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AID AND REFORM IN AFRICA

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KENYA CASE STUDY

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ACRONYMS

ADF	African Development Fund
AfDB	African Development Bank
ASAO	Agricultural Sector Adjustment Operation
BOP	Balance of Payments
CBK	Central Bank of Kenya
CG	Consultative Group
CPI	Consumer Price Index
DAC	Development Assistance Committee (of OECD)
EAC	East African Community
EC	European Commission
EDA	Effective Development Assistance
EDP	Export Development Program
EDSAC	Education Sector Adjustment Credit
ESAF	Enhanced Structural Adjustment Facility
FY	Fiscal Year
GDP	Gross Domestic Product
GPCO	General Price Control Order
ICOR	Incremental Capital/Output Ratio
IDA	International Development Association
IMF	International Monetary Fund
IPAR	Institute of Policy Analysis and Research
KANU	Kenya African National Union
KIPPRA	Kenya Institute for Public Policy Analysis and Research
KSh	Kenya Shilling
NCPB	National Cereals and Produce Board
ODA	Official Development Assistance
ODF	Official Development Finance
OECD	Organization for Economic Cooperation and Development
PFP	Policy Framework Paper
QRs	Quantitative Restrictions on Imports
SAC/SAL	Structural Adjustment Credit/Loan
SAP	Structural Adjustment Program
SDR	Special Drawing Right
SECAL	Sectoral Adjustment Loan/Credit
SOE	State-owned Enterprise
SP	Sessional Paper
SPA	Special Program of Assistance (for SSA)
SPCO	Specific Price Control Order
SSA	Sub-Saharan Africa
TA	Technical Assistance
UNDP	United Nations Development Program
WB	World Bank

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AID AND REFORM IN AFRICA
Kenya Case Study

INTRODUCTION

This case study on Aid and Reform in Kenya forms a part of a larger World Bank research project on “Aid and Reform in Africa.” The objective of the overall study is to obtain a better understanding of the causes of economic policy reforms in developing countries, in this case in a group of Sub-Saharan African (SSA) countries, and of the possible influence of foreign aid in promoting reforms. Has donor aid, particularly balance of payments assistance linked to Structural Adjustment programs (SAPs), generated, encouraged, or impeded reforms? What has been the nature of the linkage between aid and policy reforms?

This study focuses on the time period 1980-1998, the period during which the government of Kenya has been engaged, more or less continuously, in implementing a program of structural adjustment reforms, with financial support from the World Bank, IMF and other multilateral and bilateral donors. However, in order to explain the nature of the economic problems confronting Kenya at the beginning of the 1980s, when SAPs were first introduced into the aid donor/aid recipient relationship, and the economic policy framework then in place in Kenya it is necessary to describe the country’s political and economic trends during the earlier post-independence years from 1963 to 1980.

In Part I of the paper we describe the trend of aid flows to Kenya from 1970 to 1996, with emphasis on policy-based lending linked to structural adjustment reforms which became a major component of Kenya’s resource inflow after 1980. In Part II we examine the broad outlines of political and economic developments in Kenya, first for the 1963-80 period and then during the period of structural adjustment, 1980-1998. Then we present an overview of the economic policy reform agenda as it evolved during this latter period, before discussing in more detail specific reforms and their time path and sequencing in the areas of macroeconomic management, trade policy, public sector management and agricultural policy. This section concludes with a discussion of the part which key Kenyan individuals and institutions played in the generation of policy reform initiatives, in translating reform proposals into policy actions, and in the follow-up implementation of reform programs. Finally, Part III of the paper explores the linkages between the timing and volume of aid flows and the adoption of policy reforms in Kenya.

PART I: AID FLOWS

1. This section of the study presents and analyzes total aid flows to Kenya over the period 1970-1996. Development aid comprises those resources provided by donors to recipients, whether grants or loans, which fit the definition of "Official Development Assistance" (ODA) established by the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD). ODA includes both direct financial aid and technical cooperation. For details on definitions and sources of the data used in this study see Appendix 2.

