

**PUBLIC FINANCIAL MANAGEMENT REFORMS AND ECONOMIC GROWTH:
A CRITICAL LITERATURE REVIEW.**

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DECLARATION

This independent study paper is my original work and has not been presented in any other university for an award.

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LIST OF ABBREVIATIONS

PFM-Public Financial Management.

GDP-Gross Domestic Product.

UN-United Nations.

FISH-Fordham Index of Social Health.

GPI-Genuine Progress Indicator.

GSDP-Gross Sustainable Development Product.

GESDI-Gross Environmental Sustainable Development Index .

MTBF-Medium Term Budgetary Framework.

IFRS-International Financial Reporting Standards.

EU-European Union

DM-Diversity Management.

EM -Earnings Management.

IGO-Intergovernmental Organizations (IGOs)

PA-Principal-Agent

ABSTRACT

This study examines thorough extensive review of the relevant theoretical and empirical literature on public sector financial management reforms and economic growth. There have been many reforms that have been instituted in the public sector overtime especially in the finance sector. However, the rate of economic growth has not been at par with these reforms. This study therefore sought to establish the relationship between these reforms and the economic growth. The study will be of value since it will help in identifying financial reforms in the public sector that need to be given preference and it will also assist in identifying research gaps in the academic literature that need to be looked into. A number of theories have been discussed to give the theoretical literature to the reforms; they include decision theory, information asymmetry theory, agency theory and stewardship theory among others. These theories are critical in the study because they helped to indicate the possible relationship that may exist between specific reforms and the economic growth. For instance decision theory helped in relating budgets; a tool that is critical in making decisions to the economic growth. Agency theory helped to indicate the relationship that exists between the management, the stakeholders who were the Kenya citizen as well as the role played by the oversight bodies within the public sector. The major findings on public sector reforms from the studies were that the most significant way of influencing the budget was to introduce basic managerial changes since it will have an impact on prioritization of resources. However, studies should be undertaken to establish the extent to which budgetary reforms spur savings and public investment. In addition, it was noted that the relevance of financial reporting on economic development cannot be over emphasized; however, it was not clear to what extent the financial statements act as indicators of economic success and financial health in the public sector. It was also noted that without oversight, other reforms would be ineffective; it was not established how effective has oversight been in the public service since unethical practices continues to be perpetrated despite the existence of oversight bodies. It was further noted that legal enforcement was critical for public financial management reforms actualization; however, it was not clear the penalties that ought to be put due to failure to implement the reforms and the risk management initiatives that have been put in place to meet challenges of non implementation of the public finance reform. In general therefore, it was noted that there was a positive relationship between public finance management reforms and economic growth. The paper recommends that serious attention should be given to the research gaps noted which included lack of a clear policy on the appropriate mix or proportion between recurrent and development allocations in the budget, lack of indication on the contribution of information technology on the financial statements and absence of clear indication on the role played by the risk management initiatives in reducing wastages. Implementation of the recommendations that have been made in this paper with regard to public finance reforms would go a long way in strengthening their impact and contribution on economic growth and development.

CHAPTER ONE INTRODUCTION

1.1 Background of the study

In recent years, countries all over the world have experimented with public finance reforms, opting for different scopes and approaches. These reforms included the move towards performance focused policies, multi-year programming frameworks in budgeting linked to fiscal and revenues projections, the shift from cash to accrual accounting and the enhancement of the oversight and scrutiny frameworks. A well-functioning public financial management (PFM) system is a prerequisite for the sustainable implementation of government policies aimed at promoting economic growth and social development. Sound PFM policies and practices provided responses to the challenges of greater economic openness and the resultant globalization of public goods, equity in development, fair access to public service and poverty reduction. To perform their spending functions efficiently, governments' choices are expected to be consistent with national monetary and fiscal policies and achieve sustainability overtime (Vanbruanne, 2011).

Public Finance is grounded on several theories, which include among other the Fiscal theory; Musgrave (1959) developed his fiscal theory in terms of a multi-branch conception of governmental budget. There are three branches specified: The allocation branch, the distribution branch, and the stabilization branch. Other theories include the normative and positive theories of public finance as explained by Buchanan (1919) that the normative theory of public goods, best represented in the two basic papers by Samuelson, stems directly from theoretical welfare economics. A positive theory of public finance must begin with the basic efficiency analysis that is contained in the standard normative theory. In addition, it must incorporate the negative result that wholly voluntary behavior of individuals in exchange may not produce outcomes satisfying allocative efficiency requirements.

1.1.1 Public Financial Management Reforms

Lawson (2015) held that PFM reforms refers to changes on the set of laws, rules, systems and processes used by sovereign nations (and sub-national governments), to mobilize revenue, allocate public funds, undertake public spending, account for funds and audit results. While Pretorius & Pretorius (2008). Held that Public financial management reforms concerns changes

on the administration of the collection and utilization of funds by governments in order to improve efficiency and effectiveness in operations.

Guthrie, Olson & Humhrey (1999) in attempting to summarize public financial management reforms identified five different categories. The first involves changes to financial reporting systems, including the promotion of accrual based financial statements across government departments and sectors and a reliance on professionally accounting set accounting standards. The second concerns the development of commercially minded, market oriented management systems and structures to deal with the pricing and provision of public services, with emphasis on cash management, contracting out arrangements and internal and external charging/pricing mechanisms.

The third comprises the development of a performance measurement approach, including techniques such as financial and nonfinancial performance indicators, league tables, output and outcome performance measures and benchmarking. The fourth concerns the devolvement / decentralization or delegation of budgets, coupled with the attempted integration of both financial and management accounting systems also with economic –based information sets. Reforms have especially tried to link budgets with the reporting of results in financial and non-financial terms. The final category of PFM reforms involves changes to internal and external public sector audits, notably in terms of monitoring service delivery functions and providing reviews of the efficiency and effectiveness (value for money) of public services, citizen charters and program evaluations.

Common wealth secretariat (n.d) held that there are a number of fundamental transformations that should be made to the fiscal framework. This includes revenue collection expansion; since revenue is important in running of countries and jurisdictions. The external factors have a great effect on the countries tax arrangement. In the civilized world, countries are more interested with the efficiency of tax collection and reach of many persons other than in the rate of tax. Therefore, entities which deals with tax collection should be sufficiently funded and encouraged to be more efficient in the collection of taxes. A country's debts and debt levels and the cash should be well managed Countries should inculcate use of prudent principles of funding of the deficits and establish risk management processes that are aimed at enhancing efficiencies.

Proper management of borrowings has the ability to reduce the cost of debt financing in a country.

Eltis (2004) held that governments should ensure that planning is done at all levels of their administration. Since planning and proper allocation of resources is a vital activity in any administration. Budgeting is a critical component of financial planning and allocation should be transparent so as to get the views of many stakeholders. Budgeting should be results/outputs focused and not inputs focused only. This should be coupled with enhanced accounting and reporting. The office of the head of accounting services in any country should be sufficiently funded to enable it fulfil its responsibilities. Oversight well undertaken is a critical component in the implementation of public sector financial reforms. Transparency, proper reporting and accountability and penalties are key ingredients of a functioning PFM system. Oversight should be carried out by various bodies within and outside government entities. They include parliamentary committees, internal and external auditors, ombudsman, the civil society and the media.

1.1.2 Economic Growth

Economic growth is the increase in the inflation-adjusted market value of the goods and services produced by an economy over time. It is conventionally measured as the percent rate of increase in real gross domestic product, or real GDP. Of more importance is the growth of the ratio of GDP to population (GDP per capita, which is also called per capita income). An increase in growth caused by more efficient use of inputs (such as labor, physical capital, energy or materials) is referred to as intensive growth. GDP growth caused only by increases in the amount of inputs available for use (increased population, new territory) is called extensive growth.

Economic growth is an increase in the capacity of an economy to produce goods and services, compared from one period to another. Economic indicators measure economic well-being and wealth- Money is the only measure of well-being recognized by conventional economies - the price of something is a measure of its value. When countries join the UN they have to subscribe to the System of National Accounts. These accounts are used to measure the GDP.

Gross Domestic Product (GDP) is the primary indicator or measure of economic production within a country (growth and development). It is the total dollar value of all of the goods and services made and purchased within one year. Put another way, it is a tally of all of the money spent by individuals and households (2/3), government and businesses. The global GDP in the mid 90s is \$26 trillion. As a benchmark, a 2% growth in GDP is considered slow growth while a 4% annual growth is considered great. The GDP measures income, savings, credit purchases, commodity production and accumulation of capital.

Lawson (2014) held that GDP ignores social and environmental cost of growth. That is, GDP does not measure: health, infant mortality, morbidity, suicide rates, crime, poverty, environmental health/decay and destruction of the natural environment, infrastructure such as highways and bridges, family breakdown, loss of leisure time, cost of commuting to work, lack of civility in communities, lack of concern for future generations, income gap (women/men; poor/wealthy). Criticism - as the GDP increases, well-being does not necessarily increase along with it. We cannot assume that things are getting better (improved life conditions) just because more money is spent! And therefore the need for the alternative for GDP which include Fordham Index of Social Health (FISH), Genuine Progress Indicator (GPI), United Nations Human Development Index, Gross Sustainable Development Product (GSDP) and Gross Environmental Sustainable Development Index (GESDI).

