

Fiscal Asymmetric Decentralization Conundrum: Influence of County Cash Management on Household Effects in Kenya

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ABSTRACT

This study aims at determining the influence of county cash management on household effects in Kenya. This is a qualitative research that has utilized both primary and secondary data from county governments and the National Treasury respectively. The sample has been developed from the Kenya National Bureau of Statistics list of households in Kenya. The result indicates that effective cash management would enhance household welfare, leakages and lack of prioritization among others notwithstanding. The study concludes that there is need to enhance oversight of the treasury management across governments. The capacity of treasury managers should also be improved to secure fiscal discipline.

Keywords: Fiscal Asymmetry, Cash Management, Household Effects

INTRODUCTION

Fiscal management reforms trace its genesis from the implementation of the Constitution of Kenya 2010 which created 47 autonomous administrative units known as Counties. Each County government is expected to manage its own fiscal requirements including cash or treasury management, yet the national government controls key revenue sources and disbursements or transfers, hence the fiscal asymmetry. Treasury management is carried out by a treasury system. A treasury system refers to a set of organizational arrangements governing the depositing and disbursement of governmental revenue. Some of the functions of a government treasury are to provide information about fiscal flows and transactions, essential for resource allocation and policy evaluation, governmental cash management and to monitor and control public spending. One of the main roles played by county Treasuries and the National Treasury alike is revenue mobilization and which has a link to service delivery in decentralized government units. In this vein, a number of studies have been conducted by different scholars on the importance of decentralization of revenue collection as a necessary tool for the effective functioning of any government machinery. Further, it has been argued that no government agency can survive without adequate revenue. Government revenue is collected through taxation and other fees (Zayol, Kur & Lyonkyo 2017). Maina (2016), expresses the unique role played by the process of taxation as a primary mechanism of revenue mobilization by treasury officials. However, Bird (2010), insinuates that the practice must be sound for government units as an essential pre-condition for the success of public service delivery. This is because, as opined by Sanandaji and Wallace (2011) raising revenues and especially local revenue mobilization by county governments has the potential to foster political and administrative accountability by empowering communities. Accordingly,

Baumann (2013) states that successful decentralization requires that all actors be given scope and resources for the contribution to development, this is bestowed on the unique role played by treasury managers.

Lienert (2009) and Williams (2010) postulate that regardless of how cash is handled, the underlying challenge in cash management is the fact that revenue inflows and payment obligations generally do not match in any given week, month or quarter. In practice, the arrangements for expenditure management differ considerably between countries. This is because the government budget follows an annual cycle of preparation, approval, execution and evaluation. Basic cash management Treasury management or basic cash management propitiates the development of administrative techniques which are conducive to optimizing the level of disposable assets to be maintained by a company or government unit. During budget preparation, the National Treasury and forecasts the revenues it expects to flow into government and the expenditures it expects to flow out over the coming financial year (Andrews 2014, Pattanayak 2016). National treasuries have over the years built solid capacity for this role. It remains to be seen whether the same can be said about local government treasuries.

Budget formulation is one of the points in the cash management chain at which problems can begin to arise. Cash management is easier when the budget approved by the legislature is based on a reliable estimate of revenues and planned spending for the year ahead. For a number of technical and political reasons, however, formulating credible budgets is frequently a structural challenge in low-income countries (Simson and Welham, 2014).

The budget approved by the legislature may not bear a close relationship to the revenues and expenditures that are likely to materialize over the year. Where approved budgets are not credible and where expenditures cannot be financed within the available resource envelope, the budget must effectively be reprioritized in-year during execution so that it is affordable. In many countries, combinations of budget revisions, commitment controls and cash limits (or 'cash rationing') are used to force ministries to spend less money. Households depends on the government budget and the ultimate approval by the National Assembly for state Departments and Ministries to spend the money so approved on service delivery to households. The government of Kenya has devolved treasury management to county governments in tandem with the theory of fiscal federalism which advocates for regional governments which are closer to the citizens. The government has made several reforms including the public finance management reforms as enablers of the devolved treasury management towards implementation of the Constitution of Kenya 2010 which introduced the 47 County governments and the National government in Kenya (Imana, 2017).

Roberts (2013), assert that generally treasury management was concentrated on Working Capital management which became more evident during the 1992/93 World Financial crisis. Majority of countries that were able to avoid its worst effects were those that used capital controls in managing their economies and financial sector. Although generally there is no single definition that can be termed as precise and complete, comprehensively outlining the concept of treasury management in depth, several researchers have however come up with one such definition that has gained general acceptance. They define the treasury management as the overall administration of a corporate's cash flow as well as the creation and governance of policies and procedures that ensure the company manages risk successfully (Roberts, 2013). Treasury risk management on the other hand is the process of managing a firm's liquidity, mitigating its operational,

financial and reputational risk. In this paper we argue that the latter is only a concern when the requirements of the former are satisfied. As such the study refers to administration issues surrounding treasury management. A number of studies reveal that Treasury management is still a global concern not only in formal corporate world but also in informal financial sector (Case, Shiller, & Thompson 2012). Lack of expertise management, financial muscles and in-depth awareness in the management of treasury has for example adversely affected banks Sacco's (Polak, Masquelier & Michalski, 2018).