2. The data in Appendix 3, Table 1 indicate that there has been a strong, steady build-up in nominal aid flows to Kenya over this period. Gross ODA inflows increased from an annual average of US$205 million in the 1970s to over US$630 million in the 1980s, and to slightly over US$ 1 billion in 1990-96. In per-capita terms nominal gross aid flows have risen from an annual average of $15 in the 1970s to $34 in the 1980s and almost $40 in the 1990s. At the peak in 1990-91 net ODA inflows were equivalent to 14percent of GDP and to approximately 45 percent of the government budget. However, this impressive growth in nominal aid inflows merely shows that Kenya has followed the pattern for SSA as a whole, since Kenya's share of total ODA to SSA[1] has remained remarkably stable over this entire period, as is indicated in text Table 1 below.

TABLE 1
KENYA'S SHARE OF TOTAL ODA TO SUB-SAHARAN AFRICA
1970-1996
US$ billions

PERIOD	KENYA'S ODA	AFRICA'S ODA	KENYA %
1970-79	2.055	39.157	5.2
1980-89	6.732	127.644	5.3
1990-96	7.069	136.635	5.2
1970-96	15.856	302.836	5.2

Source: See Appendix 3, Table 1 for sources.

3. These ODA data tell only part of the story; certain qualifications must be added to the aggregate picture. First, an aspect beneficial to Kenya is the fact that the terms of Kenya's ODA have softened over this period, reflected in the increasing share of grants, which rose from 48 percent in the 1970s to 53 percent in the 1980s and to over 63 percent in the 1990s.[2] The breakdown of ODA into loans and grants is shown in Appendix 3, Table 2. (In this regard Kenya has lagged slightly behind the overall trend in SSA, where the grant share in ODA to all of SSA has increased from 52 percent in the 1970s to 67 percent in the 1990s.) On the negative side, the gross ODA data for the 1986-92 period are over-stated because of the inclusion of debt relief from bilateral donors on past ODA loans of approximately US$700 million (which the DAC includes in grant aid in the year that relief is provided.) The data on gross ODA excluding debt

[1] Data cover the 49 principal aid receiving countries in Sub-Saharan Africa.

[2] Loan terms have also softened since the World Bank, the major provider of development loans, phased out lending on IBRD terms in 1986; since then all World Bank loans have been on IDA terms.

relief are given in Appendix 3, Table 3. This Table also provides data on net ODA in current and constant prices. From these data series two important conclusions can be drawn. First, while there was a dramatic build-up in nominal aid flows during the 1980s, in both gross and net terms, there has been a slackening of donor support in the 1990s resulting in a sharp decline in inflows since the peak in 1989-90. Secondly, when aid flows are measured in real terms, this decline has brought aid inflows in recent years down to a level well below that of the mid and late-1980s, and even below the real value of aid disbursements in 1980.

A. Bilateral/Multilateral breakdown of ODA.

4. Appendix 3, Table 4 provided a breakdown of gross aid disbursements to Kenya according to their multilateral and bilateral sources over the 1970-96 time period. Kenya has received approximately three-fourths of its total aid from bilateral donors, with no distinct trend toward greater reliance on either multilateral or bilateral donors. The share of multilateral aid increased moderately in the 1980s, primarily due to the large disbursements of World Bank adjustment lending, but the bilateral share rose again in the 1990s with the decline in new adjustment lending after 1991. Bilateral aid has been predominantly in the form of grants—72 percent of the total—with the share of grants actually increasing in recent years, whereas multilateral aid has been predominantly in the form of loans—86 percent. The principal source of multilateral loans has been the World Bank Group (WB), accounting for almost 80 percent of total loans in the 1970-96 period,[3] with the African Development Bank (AfDB) accounting for 11 percent.

5. While the overall shares of multilateral and bilateral aid sources have not changed markedly over time, there have been significant changes within the two categories. Appendix 3, Table 5 shows the shares in total ODA by periods for the major donors/creditors. The World Bank, which accounted for 20 percent of total flows in the 1970s and 1980s, has seen its share of total disbursements reduced to 16 percent in the 1990s, due to the growing importance of certain bilateral donors, the significant reduction in disbursements for balance of payments support since the early 1990s, and a shrinking portfolio of project loans. The other principal multilateral agencies, the AfDB and the European Commission (EC), have each contributed a much smaller share of Kenya's ODA.