1.2 Research Problem

A functioning public financial management system is a pre requisite for the sustainable implementation of government policies aimed at promoting economic growth and social development. Many countries world over have undertaken reforms in many aspects of public financial management systems, with an aim of enhancing their economic growth. However, despite the many reforms; there has not been equivalent economic growth (Vanbuance, 2011). This dilemma is what this paper seeks to establish. Theoretically, public financial management reforms have a direct relationship with economic growth, implying that as reforms takes place ,it is expected that financial resources through reforms would be used economically, efficiently and effectively which would lead to growth in various sectors of the economy. Whereas this is the anticipated scenario this has not been the case. This paradox was the main motivator for studying

this area with an aimed of establishing the cause and what need to be done in order to turn around this unfavorable state.

The relationship between public financial management reforms and economic growth has been demonstrated by a number of international and local studies. Mir and Sutyono (2013) undertook a study in Indonesia and concluded that despite Public financial management reforms having been undertaken with the aim of improving transparency and accountability in public institutions, It was found that the reform initiatives failed to achieve the objectives of the improved transparencies and accountabilities as indicated by the public auditors. Qureshi (2012) did a study, where the main objective was to establish the extent of the accounting development thesis by applying it to a specific emerging economy, Pakistan, and by underscoring the socio-political ramifications of economic development that have significance for the accounting function. The study found that the relevance of financial reporting to economic development with social justice cannot be over emphasized, especially in a developing country like Pakistan. D'souza (2010) did a study on budgetary policy and economic growth, the study concentrated on tax reforms. The findings were that the amount of funds allocated on development expenditure has been declining and reforms in the tax system has not done any better in improving the tax system elasticity. Steps to improve public investment and savings are necessary to keep the economy at a higher growth path. These two areas requires a renewed drive in the management of economic policy which is lacking in the budget.

In Kenya, Yemene (2009) did a paper that re-examined the causal relationship between financial development and economic growth in Kenya for the period 1966–2013. He noted that economic growth and financial development are jointly determined, or they complement each other. A major implication of the finding is that financial development promotes economic growth in Kenya and that policies at enhancing the development of the financial sector can help to spur economic growth. Onuonga (2014) undertook a study which established that financial development accelerates and augments economic development in Kenya and that economic progress leads to development of the financial sector in Kenya. Thus, the government should strengthen the reforms in the financial sector so as to attract investors and improve the efficiency of all production activities in the country. At the same time, the government should enhance macroeconomic policies; fiscal policies, policies that attract foreign direct investment, and export promotion policies that on average lead to economic growth. Njuru, Ombuki, Wawire and Okeri

(2014) also did a study on the impact of government expenditure on private investment in Kenya. They noted that reforms on public expenditure were found to deter activities of private investors. The study concluded that there was need for government to re-allocate funds towards project which are private sector friendly and avoid those which fight or forces it away. The study recommended that government should undertake fiscal reforms in the areas that promote private investment. Such reforms were expected to encourage investors because it was a sign of government commitment to prudent financial management.

Some of the above studies support the idea that public financial management reforms have a positive impact on growth in the economy and in other areas, while other studies hold that reforms have no impact in the economy. This paper will use existing theory and literature to develop a framework of the public finance management reforms and economic growth and then assesses the importance of the public finance management reforms in economic growth and seek to establish why despite numerous reforms, the economies of most countries have not reacted positively as intended. The study will seek to establish the contribution made by various reforms such as in budgeting, accounting and reporting, oversight and fiscal decentralization reforms towards economic growth. The study will seek to answer the question, whether there is a relationship between public sector financial reforms and economic growth?

1.3 Research Objectives

General Objectives

To establish the relationship between public sector financial reforms and economic growth.

Specific objectives

- i. To determine the relationship between budgetary reforms and economic growth.
- ii. To establish the effect of accounting and reporting reforms on the economic growth.
- iii. To establish effect of oversight reforms on the economic growth.

- iv. To evaluate the relationship between fiscal decentralization reforms and economic growth.

1.4 Value of the study

Public Finance Management (PFM) majorly deals with all aspects of management of expenditure and resource generation in government. Management of resources is a critical role of management in organizations, the same way management of public finance is an important part of the governance process. Public finance management entails programmes prioritization, mobilization of resources, the budget making process, and the efficiency of resources management including expenditure controls. People's aspirations have risen towards efficiency in utilization of public funds and citizens are demanding value for money from public resources. The purview of public finance is considered to be threefold: governmental effects on efficient allocation of resources, distribution of income, and macroeconomic stabilization.

Prudent financial management involves distribution and utilization of finances effectively and efficiently coupled with collection of enough resources from the economy. Public financial management as a system comprises of generation of resources, allocation of these resources, and management of expenditure.. Public finance makes it possible for the government to undertake its programmes. The Government is the highest spender in an economy and thus the output from the spending has great impact to the growth of a country. It is therefore important to establish how best government should spend the resources with the aim of improving effectiveness and efficiencies in its operations coupled with increase in transparency since citizens have a right to know how resources are being spent because they are the contributors.

In view of the above the government institutes various changes in its operations in order to achieve the objective of prudence in the management of its resources. This study will therefore seek to establish the areas within the public financial management that contributes greatly towards the economic growth and thus the areas where emphasis needs to be put in order to make the country better. In addition, the paper will assist in identifying the research gaps in areas related to public sector financial management reforms and possible areas for further studies. It will help in enabling great understanding of public sector financial reforms and identify the various perspectives of looking at these reforms.

CHAPTER TWO THEORETICAL LITERATURE REVIEW

2.1 Introduction

Interest on public financial management reforms and economic growth require a revisit of various theories that may be used to explain the role played by public sector financial reforms. This section discusses the decision theory in sub section 2.2, information asymmetry theory in sub section 2.3, Agency theory in sub section 2.4, Equity theory in sub section 2.5, growth theory in sub section 2.6, structural change theory in sub section 2.7, stewardship theory in sub section 2.8

2.2 Decision theory

This theory is also known as the theory of choice in various disciplines such as in mathematics, philosophy, and computer science and deals with establishing the optimal decisions together with the principles and unknowns on a particular decisions and the decision's rationality. This theory has some similarities with game theory. Whereas decision theory deals with preference choices of individuals agents, game theory on the other hand deals with the way agents inter relate, whose choices have influence on each other (Roe, Busemeyer & Townsend, 2001)

Anand and Paul (2013) held that prescriptive and normative decision theory deals with establishing the most optimal decisions to make (in reality, there are circumstances where the best need not be the maximum but is within a given specified range) This is under the assumption of a decision maker who is rational and knowledgeable and able to accurately undertake computations. The application of this prescriptive approach practically is regarded as decision analysis. This method is aimed at establishing methodologies, tools and software that would facilitate making of optimal decisions. Decision support systems are the most organized and inclusive software developed in this way.

In the contrary, positive or descriptive decision theory is concerned with describing observed behaviors, however, under the assumption that the decision-making agents are behaving under some consistent rules. These rules may, for instance, have a procedural framework (e.g. Amos Tversky's elimination by aspects model) or an axiomatic framework, reconciling the Von Neumann-Morgenstern axioms with behavioral disruptions of the expected utility hypothesis, or

they may clearly give a functional form for time-inconsistent utility functions (e.g. Laibson's quasi-hyperbolic discounting).

The new prescriptions or expectations about behaviour that positive decision theory produces allow for further checks of the kind of decision-making that occurs in practice. There is a thriving discussion with experimental economics, which uses laboratory and field experiments to evaluate and feed in theory. In recent decades, there has also been increasing attention in what is occasionally called 'behavioral decision theory' and this has led to a re-evaluation of what rational decision-making requires.

Decision theory is relevant to this study in that it helps in determining the best optimal option available. This is in tandem with budgetary reforms which are aimed at improving the budgetary making process so as the best choice activity could be undertaken at the lowest cost, effectively and efficiently.

A critique of decision theory is that whereas it deals with choices of individual agents, decisions in the public sector are mostly made by committees and it is not easy to attribute specific decisions to certain individuals. Further, quantification of values as expected by the theory could be challenging in the public sector.

2.3 Information asymmetry theory

Information asymmetry theory deals with the study of decisions in transactions or activities where one party has more or better information than the other. This creates an imbalance of power in transactions, which can sometimes cause the transactions to go wrong, a kind of market failure in the worst case. Instances of this problem are adverse selection, moral hazard, and information monopoly (Charles, 2008). Commonly, information asymmetries are studied in the context of principal-agent problems. Information asymmetry causes mis-informing and is crucial in every communication process. Information asymmetry is in contrast to perfect information, which is a key assumption in neo-classical economics (Christozov, Chukova & Mateev, 2009). Information asymmetry models assume that at least one party to a transaction or activity has relevant information, whereas the other(s) do not. Particular asymmetric information models can also be used in

situations where at least one partner can enforce, or effectively retaliate for breaches of, certain parts of an agreement, whereas the other(s) cannot.