Recent fiscal audit reports indicate that there are numerous instances of fraud, wastage and poor accountability of funds in County governments since the inception of devolution in Kenya. This is against the backdrop of information that the national government has greatly increased funding in the county governments including an equalization fund pegged at 15% of the national revenue. The conundrum of this is that, there has also been cases of money budgeted for development projects being returned to the National treasury at the end of the fiscal year, yet many projects remain incomplete in various county governments in one hand while on the other hand about 42% of Kenyan households still live below the poverty level. Further, uncertainty exists on the negative correlation between the total development budget that is disbursed and is spent and the level of development, poverty prevalence or access to essential services (Republic of Kenya 2017). The above notwithstanding, this paper aimed at evaluating the influence of fiscal asymmetric decentralization on household effects in Kenya by generally evaluating the influence of cash management on household effects in Kenya.

RESEARCH METHOD

This study modeled a cross-sectional time series based on two data sets. **Secondary** county fiscal data for 2013-2018 was obtained from National Treasury. Primary data was obtained from households domiciled in the 47 counties. This was based on a Sample of 4,813 households was drawn from the 96,251 list of households used by the Kenya National Bureau of Statistics in the 2009 enumeration areas. The sample size was determined by use of Cochran's (1977) correction formula. Ordinary Least Squares (OLS) regression was used to establish the causation between the independent and dependent variables. Regression model is as follows.

$$Y = \beta_0 + \beta_1 X_1 + \varepsilon \dots \dots \dots (1)$$

Y= Dependent variable is Household effects either as Household income (HHI or Household Health Outcome (HHH)).

X₁ = County Treasury Management (CTMa)

B_i is the parameters and ε is the error term

Household income is an index based on the change in the number of income sources available to the household before devolution and at the time of the study. Similarly, Household Health outcome is the index based on the interactions with the local public health provider before and after devolution. County treasury management is the ratio of revenue generated by county and total expenditure per annum.

The *p value* at 5% significance level was used to determine the statistical significance of the constant terms coefficient terms β_1 . The coefficient of

determination R^2 was used to determine how much variation in the dependent variables is explained by the independent variables. The hypothesis to test whether fiscal decentralization when operationalized as county treasury management has impact on Household Effects was as follow;

Ho: $\beta_1 = 0$ (There is no association between County Treasury Management and household effects).

H1: $\beta_1 \neq 0$ (There is association between County Treasury Management and household effects).

RESULTS AND DISCUSSION

Treasury Management characteristics

Contribution of local government units to overalls expenditure is observed as ranging between 4.02% to 7.17% during the period under consideration as indicated in table 1 below. This is means that devolved units clearly not able to support their functions through the revenues they raise though a small effort is being made. In 2017/2018, the maximum value is observed as 43.4% which is clearly an outlier given the closeness between observed mean values and the minimum values.

Table 1: County Treasury Management Characteristics

| Year | FY2013/2014 | FY2014/2015 | FY2015/2016 | FY2016/2017 | FY2017/2018 |
|----------|-------------|-------------|-------------|-------------|-------------|
| Mean | 0.00402 | 0.05883 | 0.060708 | 0.062308 | 0.07174 |
| Min | 0.000157 | 0.038776 | 0.006195 | 0.00456 | 0.006475 |
| Max | 0.012545 | 0.244026 | 0.336641 | 0.336641 | 0.434274 |
| Std dev | 0.002436 | 0.147482 | 0.065514 | 0.071521 | 0.093124 |
| Skewness | 1.779499 | -1.61464 | 2.453712 | 2.617743 | 2.645563 |
| Kurtosis | 0.000157 | -1.61464 | 0.006195 | 0.00456 | 0.006475 |
| N | 47 | 47 | 47 | 47 | 47 |

This paper therefore agrees with the proposition by Allard (2017) developing economies their devolved units included are struggling to collect sufficient revenues in order to finance their own development projects, hence depends entirely on the central governments. We also agree with Odd et al (2012) who posit that there exists other revenue sources beyond the arms reach of county governments in Kenya which compromises the ability of county governments to mobilize revenue and other sources that are dominated by aid projects or programmes funded by a mix of international non-governmental organizations, bilateral and multilateral donors which county governments have no knowledge or control of.

Influence of County Cash Management and Household Effects-Household Income
Two indicators were used in order to establish the influence of the County Cash Management on household effects in Kenya. These were household income (HHI) and household health (HHH) characteristics. Correlation analysis was performed to establish

Table 2: Correlation Matrix:

| Variable | CTMa | HHI | HHH |
|----------|---------|-----|-----|
| CTMa | 1 | | |
| HHI | 0.6931* | 1 | |
| HHH | 0.6706* | | 1 |

* Correlation is significant at the 0.05 level (2-tailed).