6. With respect to bilateral assistance, Kenya has for many years received aid from virtually all aid-giving nations and agencies. In addition to those shown in Appendix Table 5 and mentioned in the accompanying footnote, Kenya has also received aid from Australia, Austria, Belgium, China, Ireland, Korea, Spain, Switzerland and various Middle Eastern governments and aid agencies. Among the most notable trends within the bilateral group has been the decline in the share of the United Kingdom, which was Kenya's leading development partner in the immediate post-Independence years of the 1960s and early 1970s. The nominal value of UK aid has risen only modestly over the years, from an average of US$37 million per annum in the 1970s to US$62 million per annum in the 1980s, falling back to US$55 million per annum in the 1990s. Over this same period Japanese aid has increased from 4 percent of gross ODA in the

[3] Total cumulative World Bank and IDA lending commitments to Kenya as of 6/30/98 were US$4.0 billion, of which US$1.2 billion in IBRD loans and US$2.8 billion in IDA credits.

1970s to 17 percent in the 1990s. Japan’s annual average ODA to Kenya has increased from insignificant levels in the early 1970s to US$60 million per annum in the 1980s and to US$170 million per annum in the 1990s. This is not an unmixed blessing however, since Japanese aid (and the French) has a higher share of loans to grants (60 percent loans in the 1990s) than the rest of Kenya’s ODA. Another significant trend has been the declining share of many medium-sized donors, including the Scandinavian countries, Canada and the Netherlands. Sweden’s aid has actually fallen in nominal terms, from an average of US$25 million per year in the 1980s to US$23.5 million per year in 1990-96. The trend is even more pronounced for Norway (with which Kenya actually broke diplomatic relations during 1990-95) whose aid disbursements fell from US$25 million per annum in the 1980s to US$2.5 million per year in 1992-96.

7. There are obvious reasons why Kenya has received such a large inflow of aid over many years from such a wide range of aid partners. The primary motivations for providing aid are developmental (to promote economic growth and poverty alleviation in poor countries), commercial (to cement commercial and financial relations with the aid recipient—opening markets, assuring opportunities for investors, contractors and suppliers from the aid-giving country) and political (to maintain the allegiance of governments that are politically aligned with the aid-giver—a particularly prominent feature of aid relationships during the “Cold War” era.) Kenya, since her independence in 1963, was a logical candidate to receive aid for all of the above reasons. First, the government’s management of the economy was prudent and the economic track record was relatively good, at least through the 1970s, and, despite a mixed record on economic policy reform and macroeconomic outcomes in the 1980s, still relatively better than most of SSA. Kenya was for many years a relatively attractive locale for foreign investment, at least within the SSA context, especially for consumer goods industries targeted at the East African market—prior to the collapse of the East African Community (EAC) in 1997. And throughout the years of the Cold War Kenya consistently aligned itself with the West both economically and politically. However, the end of the Cold War in 1989, which essentially eliminated the geopolitical motivation for aid, coincided with a weakening of economic reform efforts and a deterioration in economic performance in Kenya in 1989-92, as well as a hardening of political lines within the country at the same time that donors were adding “good governance” and democratization to their criteria for judging the worthiness of aid recipients. The result was an intensification in the “stop-go” relationship between donors and the Kenyan government which has persisted to the present time. This is discussed in Part II below.

B. Technical assistance (TA).

8. Appendix 3, Table 6 provides annual data on grant aid for TA. In the 1970s a high proportion of bilateral grant aid (58 percent for the decade) was devoted to TA; at that time donors were financing most development *projects* through loans. During the 1980s, when bilateral donors shifted an increasing proportion of their project assistance to grant terms, the share of TA in total grant assistance began to decline, to 39 percent in the 1980s and to 36 percent in the 1990s. However, the absolute amounts expended for TA have remained extremely high, averaging US$140 million per year in the 1980s and US$225 million per year in the 1990s. Since 1970 Kenya has received over US$3.5 billion of grant assistance for TA. Much of this finance for TA is, of course, money which the Kenyan government itself does not receive, since

it is paid directly to resident advisers by the aid-giving country or international agency, or to education and training institutions outside Kenya. And it is certainly open to question whether overall human resource capacity building and institutional strengthening in the Kenyan government has been commensurate with this level of expenditures. There are many well-documented causes for the generally disappointing record of technical assistance in Africa on both the donor and recipient sides, but any discussion of these deficiencies is beyond the scope of this paper. Nevertheless, within this massive amount of TA finance there is one component which is important for the focus of this study—that TA which has been provided for more than thirty years for the training of Kenyan economists and other officials from the key economic Ministries and agencies (*i.e.*, Finance, Planning and Central Bank) and for the provision of foreign advisers and advisory teams to these core agencies. This TA has undoubtedly had an impact in influencing the approach to analyzing economic issues and the analytical capabilities of Kenyan technocrats and institutions, as is discussed more fully in Part II.