Spence (1973) noted that in adverse selection, while discussing an understanding that has been agreed upon, the partner who is ignorant does not have information. In moral hazards, on the performance of an agreed transaction, the individual who is ignorant does not have information about the operations of a transaction neither does he/she have the ability to retaliate for the non-execution of the agreement. A classical example of adverse selection is when individuals who are high risk take up insurance cover since the insurance companies do not have ability to separate them. Due to the fact that the insurance companies do not have information about their risk exposure or because of legal reasons or other constraints. An example of moral hazard is when people get insured starts to behave recklessly because the insurance company cannot know about their new behavior or cannot retaliate against them. By failing to renew their insurance cover.

Under screening, the under informed party can persuade the other party to reveal their information. They can provide a list of options of choices in such a way that the choice made depends on the private information of the other party. Examples of situations where the seller usually has better information than the buyer are numerous but include sale of used car by sales people, loan originators, mortgage brokers, real estate agents and stock brokers. Situation where the buyers has advanced information than the person selling includes sales of estates as indicated in the will and testament, old art pieces sales without professional assessment of their values and life insurance (Arrow & Kenneth 1963). George Akerlofin while looking at the lemon's market noticed that the average price of the goods happens to go down in such a market even for those goods with perfect quality: because of unbalanced information, crooked sellers may "spoo" items such as watches and swindle buyers consequently, because of the fear of being ripped off, people will tend to evade particular purchases, or will spend less on some given items. The market of some of these goods may even die or become non-existent.

This theory is relevant to the study in that it deals with imbalance that is created by difference in the amount of information by two parties. Accounting and reporting reforms helps in making available financial data so as to remove the imbalance created by inadequate information.

A significant critique of this theory is that many governments have enacted laws that allow free access to information. In addition, access to information has been made possible by advancement in information technology where state departments post their information in their websites. This has distorted the skewed information perspective anticipated in this theory.

2.4 Agency theory

Jensen & Meckling (2012) defines an agency relationship as a contract under which one or more parties (the principal(s)) engage another party (the agent) to perform some service on their behalf which involves entrusting some decision making authority to the agent. If both parties to the relationship are utility maximizers, there is sufficient reason to believe that the agent will not always act in the best interests of the principal. The principal can limit departures from his interest by establishing appropriate inducements for the agent and by incurring monitoring costs designed to limit the deviant activities of the agent. In addition in some situations it will pay the agent to spend resources (bonding costs) to guarantee that he will not take certain actions which would hurt the principal or to ensure that the principal will be compensated if he does take such actions. However, it is generally impossible for the principal or the agent at zero cost to ensure that the agent will make ideal decisions from the principal's viewpoint.

In many agency relationships the principal and the agent will spend positive monitoring and bonding costs (non-pecuniary as well as pecuniary), moreover, there will be some departure between the agent's decisions and those decisions which would maximize the welfare of the principal. The dollar equivalent of the reduction in welfare experienced by the principal as a result of this departure is also a cost of the agency relationship, and this latter cost is referred to as the "residual loss." We define agency costs as the sum of: the monitoring expenses by the principal, the bonding expenses by the agent, the residual loss.

It is worthwhile to point out the generality of the agency problem. The problem of inducing an "agent" to behave as if he were maximizing the "principal's" welfare is quite general. It exists in all organizations and in all cooperative efforts—at every level of management in firms, in universities, in mutual companies, in cooperatives, in governmental authorities and bureaus, in

unions, and in relationships normally classified as agency relationships such as those common in the performing arts and the market for real estate.

The relevance of this theory to the study is that in the public sector, the public is the principal since they are the contributors of the resources through payment of taxes and other forms of revenue, the public sector employees are the agents in whose hands the resources have been put. To avoid the agency problems, the public through various other government entities has put in place independent auditors (both internal and external) in order to monitor expenditure and thus provide oversight on public's behalf.

One critique of the agency theory in a public sector set up is that it is not possible to identify a particular individual responsible as the agent and the other as the principal since in a public sector perspective, the general public forms the shareholders while the government is the agents.

2.5 Equity Theory

Equity theory focuses on determining whether the allocation of resources is fair to both relational partners. It proposes that persons who perceive themselves as either under-rewarded or over-rewarded will experience distress, and that this distress leads to efforts to reinstate equity within the relationship. Equity may be determined by looking at the proportion of individuals inputs and their benefits in a relationship. Individuals in a relationship need not to get equal benefits (for example getting the same level of love and financial security) or make the same contributions (for example investing equal amount of financial resources and efforts) as long as the proportion of the benefits and contribution is proportional . Just like other motivational theories, for example Maslow's hierarchy of needs, equity theory recognizes that variable and subtle personal factors affects the assessment and perception of each person on their relationship with their partners in a relationship (Guerrero, Andersen & Afifi, 2007). Anger is induced by under payment. Payment whether hourly wage or salary, is the main concern and therefore the cause of equity or inequity in most cases (Spector , 2008).

In any position, an employee wants to feel that their contributions and work performance are being rewarded with their pay. If an employee feels underpaid then it will result in the employee feeling hostile towards the organization and perhaps their co-workers, which may result in the

employee not performing well at work anymore. It is the subtle variables that also play an important role in the feeling of equity. Just the idea of recognition for the job performance and the mere act of thanking the employee will cause a feeling of satisfaction and therefore help the employee feel worthwhile and have better outcomes.

Equity theory is made up of four propositions: These include persons seeking to have their outcomes maximized (outcomes are described as rewards less cost) by developing appropriate systems for fairly allocating benefits and costs among members, this group can maximize collective benefits. Equity systems will be developed within groups and members would be encouraged and persuaded to join and work within the rules of the systems. The best way to make members within groups to be equitable is by demonstrating the gains of being equitable. Therefore, groups will always reward members who treat other members equitably and punish those that treat others inequitably. Persons often become distressed when they find themselves in relationships which are not equitable. According to equity theory, it has been noted that individuals who get too little and those that get too much equally get distressed, therefore the middle way is highly encouraged. This case is because, those who get much feel guilty while those that get little feels humiliated. Individuals who feel that they are in an inequitable relationship may do away with distress by ensuring that equity is re-introduced. The more distressed people feels as a result of inequality, the more they seek to regain equity. (Traupmann and Walster, 1978).

Equity theory is without criticism since it measures equity based on the individual contribution and what one receives in return, in a public sector perspective, resources are obtained from a large pool of persons, however, it is difficult to ensure that individual receives equivalent social benefits from the government from their contribution. In some instance, those that contribute less ends up benefiting more in the spirit of wanting to uplift them.

2.6 Theory of Growth

The growth process had been described by classical economists in regard to technological advancement and the growth of population. According to classical economists, technological advancements has been leading for sometimes but eventually fell as a result of a decline in profits affecting the accumulation of capital at this level, the economy goes into a state of stagnation. The determinants of profits, technological advancements, size of labour force, investment and the wage system are the main components of the classical theory of growth and production function stagnation (Hoselitz, 1960)

Richardo, Maithus and smith proposed the identical production function, written as $Y=f(L,K,S,N)$ which holds that outputs is determined by land, capital stock, level of technology and labour force. In the classical growth model land is taken for the supply of known and economically useful resources. It is not the land under cultivation and its productiveness that dictates the level of national output but the entire spectrum of known and usable natural resources. Except Adam smith, majority of other classical economists held that the production function is homogeneous and linear. Meaning that the returns are constant to scale and thus output would double if the other factors of productions are doubled. Adam smith holds that enhanced division of labour would have an increasing return to scale (Eltis, 2004).

How would the output react to an enhanced supply of labour yet the land is fixed? That is the question that would be answered had the term land be restricted to land under cultivation only. Since its supply is a fixed amount. Output would not indicate a constant reaction to the increase in the amount of land, this is according to classical economists. The classical economists' referred to four separate reactions of output which depends on the production stage. These are diminishing returns, increasing marginal returns, diminishing average returns and diminishing total returns (Adelman, 1962)

This theory is relevant to this study since it shows the various factors are necessary for production and when used optimally would lead to an increase in the economic growth of a country or region. These factors includes production function, investment, technological advancement, size of labour force, the determinants of profit and the wage system

A critique of this theory is that some production functions used in determining growth are not relevant in the public sector. These include stock of capital which may not have been determined, labour force is considered as expenditure, while the level of technology has not been well embraced in the public sector.

2.7. Structural Change Theory

Structural change is a shift or change in the basic ways a market or economy functions or operates (Root, 2016). Such change can be caused by such factors as economic development, global shifts in capital and labor, changes in resource availability due to war or natural disaster or discovery or depletion of natural resources, or a change in political system. For example, a subsistence economy may be transformed into a manufacturing economy, or a regulated mixed economy may be liberalized. A current driver of structural change in the world economy is globalization. Structural change is possible because of the dynamic nature of the economic system (Pasinetti, Luigi L, 1981).

Patterns and changes in sectoral employment drive demand shifts through the income elasticity. Shifting demand for both locally sourced goods and for imported products is a fundamental part of development. The structural changes that move countries through the development process are often viewed in terms of shifts from primary, to secondary and finally, to tertiary production. Technical progress is seen as crucial in the process of structural change as it involves the obsolescence of skills, vocations, and permanent changes in spending and production resulting in structural unemployment (Sharp & Margeret, 1980)

This theory is relevant to the study in that it deals with reforms or changes and the key subject in this study is on institutional changes with regard to financial management. The theory holds that the structural changes that move countries through the development process are often viewed in terms of shifts from primary, to secondary and finally, to tertiary production. This could be the stages in which public finance management reforms follow.

