phase of a three year Medium Term Expenditure Framework (MTEF) which will outline:

1. Priorities for allocation of public resources.
2. Measures for the most effective implementation of policies and expenditure programme.

Once such an integrative framework is established, annual budget will be formulated within a long-term framework as outlined in the MTEF.

The shift to MTEF as the model for budgeting has been in vogue in a number of countries applying it successfully. In Africa, South Africa, Malawi and Uganda have adopted the MTEF while New Zealand and Australia have also successfully used it in their budgetary systems with appropriate variations.

Conceptualising MTEF

The MTEF is regarded as an extension of the early multi-year projections of revenue and expenditure. A multi-year budgeting occurs when decisions are made with regard to appropriations that cover expenditure requirements for specified fiscal years.

The MTEF is designed to impose discipline in planning and managing national resources by establishing an explicit link between the policy framework and the budgetary process. It seeks to bring a better integration of policy reform, budgeting and expenditure management. It attempts to link sector objectives to national priorities and thereby achieve greater result from existing level of resources.

> It is through this definition of the resource envelope that MTEF changes the psychology of budgeting from a "needs" to an "availability"

MTEF indicates the size of the financial resources needed during a 3 - 5 year period for purposes of meeting the policy commitments and goals determined and approved by the government and the legislature. It is within the framework that the annual budget is made and executed. The key components of the MTEF are:

? ? Setting fiscal targets, either top down to allocate resources between sectors or bottom up to reallocate resources within sectors.
? ? Forward estimates of the costs of existing policies.
? ? An institutional mechanism for evaluating the trade offs to be made.
? ? Enhanced predictability and transparency.

As a comprehensive government strategic policy and expenditure framework, an MTEF provides the government ministries with greater responsibility for resource allocation and resource used. It is through this definition of the resource envelope that MTEF changes the psychology of budgeting from a "needs" to an "availability". The MTEF consists of a top-down resource envelope, a bottom-up estimation of the current and medium costs of existing policy and, ultimately, the matching of those costs with available resources.

Thus shifting focus to what the budget should deliver as opposed to what inputs are required increases the appetite for efficiency and effectiveness

The MTEF seeks to improve the macro economic balance by developing consistent and realistic resource framework and improve the allocation of resources to strategic priorities between and within sectors. It allows departments to plan over the medium term and also creates a framework for assessing new policy proposals and their financial implications. MTEF gives realistic projections of what government can deliver in terms of provision of public services. This goes to enhance the creditability of policy and planning.

The MTEF should be able to create a link between inputs received by the spending agencies, their results and how these results impact on the intended beneficiaries. It therefore prepares ground for both the financial and performance audit. To ensure that intended outcomes are achieved, subsequent allocations to departments are dependent on their performance. It therefore becomes difficult for departments to continue requesting for funds for activities which they cannot demonstrate progress in achieving the outputs.

The mismatch between policy promises and policy practice is a function of the truncation that exists between policy making, budgeting and planning. The MTEF places policy funding side by side so that expenditures can be drawn by priorities but choices are made from an affordable set of alternatives.

The analytical framework provided by MTEF enables the evaluation of trade offs inherent in policy choices a mechanism for linking policy making and budgeting and for making and space in the budget process for the necessary spending adjustments to effect transformation.

Prioritising expenditure; efficient and effective services and making spending affordable are key objectives of any budgeting system which the MTEF tries to achieve by costing policies and putting limits and targets on each ministry. By costing all policies and making distinctions between the carry through costs of existing policy and the costs of new policies, the MTEF responds to the prioritisation objective of budgeting. MTEF places limits for each department and the output targeted within these limits. It is incumbent upon the departments to decide inputs/allocations of resources required to meet the outputs. Thus shifting focus to what the budget should deliver as opposed to what inputs are required increases the appetite for efficiency and effectiveness. The operational space provided to departments is accompanied by greater demands for accountability for results.

To achieve the affordability objective MTEF establishes the amount of resources available and targets revenue for borrowing. It is on the basis of this process that departmental allocations are made.

MAIN COMPONENTS OF MTEF

? ? Articulation of a clear long term vision and national objectives.
? ? Identification of key national priorities on the basis of which expenditure is to be incurred.
? ? Forecast a realistic level of available resources and determine the desired macro and sectoral parameters.

- ? ? Estimation of aggregate resource envelope consistent with macro economic forecast from tax, donors and domestic borrowing.
- ? ? Agreement on sector priorities and sharing of aggregate resource envelope among broad sectors based on agreed national objectives and priorities
- ? ? Ministries compete for resources from various broad sectors.
- ? ? Preparation of a three year rolling financial plan.

THE INSTITUTIONAL FRAMEWORK FOR MTEF

The government has established an elaborate institutional framework for the implementation of MTEF as represented here below:

CABINET: Oversees and guides the implementation of MTEF process

PLANNING AND BUDGET STEERING COMMITTEE :Chaired by the Head of Civil Service, this committee comprises PSs and Accounting Officers. Its task is to evaluate the macroeconomic Working Group and their linkage to national objectives. The committee is also mandated to validate the allocation of the national resource envelope to the six broad sectors as recommended and submit the same to the Cabinet.

MTEF SECRETARIAT: Established under MOF to coordinate the entire MTEF process including coordinating the activities of the macro-economic working group and the sectoral working groups

MACROECONOMIC WORKING GROUP: Develop and update the overall resource envelope and macroeconomic targets. Chaired by Director of Planning and has representation from Kenya Revenue Authority (KRA), Central Bank of Kenya (CBK), Kenya Institute of Public Policy Research and Analysis (KIPPRA).

SECTORAL WORKING GROUPS: Responsible for developing sectoral policies and objectives, evaluating Ministry Departments estimates submissions and ensuring that the inputs, activities, outputs and outcomes are in line with national objectives. They are 6 in total: Agriculture and Rural Development; Physical Infrastructure; Human Resource Development; Industry and Trade; Public Administration; Public Safety, Law and Administration.

CONCLUSION

For the MTEF to work it requires committed will at the highest level to ensure that allocations once made on the basis of policy priorities are not adjusted to respond to political interests. It also requires strong management to ensure that donors comply with MTEF outlines so as not to distort or display development priorities as stated improved/enhanced revenue collection is also an imperative to avoid recurrent shortfalls that would occasion continuous spending adjustments.

In the Next Issue of the Budget Focus, we undertake an analysis of the First Quarter of the 1999/2000 Financial Year as well as a critique budget processes that led to the adoption of the MTEF.

We wish to acknowledge the following works from which the preparation of this bulletin has enormously benefited:

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2. Walker L. and Mengistu B., Spend and Deliver: A Guide to Medium Term Expenditure Framework, Idasa, Capetown, 1999
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