C. Adjustment or program lending.

9. Kenya, like many other SSA countries, has received a very sizable amount of lending for balance of payments support, also referred to as program lending and, since 1980, identified with “structural adjustment programs” or SAPs. Most of this lending has come from the World Bank and IMF, with smaller amounts from the AfDB and bilateral donors, the latter often linked to World Bank-supported adjustment programs. A complete listing of IMF and World Bank/IDA adjustment lending to Kenya is provided in text Table 2 below. Data on total disbursements of adjustment loans from all sources is provided in Appendix 3, Table 7.

TABLE 2
IMF AND WORLD BANK/IDA POLICY REFORM LOANS TO KENYA
1974-1996

YEAR	TYPE	AMOUNT	COMMENTS
IMF			
1974	Oil Facility	SDR 63.9m	Drawn during 1974-76.
1975	Extended Facility	SDR 67.2m	Only SDR 7.7m. drawn.
“	Standby	SDR12.0m	Drawn and fully repaid in same year.
1976	Compensatory Facility	SDR 24.0m	
1978	Standby	SDR 17.25m	Fully disbursed by 8/79.
1979	Standby	SDR 122.5m	Not drawn, canceled 10/14/80.
“	Supplemental Facility	SDR 70.7m	Not drawn, canceled 10/14/80.
“	Compensatory Facility	SDR 69.0m	
1980	Standby	SDR 241.5m	Only SDR 90m drawn, canceled 1/7/82.
“	Supplemental Facility	SDR184.8m	Only SDR 50.1m drawn, canceled 1/7/82.
1982	Standby	SDR 151.5m	Only SDR 90m drawn, cancelled 1/7/83.
“	Supplemental Facility	SDR 96.8m	
“	Compensatory Facility	SDR 60.4m	
1983	Standby	SDR 175.9m	
1985	Standby	SDR 85.2m	
1986	Compensatory Facility	SDR 37.9m	

1988	Standby	SDR 85.0m	Only SDR 62.6m drawn, canceled 5/15/89.
“	SAF	SDR 99.4m	Only SDR 28.4m drawn, replaced by ESAF 5/15/89.
1989	ESAF	SDR 261.4m	SDR 216.2m drawn prior to 11/91, was suspended 1/92, expired 3/93. Balance renegotiated 12/93, drawn by 12/94.
1996	ESAF	SDR149.6m	Only SDR 25.0m drawn, suspended 7/97, expired 4/99.
WORLD BANK			
1975	Program Loan	$30.0m	
1980	SAL I	$55.0m	IDA lending terms.
1982	SAL II	$130.9m	$70.0m on IDA terms, $60.9m on IBRD terms.
1986	ASAO I	$40.0m	IDA terms. Also IDA reflows of $20.8m.
1988	Industrial Sect. Adjust	$102.0m	IDA terms. Also IDA reflows of $63.1m.
1989	Financial Sect. Adjust	S120.0m	IDA terms. Also IDA reflows of $114.6m.
1990	EDP	$100.0m	IDA terms. Also IDA reflows of $53.0m.
1991	ASAO II	$75.0m	IDA terms. Only $30.9m. of balance of payments support disbursed, balance canceled 12/92.
“	EDSAC	$100.0m	IDA terms. 2nd and 3rd tranches affected by 11/91 aid freeze, credit not fully disbursed until 1995. Also IDA reflows of $96.2 m.
1996	SAC I	$90.0m	IDA terms. Only $44.5m of credit and $35.3 m. of IDA reflows disbursed. Balance of credit and $42.1 m. of IDA reflows canceled 6/98.

10. Kenya first received loans for balance of payments support in the mid 1970s in response to the first “oil crisis;” a US$30 million program loan from the World Bank and US$ 128 million from the IMF through the Special Oil Facility, Compensatory Financing Facility and the Extended Fund Facility. (The IMF credits were not fully utilized and were allowed to lapse when the balance of payments situation improved following the coffee boom in 1976-77.) Such program loans were not a common practice for the World Bank at that time, having been confined largely to India and Bangladesh. This mid-1970s program lending and associated IMF drawings carried very low conditionality, since the Kenyan economy had been performing well up to that point, economic management was generally sound, and the World Bank and IMF were reconciled to the already-established market interventions of the government, i.e., the fixed exchange rate and interest rates, price controls and the sizable and growing state-owned enterprise (SOE) sector.[4]