Critique, whereas this theory may have all the good intentions for the economy to grow for example from primary, to secondary and finally, to tertiary production, this may not be possible due to the natural tendency of individuals being resistant to change and thus this theory should be

accompanied by measures that ensure change is well managed for it to achieve the intended benefits/ targets.

2.8 Stewardship Theory

Stewardship theory is a theory that managers, left on their own, will indeed act as responsible stewards of the assets they control. This theory is an alternative view of agency theory, in which managers are assumed to act in their own self interests at the expense of shareholders. It specifies certain mechanisms which reduces agency loss including tie executive compensation, levels of benefits and also managers' incentive schemes by rewarding them financially or offering shares that aligns financial interest of executives to motivate them for better performance. In American politics, an example of the stewardship theory is where president practices a governing style based on belief they have the duty to do whatever is necessary in national interest, unless prohibited by the Constitution (Barney & Hesterly, 2008).

Stewardship Theory has been framed as the organizational behavior counterweight to rational action theories of management this theory holds that there is no conflict of interest between managers and owners, and that the goal of governance is, precisely, to find the mechanisms and structure that facilitate the most effective coordination between the two parties). Stewardship Theory holds that there is no inherent problem of executive control, meaning that organizational managers tend to be benign in their actions. The essential assumption underlying the prescriptions of Stewardship Theory is that the behaviors of the manager are aligned with the interests of the principals. Stewardship Theory places greater value on goal convergence among the parties involved in corporate governance than on the agent's self-interest. The economic benefit for the principal in a principal-steward relationship results from lower transaction costs associated with the lower need for economic incentives and monitoring. Researchers, in general, have tended to ignore the principal as the agent and have overemphasized the role of the manager as the agent (Donaldson & Davis, 1991)

This theory is relevant to the study in that public finance managers are stewards of public resources. The Managers according to this theory should embrace a governing style based on belief they have the duty to do whatever is necessary in national interest, unless prohibited by the Constitution.

This theory holds that managers left on their own, will indeed act as responsible stewards of the assets they control, this may not be the case as it has been noted in many governments. In some governments, many unethical behaviour such as corruption by the managers have been witnessed and therefore the validity of this stands to be questioned.

2.9 Summary of the Theoretical Framework

Various theories that are relevant to this study have been discussed extensively. They include Decision theory, which deals with pin pointing the uncertainties, values and other related issues in a decision, the resulting optimal decision and its rationality. This is well demonstrated in the field of computer science, philosophy, sociology, economics mathematics and statistics. It is relevant to this study in that it helps in determining the best optimal option available. This is in tandem with budgetary reforms which are aimed at improving the budgetary making process so as the best choice activity could be undertaken at the lowest cost, effectively and efficiently. The other theory is the information asymmetry theory which engages with the decision studies in operations where one partner in a transaction has better or advanced information than the other partner. This theory is relevant to the study in that it deals with imbalance that is created by difference in the amount of information by two parties. Accounting and reporting reforms helps in making available financial data so as to remove the imbalance created by inadequate information.

Agency theory, agency relationship is a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. The relevance of this theory to the study is that in the public sector, the public is the principal since they are the contributors of the resources through payment of taxes and other forms of revenue, the public sector employees are the agents in whose hands the resources have been put. To avoid the agency problems, the public through various other government entities has put in place independent auditors (both internal and external) in order to monitor expenditure and thus provide oversight on public's behalf. Another theory is the equity theory which focuses on determining whether the distribution of resources is fair to both relational partners. This theory is relevant in this study in that it helps in distribution of resources in a fair way. Growth theory; classical economists had described the process of growth in terms of population growth and the rate of progress in

technology. This theory is relevant to this study since it shows the various factors that are necessary for production and when used optimally would lead to an increase in the economic growth of a country or region. Structural change theory; Structural change is a shift or change in the basic ways a market or economy functions or operates. This theory is relevant in that it deals with reforms or changes and the key subject in this study is on institutional changes with regard to financial management. Stewardship theory; a theory that managers, left on their own, will indeed act as responsible stewards of the assets they control. This theory is relevant in that public finance managers are stewards of public resources.

CHAPTER THREE: EMPIRICAL LITERATURE REVIEW

3.1 Introduction

This section presents analytical review of empirical discourse on public financial management reforms and economic growth. Sub section 3.2.1 deals with budgetary reforms and economic growth. Sub section 3.2.2 looks at accounting and reporting reforms and economic growth. Sub section 3.2.3, looks at oversight reforms and economic growth and sub section 3.2.4, deals with fiscal decentralization reforms and economic growth. 3.3 is the summary of the empirical literature and research gap and 3.4 is that conceptual framework.

3.2 Empirical Studies

3.2.1 Budgetary Reforms and Economic Growth.

D'souza (2010) did a study on budgetary policy and economic growth, the study concentrated on tax reforms and it held that in order to understand what conditions make it possible for reforms in tax that have an effect on economic growth, a non complex model of macro-economic was used. Governments have 3 targeted variables; the balance of trade surplus, the level of price and output level. Debate has been there and no agreement has been reached on the pattern of assignment of instruments used in making policy to various targets and trade off between targets in countries which are developing. It concentrated on those targets which were not fully satisfied majorly on their conditions. It was noted that the share of government development expenditure was declining and the income elasticity of the system of tax has not been enhanced by the reforms in the tax system. Direct measure of saving and investments are needed in order to keep the economy on an increasing growth path. These require a renewed push to policy related to economy which has been lacking in the budget.

Ahmed and Siddiqui (2013) did a study on Budgetary Reforms for Growth and Poverty Reduction in Pakistan. They noted that; regarding public expenditure management, efforts underway to prepare a Medium-Term Budgetary Framework (MTBF) is a welcome development along with the DFID technical assistance. The strategic content to the MTBF is provided by the PRS (Poverty Reduction Strategy), which is also moving along. The implementation of the MTBF, however, has been rather slow. International experience suggests that this can be a

powerful tool to improve the effectiveness of public spending provided it is well implemented. This requires a serious effort, including enhancing the capacity of the Ministry of Finance and other line ministries to undertake this exercise, especially regarding ability to link the MTBF to the PRS, and update this as necessary. The underlying data needs e.g. costing of sectoral programmes; are quite substantial.

Wildavsky (2011) did a study on Political Implications of Budgetary Reform. The study revealed that by far the most significant way of influencing the budget is to introduce basic political changes. Provide the President with more powers enabling him to control the votes of his party in Congress; enable a small group of Congressmen to command a majority of votes on all occasions so that they can push their program through. Then you will have exerted a profound influence on the content of the budget. A second implication is that no significant change can be made in the budgetary process without affecting the political process. There would be no point in tinkering with the budgetary machinery if, at the end, the pattern of budgetary decisions was precisely the same as before. On the contrary, reform has little justification unless it results in different kinds of decisions and, when and if this has been accomplished, the play of political forces has necessarily been altered. Enabling some political forces to gain at the expense of others requires the explicit introduction and defense of value premises which are ordinarily missing from proposals for budgetary reform. Since the budget represents conflicts over whose preferences shall prevail, the third implication is that one cannot speak of "better budgeting" without considering who benefits and who loses or demonstrating that no one loses. Just as the supposedly objective criterion of "efficiency" has been shown to have normative implications, so a "better budget" may well be a cloak for hidden policy preferences.

M'Amanja and Morrisey, 2013 did a study on fiscal policy and economic growth in Kenya. They held that debate on whether fiscal policy enhances growth had been debated for a long time. One side holds that government operations are vital for economic growth while the opposing side holds a different view that government activities are bureaucratic and not efficient thus suppressing economic growth. Results are equally mixed in the empirical literature. The paper was not aimed at providing solution to the never ending debate but to add into fiscal-growth literature by taking Kenya, developing country as a case study. Time series technique was put in use to examine the relationship between a number of fiscal policies steps and the economic

growth on yearly information for the duration 1964 to 2002. Government expenses were classified into productive and non productive and revenue tax into distortionary and non distortionary. Un productive expenses and non distortionary revenue tax were found to be neutral to growth as had been predicted by the economic theory. However, against what was anticipated, productive expenses had high negative growth effect while there was no indication of distortionary consequences on growth of taxes that are distortionary. Moreover, government investments were noted to have positive effect on growth in the long term. In Kenya these results would be helpful to makers of policies when developing expenditure and tax policies.

3.2.2 Accounting and Reporting Reforms and Economic Growth.

Staubus (2013) held that many countries lately have faced financial statements which were false and others which were erroneous requiring occasional restatement. These are failures of individual's fiduciary obligations and demonstrate the level of their unethical behavior. In America, financial reporting is regarded generally as adequate. However, some people holds that wellbeing of those responsible with these reports disagrees with the interests of the purposed beneficiaries of these statements. The key responsibilities for the poor financial reporting lies on the high level management, since in some incidences, they are motivated to give good reports on their leadership forgetting their fiduciary responsibilities to the shareholders. The auditors too have responsibilities to the users of the financial statements, but they too are compromised by the top management. The accountant in academia and the members of the bodies setting the accounting standards have been ethically compromised. Regulations should be put in place to control the positive reporting by the management and the investors' interest. The closeness between auditors and management should be checked and instead auditors be made to be close to investors.