We have established a strong positive relationship between county cash management and

household effects. This is supported by a correlation coefficient of 0.6931 as indicated in table 2. The association between the two variables is significant at 5% level of significance. The findings imply that an increase in county cash management would increase household effects in Kenya. Further, the findings reveal that there is a strong positive relationship between county cash management and household health outcomes. This is supported by a correlation coefficient of 0.6706. The association between the two variables is significant at 5% level of significance. The findings imply that an increase in county cash management would improve household health.

Table 3: Regression Model: CTMa and HHI

| | Coef. | Std. Err. | t | P> t |
|------------------------|----------------------------------|-----------|-------|-------|
| CTMa | 0.00013 | 1.14E-05 | 11.34 | 0.000 |
| _cons | 1.17744 | 0.043239 | 27.23 | 0.000 |
| R squared | 0.4804 | | | |
| Adj. R squared | 0.4767 | | | |
| F (1, 139) | 128.54 | Prob.>F | 0.000 | |
| Skewness/Kurtosis test | Chi2=55.90; Prob> chi2=0.000 | | | |
| Breusch-Pagan test | Chi2=0.25; Prob> chi2=0.6182 | | | |
| Wooldridge test | F(1, 46) =0.177; Prob>F = 0.6758 | | | |

The results indicate that there is a positive and significant relationship between county treasury management and household effects. This is indicated by a beta coefficient of 0.00013 and a p value of 0.000. The results imply that for every one-unit change in county treasury management, household income would change by 0.00013 units holding all factors constant. The beta coefficient has a positive sign, which indicates that there is a direct relationship between county treasury management and household income. Further, the F value of 128.54 indicates that the model is a good estimate given its p value of 0.000 at 5% significance level. The results imply that county treasury management is a good predictor of household income. In addition, the R² of 0.4804 indicate that county treasury management explains 48.04% of the total variations in household income. Wooldridge test reported a p value of 0.6758, which is greater than 0.05 and therefore, there was no auto correlation.

The study finds that there is a strong positive relationship between county treasury management and household income. This is supported by a correlation coefficient of 0.6931. The association between the two variables is significant at 5% level of significance. The findings imply that an increase in county treasury management would increase household income. This is in tandem to the findings Alam et al (2016) and Hanabe et al (2018), which is proof that though devolution

is a political process the economics benefits can be achieved in a leapfrog manner.

Influence of County Treasury Management and Household Effects-Household health outcomes

The study Further sought to establish the influence of the County Cash Management on household effects, when household health characteristics are used as a measure, Table 4 indicates the result on the relationship between county treasury management and household effects under household health.

Table 4: Regression Model: CTMa and (HHH)

| HHH | Coef. | Std. Err. | t | P> t |
|-------------------------------|--|-------------------|--------------|--------------|
| CTMa | 0.000192 | 0.000018 | 10.66 | 0.000 |
| _cons | 1.737118 | 0.068098 | 25.51 | 0.000 |
| R squared | 0.4497 | | | |
| Adj. R squared | 0.4457 | | | |
| F (1, 139) | 113.58 | Prob.>F | 0.000 | |
| Skewness/Kurtosis test | Chi2=; Prob> chi2=0.000 | | | |
| Breusch-Pagan test | Chi2=0.25; Prob> chi2=0.6182 | | | |
| Wooldridge test | F(1, 46) =0.177; Prob>F = 0.6758 | | | |

The study finds that there is a positive and significant relationship between county treasury management and household health. This is indicated by a beta coefficient of 0.000192 and a p value of 0.000. The results imply that for every one-unit change in county treasury management, household health would change by 0.000192 units holding all factors constant. The beta coefficient has a positive sign, which indicates that there is a direct relationship between county treasury management and household health outcomes. An increase in county treasury management is expected to have a positive influence on household health outcomes. The results imply that county treasury management is a predictor of household health. In addition, the R^2 of 0.4497 indicate that county treasury management explain 44.97% of the total variations in household health. County treasurers' progressive actions are therefore key in promoting health in households as confirmed in related studies such as Hatfield & Kosec (2013) and Purfield, (2016). We however do not quite agree with the proposition by Pranab (2002) that treasury management impact is only observable in advanced economies.

CONCLUSIONS

Effective cash management for has the potential of enhancing household welfare whether considered as household income or health reducing poverty in fiscal decentralization conditions. This can be adjudged as the impact fiscal decentralization owing to the fact that citizens are closer to fiscal processes. More impact is expected if reducing leakages and dealing with lack of prioritization of both recurrent and development expenditure in county governments. The Theory of Fiscal Federalism advances an argument in favor of the expansion of fiscal space in decentralized economies, has been confirmed by this paper. There is need to enhance oversight of the treasury management across governments by restructuring the existing bodies bestowed with oversight responsibilities. The capacity of treasury managers should also be improved to secure fiscal discipline.

This study relied on household welfare measures of income and health outcomes. Future studies may have to consider what the interactions would be of economic or enterprise data such as county GDP was used among others.

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