11. In the late 1970s and early 1980s the Kenyan economy experienced a series of shocks, some of which affected all developing countries, but others which were specific to Kenya. In

[4] The so-called “Washington consensus” on the virtues of liberalization and a substantially reduced role for government in economic affairs only evolved during the era of structural adjustment in the 1980s. See “What Washington Means by Policy Reform” in Williamson, John (ed.), Latin America’s Adjustment: How Much Has Happened?, Institute of International Economics, Washington, D.C., 1990.

response to these shocks the World Bank, IMF and other donors responded with a substantial commitment of structural adjustment lending. Kenya was, in fact, the first SSA country to receive structural adjustment funding from the World Bank (and, later, the first to receive an Enhanced Structural Adjustment Facility [ESAF] loan from the IMF). The Bank committed an IDA Structural Adjustment Credit (SAC) of US$55 million in March 1980 and a second combined Structural Adjustment Loan/Credit of US$130.9 million in July 1982. However, because of Bank dissatisfaction with the government's progress in meeting the policy reform conditions, release of the US$50 million second tranche of the 1982 operation was delayed for nine months until early 1984. These funds were finally disbursed even though the conditions, especially those dealing with cereals market liberalization, were not fully met.

12. While the World Bank and Kenyan government had earlier discussed a possible third structural adjustment operation this did not materialize. Despite Kenya's continuing balance of payments deficit there was a hiatus in further adjustment loan commitments and disbursements until 1986, although the decline in this form of assistance was offset to some extent by a large volume of food aid in response to a devastating drought in 1984. This stop-go pattern in adjustment lending, resulting from donor dissatisfaction with the pace and/or extent of policy reforms, and the strained relations between the government and donors which ensued, was repeated in the early 1990s and again since 1996.

13. The momentum of economic reform in Kenya was renewed in 1986 following the adoption by the government of Sessional Paper No.1, Economic Management for Renewed Growth (SP#1).[5] Policy dialogue with the World Bank and IMF had resumed during 1985 while this comprehensive policy reform document was under preparation. As implementation of the policy reform proposals set out SP#1 got underway, the IMF and World Bank responded—the IMF initiated a program of lending under the SAF, later converted to an ESAF, and the World Bank undertook a new program of IDA sectoral adjustment credits (SECALs). These WB/IMF initiatives were supplemented by loans and grants for balance of payments support from bilateral and other multilateral donors.

14. Between 1986 and 1991 the World Bank approved six SECALS (two based on agricultural sector policy reforms, one supporting industrial sector reforms, one in the financial sector, an export development program, and an educational sector policy support operation.) The total original commitment of these six IDA credits was US$537 million, but they were supplemented by an additional US$348 million in "IDA reflows"— additional IDA lending disbursed to offset debt repayments on previously contracted World Bank loans. IDA reflows are only disbursed to those eligible countries which have ongoing adjustment programs and are linked to disbursements under the associated adjustment credits. Most of these commitments were disbursed during 1987-91. During this same period the IMF disbursed US$360 million of SAF and ESAF funds.

15. As described in Part II, this infusion of balance of payments support, along with continued project lending, contributed to a recovery in the growth rate of the Kenyan economy in

[5] Sessional Papers are policy papers prepared by Ministries and submitted to the Parliament for approval.

the second half of the 1980s. However, donor frustration began to build over lagging implementation of the government's commitments under the adjustment program, associated with increasing donor concerns over corruption and governance issues. This led, at the Consultative Group Meeting (CG) of November 1991, to a suspension of already committed adjustment lending and a refusal to commit any new adjustment support until "substantial" progress was seen on all of the above fronts.[6]. It has been estimated that this freeze, which lasted until mid-1993, or later for some donors, affected over US$400 million in financial support which would otherwise have been disbursed during 1991-93, including the undrawn balance of the IMF ESAF (US$63.2 million); second tranches of the World Bank Second Agricultural Sector Adjustment Credit (ASAO II, US$33 million) and Export Development Program (EDP, US$25 million plus US$53 million in IDA reflows); second and third tranches of the Education Sector Adjustment Credit[7], (EDSAC, US$65 million plus US$52 million in reflows); an African Development Fund (ADF) credit of US$35.3 million; and bilateral grant aid from Japan (US$77.3 million) and Germany (US$18.2 million) along with smaller amounts from the UK, EC and Netherlands. In addition, US commodity and military aid of some US$43 million was frozen, while the US Department of Agriculture canceled negotiations of a proposed US$100 million wheat import program under US PL 480. Finally, a STABEX grant of US$ 26 million equivalent from the EC, which was not formally linked to the structural adjustment program, was also held up until the end of 1992. Again, as in 1984, some of this cut-off in aid was offset by inflows of emergency relief and food aid in response to the severe drought of 1992-93; however the magnitude of this relief assistance was far below the amount of aid suspended.