Qureshi (2012) did a study with the main objective being the extent the accounting development thesis by applying it to a specific emerging economy, Pakistan, and by underscoring the socio-political ramifications of economic development that have significance for the accounting function. The study found that the relevance of financial reporting to economic development with social justice cannot be over emphasized, especially in a developing country like Pakistan. First, its credibility is the basis of investors' confidence which is die essential link between savings and investment the two basic components of capital formation. Timely,

accurate, informative, and readable financial reports could enlighten the general public, enhance their understanding of the operation of business and industry, and engender their confidence and trust in their country's business enterprise. This would encourage them to make their otherwise hoarded savings available for economic investment. Their support and participation in developmental efforts would thus be obtained, and in addition, they would share the growing prosperity of the country. Secondly, financial reports are important indicators of economic success and financial health of an enterprise. The income statement, especially, provides basic data to measure the degree of effective utilization of resources and profitability of the enterprise. Since capital flows from low-profit firms to high-profit firms, the financial reports form a basis for the all-important economic function of resource allocation. Finally, the functioning of a broad based capital market depends heavily on the quantity, quality, and comprehensibility of company financial data. The broad based capital market would stimulate wide-spread participation by a large variety of investors and channel their funds to productive employment. The resultant dilution of economic concentration would instill confidence and initiative in prospective entrepreneurs whose entry to the market would promote competition. Growing competition would reduce inefficiencies, eliminate misallocation of resources, and create the emergence of a better functioning economy

Li (2010) did a study that examined whether the mandatory adoption of International Financial Reporting Standards (IFRS) in the European Union (EU) in 2013 reduced the cost of equity capital. Using a sample of 6,456 firm-year observations of 1,084 EU firms during the 1995 to 2006 period, He found evidence that, on average, the IFRS mandate significantly reduces the cost of equity for mandatory adopters by 47 basis points. He also found that this reduction is present only in countries with strong legal enforcement, and that increased disclosure and enhanced information comparability are two mechanisms behind the cost of equity reduction. Taken together, these findings suggest that while mandatory IFRS adoption significantly lowers firms' cost of equity, the effects depend on the strength of the countries' legal enforcement.

Labelle, Gargouri and Francoeur (2010) proposed and empirically tested a theoretical framework incorporating Reiden backhand Robin's (J Bus Ethics 10(4):273-284, 1991) conceptual model of corporate moral development. They used to examine the relation between governance and business ethics, as proxied by diversity management (DM), and financial reporting quality, as proxied by the magnitude of earnings management (EM). The level of DM and governance quality are measured in accordance with the ratings of Jantzi Research (JR), a leading provider of social and governance research for institutional investors. This DM score was part of an index developed by JR that investment managers use to integrate DM criteria into their investment decisions. As expected, a negative relation between corporate DM development and financial reporting quality is found while controlling for other factors known in the literatures on governance and accounting choices to affect earnings quality. Despite some caveats presented in conclusion, this study contributes to the ethics, governance, and financial reporting literatures by studying the dynamics between governance and ethics in the prevention of EM.

Moyi & Ronge (2006) Empirical analysis reveals the adverse effect of inflation on tax revenues. The tax structure is less buoyant and possibly inelastic although indirect taxes, and not direct taxes, hold the capacity to improve the flexibility of the tax system. The challenges that confront tax design include taxation of agriculture and the informal sector, repeal of tax holidays, high effective protection, high dispersion of tariff rates, detailed and rigid custom rules, poor response of VAT to reforms, weak capacity to process large volumes of returns and refunds for zero-rated transactions. In addition, Kenya's tax system is burdensome in terms of time taken to prepare and submit tax returns.

3.2.3 Oversight Reforms and Economic Growth.

Ribicoff (2005) held that the impact of government regulation on the nation's health, safety and economic well-being was one of the most important issues facing America this bicentennial year. The President, leaders of Congress and industry, consumer advocates, and academicians had concluded that the substance and procedure of federal regulatory agency activity needed close scrutiny and significant change. Because Congress created the federal regulatory agencies and was responsible for overseeing their activities, any reform effort must provide for improved congressional oversight. Without better congressional oversight, reorganization and reform of the federal regulatory bureaucracy will be ineffective.

Grigorescu (2010) did a study the study asked why so many intergovernmental organizations (IGOs) have established recently offices and policies intended to facilitate the oversight of their bureaucracies. It begins from a set of hypotheses derived from the principal-agent (PA) literature, a natural starting point for answering this question. It then considered explanations based on norms and institutional diffusion to offer a more complete explanation of developments. The study argued that the empowerment of democratic norms and institutional diffusion processes across IGOs had altered member-states' preferences and allowed them to overcome collective action problems involved in the adoption of oversight mechanisms. The hypotheses were tested across more than 70 organizations. The results suggested that arguments extracted from the PA literature and the one on norm allow us to understand which IGOs are more likely to have bureaucratic oversight mechanisms. On the other hand, models that also take into account diffusion processes allow us to understand better when such mechanisms are adopted.

Friedberg, Schwartz and Amrani (2013) noted that ethics research community has all but ignored issues of oversight ethics? The vices and virtues of overseers. This study developed a conceptual framework for exploring the ethics of oversight and provided insights into the design of codes of ethics for oversight institutions and for overseers. Analysis of business licensing in Israel revealed prospective and retrospective oversight ethics problems at the levels of national and local policy and implementation: Overseers failed to act on knowledge of breaches of business licensing stipulations and took action known to be slow and ineffective; policymakers neglected their duty to enact significant policy change in an over sight system that was clearly not working. Partially as a result of these oversight failures, over one third of Israeli businesses are unlicensed, 23 people were killed in the collapse of an unlicensed banquet hall, 2 major fires erupted in the same shopping mall, and a fire in a fertilizer warehouse very nearly became a mega-disaster.

Norton and Smith (2008) did a paper that examined and compared the new approach of public finance management. The U.S.A watch dog which is referred to as the Government Accountability Office; in its ability to supervise and hold the executive to account. The UK counterpart is known as National Audit Office. The outcome of the study revealed that the U.S.A Government Accountability Office was more effective than the UK audit office. The reason why

the USA office is strong is because it gets its powers from a written constitution unlike in UK which does not have written constitution. Consequently, the duties, powers and self – perception of the National Audit Office is greatly weaker and variable than the powers of the Government Accountability Office.

Muathe and Cheche (2014) did a study on public sector reforms in Kenya, that were aimed at making the public sector more efficient in provision of goods and services, these reforms have been around since the world financial crises of the 1980s that resulted from the unprecedented surge in oil values and the downfall of centrally planned economic systems of the eastern bloc. The reforms have been characterized by implementation of prudent management of resources through introduction of financial and non-financial controls. One of the significant pillars of public sector reforms is the introduction of performance contracting. Though performance contracting has got positive reception, it is true that its implementation has not been without fair share of challenges.

3.2.4 Fiscal Decentralization Reforms and Economic Growth.

Ogawa and Yakita (2009) did a study that analyzed the fiscal decentralization and equalization transfers in a two-region model of endogenous growth. In the model, two levels of government with different objectives are considered: the local governments maximize the utility of the residents of the region, and the central government makes the equalization transfers to close the gaps in fiscal capacity among the regions and pays attention to the economic growth rate. The first result demonstrated that the preferred tax rate chosen by the local government is positively affected by the magnitude of fiscal decentralization. The second result shows that the fiscal equalization policies of the central government have no influence on the speed of interregional growth convergence. Furthermore, the normative implication is obtained from our final results that there exists an optimal degree of fiscal decentralization to reach the central government's goal of growth maximization, but the magnitude of fiscal decentralization chosen by the central government is excessive to entail the highest regional welfare.

Lin and Liu (2014) undertook an investigation on the effect of fiscal decentralization initiated in the mid-1980s in China on the growth rate of per capita GDP. It was noted that fiscal

decentralization had made a significant contribution to economic growth, which is consistent with the hypothesis that fiscal decentralization can increase economic efficiency. In addition, they found that rural reform, capital accumulation, and non state sector development were the key driving forces of the economic growth in China over the past 20 years or so. These results allowed drawing of two inferences. First, and more general, was that institutional arrangements are important. Apart from fiscal decentralization, other reforms (such as the household responsibility system in the rural sector and the “privatization” of the industrial sector by way of enlarging the non-state-owned enterprises) have also been favourable to economic growth in China. Second, according to the data set, fiscal decentralization had increased the growth rate in China mainly by improving the efficiency of resource distribution rather than by inducing more investment. It should be noted that the changes in the fiscal relationship between the central and provincial governments in China since the 1980s are much more complicated. The marginal rate of budget revenues retained by provincial governments, which had been adopted as the measure for fiscal decentralization in the experiential investigation, would not fully capture the complexity. A better understanding of the factors and mechanisms that are crucial to the central-province negotiation process was of great concern. For this reason, the results of this study were to be viewed as provisional, and further investigation is most advisable.

Wallace (2013) did a study that highlighted the outstanding contrast on the degree of fiscal centralization of the industrialized and the developing countries: government in the developing nations tends to be far more centralized (as measured by the current fiscal indices) than in the industrialized countries. This noticeable differential in degrees of fiscal centralization is extensively documented. Over two decades ago in an empirical study of fiscal federalism (Oates, 1972), found that, for a sample of 58 countries, the measures of fiscal centralization were significantly and negatively correlated with levels of per capita real income. And, recently, using a sample of 43 countries, the sample statistics (1985) indicated an average share of central-government spending in total public expenditure of 65 percent in the subsample of 18 industrialized countries as opposed to 89 percent in the subsample of 25 developing nations. In terms of public revenues, the mean share of central governments in the developing countries was in excess of 90 percent. These measures thus leads to the conclusion that central government in the developing countries assumes the lion's share of fiscal responsibility.

3.3 Summary of Empirical Literature and Research Gap

No	Researcher and Focus of the study	Findings	Research Gap
1	Ribicoff (2005) Did a study on congressional oversight and regulatory reform.	Without better congressional oversight, reorganization and reform of the federal regulatory bureaucracy will be ineffective.	Further study should be undertaken to evaluate the effectiveness of oversight mechanism in the public sector
2	Moyi & Ronge (2006) did a study in Kenya to establish the effect of inflation on tax revenue	Empirical analysis revealed the adverse effect of inflation on tax revenues	Studies should be undertaken to establish the risk management initiatives initiated to cushion tax revenue against inflationary pressures.
3	Norton and Smith (2008) did a study that compared the oversight bodies in USA and in UK	The outcome of the inspection indicated that the USA oversight body (Government Accountability Office) was more effective than its UK counterpart (National Audit Office).	A detailed study should be undertaken to establish how to strengthen the oversight units in the public sector.
4	Ogawa and Yakita, (2009) did a study on equalization transfers, Fiscal decentralization, and economic growth	Preferred tax rate chosen by the local government is positively affected by the magnitude of fiscal decentralization. Fiscal equalization policies of the central government have no influence on the speed of interregional growth convergence.	A study may be undertaken to establish the effect of the tax charged by the decentralized unit on the overall economic growth in a country. Further a study may be undertaken to establish why fiscal equalization policies of the central government have no influence on the speed of interregional growth convergence.
5	Labelle, Gargouri and Francoeur (2010) Did a study on Ethics, Diversity Management, and Financial Reporting Quality	The study indicated a negative relationship between diversity management and financial reporting while taking charge of the other factors on governance and accounting choices.	A critical study should be undertaken to establish what causes the negative relationship in a situation where as corporate diversify, the financial reporting quality decreases.
6	Li (2010)	While mandatory IFRS adoption	Further studies should be conducted to

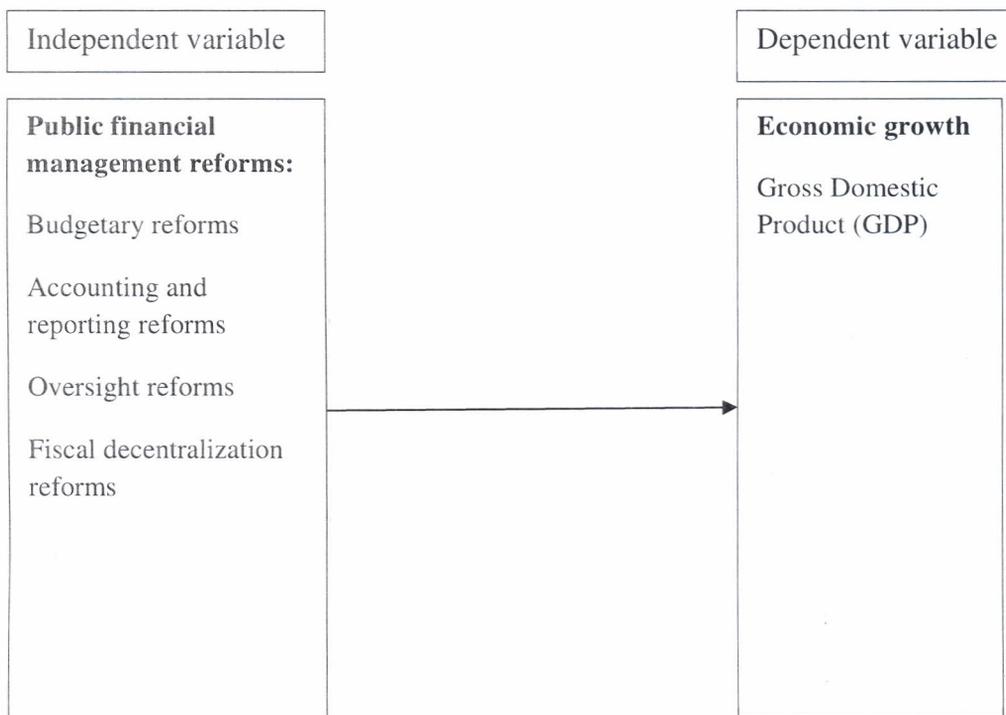
	Undertook a study, does Mandatory Adoption of International Financial Reporting Standards in the European Union Reduce the Cost of Equity Capital?	significantly lowers firms' cost of equity, the effects depend on the strength of the countries' legal enforcement.	establish whether adoption of IFRS lowers the cost of debt. And under what circumstances does this happen.
7	D'souza (2010) Did a study on budgetary policy implementation and economic growth.	The results indicated that the portion of development expenditure has been declining and that the income elasticity in the system of tax had not been enhanced by the tax reforms.	The study majored heavily on tax reforms and ignored other reforms in the public finance.
8	Grigorescu (2010) Did a study on the Spread of Bureaucratic Oversight Mechanisms across Intergovernmental Organizations	The results suggested that arguments extracted from the Principal Agent literature and the one on norms allowed understanding of which intergovernmental organizations are more likely to have bureaucratic oversight mechanisms. On the other hand, models that also take into account diffusion processes allowed understanding better when such mechanisms are adopted.	Studies should be undertaken to establish the implication of breaching the Agency Theory on the bureaucratic oversight mechanisms.
9	Wildavsky (2011) Did a study on Political Implications of Budgetary Reform.	The most significant way of influencing the budget is to introduce basic managerial changes and that reform has little justification unless it results in different kinds of decisions.	Studies should be undertaken to establish the extent to which budgetary reforms spur savings and public investments.
10	Qureshi (2012) Did a study on economic Development, Social Justice and Financial Reporting: Pakistan's Experience with Private Enterprise	The study found that the relevance of financial reporting to economic development with social justice cannot be over emphasized. Financial reports are important indicators of economic success and financial health of an enterprise. the functioning of a broad based capital	Studies should be undertaken to establish the extent with which financial statements acts as indicators of economic success & financial health in the public sector.

		market depends heavily on the quantity, quality, and comprehensibility of company financial data	
11	M'Amanja and Morrisey, (2013) did a study on fiscal policy and economic growth in Kenya	They found as foreseen by the theory of economics, unproductive expenses and non distortionary tax revenue do not have any effect on growth. However, productive expenses have strong unfavorable impact on growth and there was no distortionary impact on growth from dictionary taxes.	Further studies should be undertaken to establish the extent governments expend on unproductive expenditure and on public investment.
12	Wallace E. O (2013) did a study on fiscal decentralization and Economic growth	It was noted that measures of fiscal centralization were greatly and negatively correlated with per capita real income levels	Study should be undertaken to establish how best to undertake fiscal decentralization, since it appears to be the most preferred system of governance in developed countries.
13	Friedberg, Schwartz and Amrani (2013) did a study on Oversight Ethics: The Case of Business Licensing.	Partially as a result of these oversight failures, over one third of Israeli businesses are unlicensed, 23 people were killed in the collapse of an unlicensed banquet hall, 2 major fires erupted in the same shopping mall, and a fire in a fertilizer warehouse very nearly became a mega-disaster.	Study should be undertaken to establish how best oversight failures could be avoided in an organization.
14	Staubus (2013) Did a study on ethics failures in corporate financial reporting.	That primary responsibility for financial reporting failures and deficiencies falls on corporate management and accounting personnel but that auditors, academic accountants, and members of standards setting bodies must bear shares of the blame.	Studies should be done to establish the fiduciary responsibilities on financial reporting in the public sector.
15	Ahmed and Siddiqui (2013)	Efforts are underway to prepare a	The study may be replicated in other

	Did a study on Budgetary Reforms for Growth and Poverty Reduction in Pakistan.	Medium-Term Budgetary Framework (MTBF). However, The implementation of the MTBF has been rather slow.	jurisdictions for comparison .Probably in Africa.
16	Cheche and Muathe (2014) did a study in Kenya that critically looked at studies conducted on reforms in the public sector, identifying agreements among scholars and disagreements as well as gaps that exist in the literature on these subject.	Though performance contracting and other reforms have received encouraging reception, it is evident that their implementation has not been without fair share of challenges.	Studies should be undertaken to establish the various challenges on the implementation of public sector reforms and how best to solve those challenges.
17	Lin & Liu (2014) undertook a study of Fiscal Decentralization and Economic development in China	That institutional arrangement is important. And that fiscal decentralization had raised the growth rate in China mainly by improving the efficiency of resource distribution rather than by generating more investment.	Studies ought to be undertaken on how to induce investments while at the same time decentralize resources.