16. While some of the frozen commitments were subsequently canceled, or simply never renegotiated, including the second tranche of ASAO II, the German grant and the USAID commodity support, about half of the total affected by the freeze was eventually disbursed to Kenya in 1993-95, after the government renewed its reform efforts and made major progress in liberalization of both external trade and the domestic economy. In response to these renewed reform efforts of 1993-95, the IMF renegotiated and disbursed the US$63 million balance of the suspended 1989 ESAF and in April 1996 agreed to a new ESAF arrangement for SDR 150 million (US$220 million) over three years. The World Bank disbursed the outstanding tranches of the EDP and EDSAC and associated IDA reflows between mid-1993 and end-1995, and in June 1996 approved a new Structural Adjustment Credit of US$90 million (plus IDA reflows of US$35 million).

17. Since 1996, however, the performance of the Kenyan Government in the implementation of structural adjustment policies has again been disappointing to the World
Bank and IMF; they have seen, as in 1990-91, a slackening of reform efforts and failure to meet fully the SAC and ESAF conditions. As a result the ESAF program was suspended in mid-1997, after only SDR 25 million had been drawn, and was allowed to expire in February 1999, while the second tranche of the SAC was canceled in mid-1998 and associated 1996-97 IDA reflows of

[6] This donor action at the November 1991 CG meeting has been widely misunderstood. It has often been characterized as a freeze on all aid, but in fact aid for ongoing and new development projects, technical assistance and emergency relief continued as before.

[7] This credit was approved, and the first tranche of US$34 million disbursed, in September 1991, only two months before the donor meeting of November 1991 which imposed the freeze on balance of payments support.

US$42 million were allowed to lapse. The total amount of balance of payments support forgone by the Kenyan government since 1997, on the hypothesis that fully satisfactory implementation of the ESAF and SAC would have led to follow-on operations from the World Bank and IMF, is probably very close to the total of financial aid that was frozen in November 1991. This up-and-down, on-off experience with adjustment support to Kenya over the entire 1980-99 period is discussed in detail in Part II.

18. A summary of the entire 1970-96 period for which detailed data have been provided shows clearly the growing importance of program or structural adjustment lending for Kenya. Total ODA loans plus IMF drawings provided as balance of payments support totaled almost US$3 billion, rising from just over US$290 million in the 1970s to US$1.6 billion in the 1980s, and US$934 million, or US$133 million per year, in 1990-96. The share of gross ODA plus IMF drawings provided as balance of payments support rose from 12.8 percent in 1970-79 to 21 percent in 1980-89, dropping back to 12.8 percent in 1990-96. For the World Bank, adjustment lending over the 1980-96 period, including IDA reflows, totaled US$1.08 billion, equivalent to 43 percent of total IBRD and IDA lending, and for the period of intensive sectoral adjustment lending, 1987-91, it represented 61 percent of total disbursements. Of course the *net* flow of adjustment lending over the entire period was much less than the totals cited above, due to repayments of principal and interest charges.[8]

D. Aid coordination.

19. Given the multiplicity of multilateral and bilateral donor agencies active in Kenya, donor coordination has been an ongoing challenge. Each donor has its own program priorities, procurement and disbursement procedures, and regular program and policy discussions with the government. All of these make heavy demands on the time of senior government officials. At the same time the Kenyan government has demonstrated little effort or inclination to better coordinate donor activities. In an effort to enhance donor coordination the World Bank organized a Consultative Group (CG) for Kenya in the early 1970s. This group met regularly throughout the 1970s and 1980s, normally once every two years.[9] In the early 1990s, as donor concerns grew over economic management, economic policy reforms, political reforms and corruption, CGs were held in both 1990 and 1991, as well as meetings of donors without the government's presence. Following the suspension of program aid in November 1991 a formal CG was not held again until November 1993, but several informal, donors-only meetings were held in the interim to review progress, or lack of progress, in reforms. Following the resumption of the formal CG process in late 1993, meetings were held in 1994 (two), 1995 (informal) and 1996, but with the slowing-up of reforms since 1996 there have been no further formal CG meetings since that year.