3.4 Conceptual Framework

The figure below shows the relationship between public financial management reforms as the independent variable and economic growth as the dependent variable. Public financial management reforms are classified as budgetary reforms, accounting and reporting reforms, oversight reforms and fiscal decentralization reforms while the economic growth would be measure by the gross domestic product (GDP).



CHAPTER FOUR

SUMMARY, CONCLUSION AND RECOMMENDATION

4.0 Introduction

This section discusses the summary of the empirical studies that have been looked into in sub section 4.1, the Conclusion derived from the studies in sub section 4.2 and the recommendation thereof in sub section 4.3.

4.1 Summary

The study aimed at establishing whether there is a relationship between public sector financial reforms and economic growth. This was occasioned by the fact that there have been too many reforms in the public financial management but the economy has not been growing at the equivalent rate. The study specific objectives sought to establish the relationship between budgetary, accounting and reporting, oversight reforms, fiscal decentralization and the economic growth. The study looked at various theories such as decision theory, information asymmetry theory, Agency theory, Equity theory, growth theory, structural change theory, stewardship theory. Various empirical studies were evaluated and it was established that;

There is diversity from studies on whether or not public financial management reforms influences economic growth. Below is a summary of some of these studies and my contribution in each reform.

D'souza, 2010 revealed that the portion of development expenses in public expenses has been declining and the income elasticity of the system of tax has not been enhanced by the tax reforms. Direct steps to enhance public investments and savings should be encouraged in order to keep the economy on a high growth path. This would only be undertaken through a new push in the economic policy which has been lacking in the budget. In addition, efforts are underway to prepare a Medium-Term Budgetary Framework (MTBF) this is a welcomed development, the implementation of the MTBF has been rather slow. Wildavsky, 2011 while carrying out a study on management implications of budgetary reform noted that so far the most significant way of influencing the budget is to introduce basic management changes. Since the budget represents conflicts over whose preferences shall prevail, one cannot speak of "better budgeting" without

considering who benefits and who loses or demonstrating that no one loses. Reform has little justification unless it results in different kinds of decisions.

There should be a clear proportion of both capital and recurrent expenditure in the budget. These would help in monitoring the economic growth. Preference in the budget should be made based on a sector's contribution in the economy. This would then lead to the "better budgeting", since the end result of budgeting is improvement in the economy. Implementation of the medium term expenditure framework is not enough, what is important is the output of the expenditure such as how many roads have been made, how many structures have been raised and much more tangible developments.

M'Amanja and Morrisey, 2013 did a study on fiscal policy and economic growth in Kenya. Categorizing government expenses in tax into non distortionary and distortionary. They established that non distortionary revenue from tax and unproductive expenditure are neutral to growth as projected by the theories of economics. Against the projections, expenditure which was productive had a strong negative impact on growth; while there was no proof of distortionary impacts on growth of taxes that were distortionary. It was further found out that governments investments were noted to be advantageous to growth in the long term. These results would be helpful to the Kenyan policy makers as they would use them in developing taxes and government expenditure policies, which would help in boosting investments.

The budget estimates should be categorized in terms of productive expenditure and non productive expenditure. Governments should strike a balance these two areas since they both contribute toward economic growth. The finding that productive expenditure has strong adverse effect on growth stands to be challenged through a repeat study in another jurisdiction since in an idea situation; productive expenditure should have a great impact on the economic growth.

Muathe and Cheche (2014) did a study on public sector reforms in Kenya that were aimed at making the public sector more efficient in provision of goods and services. The reforms had been characterized by introduction of prudent management of resources through adoption of financial and non-financial controls. One of the key pillars of public sector reforms in Kenya was the

introduction of performance contracting. It involved the establishment of strict compliance with the budgetary ceilings and the adoption of timeliness in the budget making process. Though performance contracting has received positive acceptance in the public sector, it has equally faced implementation challenges, and its importance as a management tool has been going down. The implementation of performance in general and its application on the budget has not been satisfactory. The reason being the senior officers in government have not been serious in seeing to it that they have been implemented. It has become a route to prepare the performance contracts, but no disciplinary measures exist for those that do not perform as per the contract.

Qureshi (2012) noted that the relevance of financial reporting to economic development with social justice cannot be over emphasized, especially in a developing country. Timely, accurate, informative, and readable financial reports could enlighten the general public, enhance their understanding of the operation of business and industry, and engender their confidence and trust in their country's business enterprise. Financial reports are important indicators of economic success and financial health of an enterprise. The income statement, especially, provides basic data to measure the degree of effective utilization of resources. The functioning of a broad based capital market depends heavily on the quantity, quality, and comprehensibility of company financial data.

In as much as the financial statement acts as indicators of economic success, they are often not easy to understand. The reason is they contain figures that one may not easily understand. For the public sector financial statements to make sense, there could be pictorial presentations of how the funds had been expended. This would make them more informative and easy to understand.

Li (2010) did a study that examined whether the mandatory adoption of International Financial Reporting Standards (IFRS) in the European Union (EU) in 2013 reduced the cost of equity capital. Using a sample of 6,456 firm-year observations of 1,084 EU firms during the 1995 to 2006 period, He found evidence that, on average, the IFRS mandate significantly reduces the cost of equity for mandatory adopters by 47 basis points. He also found that this reduction is present only in countries with strong legal enforcement,

and that increased disclosure and enhanced information comparability are two mechanisms behind the cost of equity reduction.

Taken together; these findings suggest that while mandatory IFRS adoption significantly lowers firms' cost of equity, the effects depend on the strength of the countries' legal enforcement. In addition, most developing countries have not embraced the use of IFRS in the preparation of their final accounts. It therefore hinders the use of final accounts to gauge the economic growth.

Norton & Smith, 2008 did a paper that inspected and compared as per the new public expenditure administration approach, the USA watch dog, and its UK counter part in their ability to hold to account the executive section of governments. The USA watch dog is known as the Government Accountability Office while the UK watch dog office is known as the National Audit Office. The results showed that the USA watch dog office is more powerful than its UK counterpart. It was noted that the USA watch dog body is more effective because it is backed by a written constitution unlike in the UK. Consequently, the responsibilities, duties and powers of the UK National Audit Office are significantly weak and can be easily changed than those of the USA Government Accountability Office.

Strong oversight institutions have the potential of putting every individual in the public sector to account. They should be independent, free from interference by parties within the governments. While these may be a bit difficult, the oversight body must strive to be and appear independent. Rotation of auditors is one of the measures that may be taken to ensure that their independence may be established. Further, the security of tenure of the head of the oversight body should be paramount. The threshold for his/her removal should be a bit high. These would made him/her to work without fear or favour.

Ogawa & Yakita 2009 held that the preferred tax rate chosen by the local government is positively influenced by the magnitude of fiscal decentralization. In addition, fiscal equalization policies of the central government have no influence on the speed of interregional growth convergence. Furthermore, there exists an optimal degree of fiscal decentralization to reach the central government's goal of growth maximization, but the magnitude of fiscal decentralization chosen by the central government is excessive to entail the highest regional welfare. It was noted that fiscal decentralization had made a important contribution to economic growth, which is

consistent with the hypothesis that fiscal decentralization can enhance economic efficiency. In addition, it was noted that rural reform, nonstate sector development and capital accumulation were the key driving pillars of the economic growth in the past 30 years or so. These results allowed drawing of two inferences. First, and more general, was that institutional arrangements are important. Apart from fiscal decentralization, other reforms (such as the household responsibility system in the rural sector and the “privatization” of the industrial sector by way of expanding the non state or privately owned enterprises) have also been favorable to economic growth in China. Secondly, according to the data set, fiscal decentralization had raised the growth rate in China mainly by increasing the efficiency of resource distribution rather than by generating more investment. Governments in the developing nations are far more centralized (as measured by existing fiscal indices) than in the industrialized countries. This marked discrepancy in degrees of fiscal centralization is widely recorded. Over two decades ago in an experiential study of fiscal federalism it was established that for a sample of 59 countries, measures of fiscal centralization were significantly and negatively correlated with per capita real income levels.

Fiscal decentralization as noted has made significant contribution in the development of the rural areas. However, the decentralized units should be arranged in such a way that they facilitate growth. In addition, governments should strive to ensure that the resources entrusted to them are allocated efficiently. In order to achieve the intended objectives and targets.

4.2 Conclusion

From the theories and studies undertaken, majority holds that there is a positive relationship between public financial management reforms and economic growth.

D’souza, 2010 held that there was need for direct measures that would enhance investments and savings. This would be made possible by carrying out some new push in the management of the economic policy which has been lacking in the budget; this will maintain the economy in an increasing growth path. Efforts are underway to prepare a Medium-Term Budgetary Framework (MTBF) this is a welcomed development, the implementation of the MTBF has been rather slow. Wildavsky, 2011 held that since the budget represents conflicts over whose preferences shall prevail, one cannot speak of "better budgeting" without considering who benefits and who loses

or demonstrating that no one loses. Reform has little justification unless it results in different kinds of decisions.

Public investment is of paramount importance to the economic growth. Public investments are part and parcel of public sector budgets. These leads to the conclusion that budgets and budgets reforms are significant since most of reforms in budgets are aimed at their improvement.

M'Amanja and Morrissey, 2013 did a study on fiscal policy and economic growth in Kenya. Classifying government expenses into two categories these are productive and unproductive and tax revenue into two category these are, non distortionary tax and distortionary tax. They established out that expenditure which were unproductive and tax revenue which is distortionary had no effect on growth as predicted by the theories of economics. However, against predictions, expenditure which was productive had a powerful negative impact on growth while there was no proof that distortionary taxes had distortionary effects on growth. Moreover, investments were noted to uplift growth in the long run. The results would be helpful to Kenyan policy makers while developing taxes and expenditure policies. These policies should be aimed at ensuring that unproductive expenses are reduced and investments increased.

Governments should strike a balance between productive and unproductive expenditure in order to have a balance in the economy. Public investments should also be given priority since they have long term benefits. This requires a careful preparation of the budget by undertaking appropriate reforms.

Muathe and Cheche (2014) did a study on public sector reforms in Kenya that were aimed at making the public sector more efficient in provision of goods and services. The reforms had been characterized by introduction of prudent management of resources through adoption of financial and non-financial controls. One of the key pillars of public sector reforms was the introduction of performance contracting. It involved establishing strict compliance with the budgetary ceilings and the introduction of strict timeliness in the budget making process. Though performance contracting has received impressive reception in the public sector, it has equally faced a fair share of implementation challenges.

Organizations should have a balance of financial controls and non financial controls. Financial controls tell when good organizational performance is reflected in good financial outcomes they

include management of costs and expenses. While non financial controls measurement is important as they are likely to affect profitability in the long term. They include customer loyalty and employee satisfaction. However, establishing these controls is not enough; their implementation is what makes the difference. Officers responsible for the implementation of these controls should be put under performance contracting so as to ensure that these controls are implemented. Financial controls introduction are part of reforms in the public sector that play an important role in shaping the outcome in the economy and thus should be taken seriously.

Qureshi (2012) noted that the relevance of financial reporting to economic development with social justice cannot be over emphasized, especially in a developing country. Timely, accurate, informative, and readable financial reports could enlighten the general public, enhance their understanding of the operation of business and industry, and engender their confidence and trust in their country's business enterprise.

Financial reports are important indicators of economic success and financial health of an enterprise including the public sector. These statements should be timely and informative. They should have graphical presentations and picture for ease of understanding on all the output of the public expenditure as citizens will be able to see areas where resources have been utilized. Properly prepared financial statements create confidence on the citizens on the government and thus encourage them to make investments in the government investments areas such as bonds and treasury bills.

Li (2010) did a study that examined whether the mandatory adoption of International Financial Reporting Standards (IFRS) in the European Union (EU) in 2013 reduced the cost of equity capital. He also found that this reduction is present only in countries with strong legal enforcement, and that increased disclosure and enhanced information comparability are two mechanisms behind the cost of equity reduction.

Implementation of IFRS has been taking place in phases, a clear example of accounting reforms. Adoption of international financial reporting standard has the ability to reduce cost of capital. However, implementation and enforcement legally plays an important role in ensuring that the intended objectives of IFRS are met.

Norton & Smith, 2008 did a paper that inspected and compared as per the new public expenditure administration approach, the USA watch dog, and its UK counter part in their ability to hold to account the executive section of governments. The USA watch dog is known as the Government Accountability Office while the UK watch dog office is known as the National Audit Office. The results showed that the USA watch dog office is more powerful than its UK counterpart. It was noted that the USA watch dog body is more effective because it is backed by a written constitution unlike in the UK. Consequently, the responsibilities, duties and powers of the UK National Audit Office are significantly weak and can be easily changed than those of the USA Government Accountability Office.

From the above case it is clear that the oversight institutions require protection through written legislations. For example the USA, the Government Accountability Office is enshrined in the USA constitution unlike in the U.K. For oversight to be effective, it needs protection. It should be free from manipulation from other entities. The holders of these positions should have security of tenure so that they may work without fear or favour.

Ogawa & Yakita 2009, noted that fiscal decentralization had made a great contribution to economic development, which is consistent with the hypothesis that fiscal decentralization can increase economic effectiveness. In addition, it was noted that rural reform, non state sector development and capital accumulation were the significant driving forces of the economic development in the past 30 years or so.. These results allowed making of two conclusions. First, that institutional arrangements are important. Secondly, according to the data set, fiscal decentralization had increased the growth rate in China mainly by enhancing the efficiency of resource distribution rather than by stimulating more investment. Government in the developing nations seems to be far more centralized (as measured by current fiscal indices) than in the industrialized countries.

It's true that rural reforms play a significant role in economic development but these reforms should be organized in such a way that they are consistent with the national government policies, such that the country could move in one direction strategically. This would give the country strategic competitiveness. The structure of the decentralized units and the country plays a great role as a whole. It helps in assigning responsibility and ensures accountability. Governments should consider entrenching reforms in the regional governments that would enhance efficient

utilization of resources even as they consider increasing investments. African countries which tend to be more oriented towards centralization should consider decentralization as it has been successful in other jurisdictions such as in China.

4.3 Summary of Research gaps.

From the studies reviewed, a number of research gaps were noted such as it was not clear to what extent budgetary reforms spur savings and public investment. Further, it was not clear why implementation of budgetary reforms has been rather slow, it was not revealed the kind of decisions that are made as a result of these reforms. Questions still remain on the nature of financial reports that are developed as a result of reforms and their contribution to the organizations. It has not been demonstrated how financial statements act as indicators of economic success and financial health of the public sector.

The fiduciary responsibilities of individuals on financial reporting should be established .The contribution of legal enforcement of the public finance reforms and other initiatives need to be evaluated for effectiveness. The effectiveness of oversight mechanism should be evaluated in the public sector, this may be occasioned by the existence of many unethical practices within the public sector despite there being many oversight bodies within the public sector. In addition, it is not clear the extent with which fiscal decentralization improves operational efficiency in the public sector. It is further not clear why governments in developing countries seem to prefer centralization instead of decentralization.

It is not clear on the extent with which governments expend on unproductive expenditures and on public investments. It is further not documented on the risk management initiatives that have been established within the public sector that could assist in solving the challenges that are faced during the implementations of reforms within the governments.

4.4 Recommendations

From the review undertaken the following recommendations may be made on this area of study. There is need for greater budgetary reforms that are intended to increase capital investments and savings. The financial management reforms should be fast tracked in order for the intended objective and benefits to be realized. Clear performance timelines and indicators should be put in

place on all the reforms started in the public sector. Reforms should take into account the political willingness by the parties involved otherwise they may not be implemented or may be implemented in the wrong way. For reform to be justified; they should result in different kinds of decisions. The gainers and losers as a result of reforms should be well spelt out.

The corporate managements and accountants should take responsibility of fiduciary responsibility over the financial statements, auditors and members of standard setting board should also take oversight responsibility. The excessive powers to managers under corporate governance should be monitored to avoid abuse. The general public should be enlightened on the contents and informational role of the financial statement for proper interpretation for it to be useful. It should be clear on what should be looked at in the financial statement so as to measure firm's stability. It should be clear on what information the income statement, the balance sheet, the cash flow and other documents mean. IFRS should be encouraged so as to reduce the cost of equity by majority of firms. Further, strong legal enforcement should be done so as to ensure efficient implementation of IFRS. There should be a balance between corporate diversity management development and financial reporting quality such that one should not over exceed the other. Otherwise, excess of each may lead to corporate failure.

Established oversight mechanism in an organization should be strengthened for efficient implementation of activities. Without proper oversight, reforms and reorganizations in government and other institutions may not be effective. Empowerment of democratic norms and institutional diffusion processes across IGOs should be an ongoing process that should be undertaken throughout in the organization so as to have positive impact on the member states' preferences. Oversight failures should be discouraged as much as possible. And persons responsible for the failure in case of their occurrence should be held accountable. The oversight organs within the public service should be enshrined in the constitution or equivalent written document for them to be effective. This helps them to have legal backing and independence to operate. The independence contemplated in this case, would give the persons involved autonomy and assurance that they have safe guard against unfair treatment as they discharge their duties.

Governments should ensure that there is an optimal degree of fiscal decentralization to reach the central government's goal of growth maximization which should take into account regional welfare. Fiscal decentralization should be enhanced so as to have significant contribution to

economic growth. Further, rural reform, capital accumulation, and non state sector development should be undertaken as they are the key driving forces of the economic growth. Government in the developing nations should consider being less centralized as it appears that decentralized form of government has been performing better even in the developed countries.

Unproductive expenditures should be reduced and at the same time public investment should be boosted. Risk management measures should put in place to deal with the effect of inflation on tax revenue. Studies should be undertaken to establish the various challenges on the implementation of public sector reforms and how best to solve those challenges.

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