[8] In the case of the IMF, all drawings, including the more concessional SAF and ESAF, have much shorter grace and repayment periods than other concessional loans. When repayments to the IMF are taken into account, the net flow of IMF resources during 1970-96 was only US$115 million. When interest charges are included the net balance was negative.

[9] Formal Consultative Group meetings chaired by the World Bank were held in fiscal years 1972, 1974, 1977, 1979, 1982, 1984, 1986 and 1989.

20. The formal CG process described above is supplemented by regular meetings in country of the local donor community comprising the heads of donor and UN agencies and their staffs in Nairobi. This local coordination group is co-chaired by the World Bank and UNDP. In addition, there are sector coordination sub-groups for all the major sectors receiving significant donor aid, such as health, education, agriculture, etc., including a "good governance" or "democratic development" group. The Kenyan Government participates regularly in some, but not all, of these sectoral coordination meetings. Periodically the Kenyan government has convened meetings in Nairobi to inform donor representatives and ambassadors of the government's plans and progress in economic reforms, poverty alleviation, governance, etc. In general, through the structural adjustment period there has been broad agreement within the donor community over the priorities for economic reform in Kenya and, accordingly, on whether withholding aid or proceeding with disbursements and new commitments of policy-based lending is warranted.[10]

E. Debt and Debt relief.

21. After growing slowly until the late 1970s, Kenya's external debt more than doubled in the 1980s, rising from US$3.4 billion in 1980 to US$7.1 billion in 1990. Total foreign debt peaked at US$7.5 billion in 1991 but has since been reduced modestly, to US$6.9 billion in 1996. However, within the total debt stock the share of public and publicly guaranteed debt has grown more rapidly, from US$2.1 billion in 1980 to US$4.8 billion in 1990 and to US$5.9 billion in 1995, before dropping to US$5.6 billion in 1996.[11] While some of this debt was contracted on commercial terms, especially in the late 1970s, most of it was aid-related. As a low-income country Kenya qualified for conversion of a substantial part of bilateral aid to a grant basis, which occurred in the 1980s as mentioned above. Between 1986 and 1992 bilateral donors also provided debt forgiveness of prior ODA debt of US$700 million. The major sources of ODA debt relief were the US (US$118.5 million, while an additional US$ 38.7 million was revoked in connection with the 1991 aid freeze), Germany (DM 600 million), Canada (US$ 90 million), Netherlands and the UK. The Japanese government has not provided debt forgiveness, but has offset debt repayments with supplemental grant aid.

22. Until the decade of the 1990s the Kenyan Government had always serviced the country's official external debts, including those on commercial terms. The country had avoided arrears and had never been forced to seek debt relief from the Paris Club, London Club, or from individual creditors. However, as the economy fell into recession in the early 1990s, with accompanying severe balance of payments constraints and shortages of foreign exchange, and with the curtailment of donor balance of payments support in late 1991, the government began to accumulate arrears on official debt, both to ODA donors and to Paris and London Club creditors.

[10] As stated earlier, the donor consensus underlying the freeze of balance of payments support which was imposed in November 1991 was essentially maintained until the subsequent Consultative Group meeting in November 1993. While the World Bank and IMF began release of suspended funds in mid-1993 based on the new policy agreement reached in May 1993, bilateral donors held up on similar releases until receiving the WB/IMF report on Kenya's renewed reform efforts at the 1993 CG. The one exception was the release by Japan prior to the CG of US$75 million which had been tied to release of the second tranche of the WB Export Development Program. This "premature" release came in for some criticism from other donors, but any criticism was mild and not of lasting significance.

[11] See annual editions of World Bank, World Debt Tables and Global Development Finance.

By mid-1993 arrears on external debt peaked at approximately US$750 million, close to 15% of the outstanding stock of official debt. However, with the re-establishment of a strong reform program and the resumption of balance of payments support in 1993 the foreign exchange crisis was alleviated and regular debt repayments were resumed. In January 1994 Kenya was able to negotiate with the Paris Club a highly favorable refinancing (of arrears only) over an eight-year repayment period. A similarly favorable refinancing of arrears was subsequently negotiated with the London Club.

F. Special Program of Assistance (SPA).

23. In the late 1980s the World Bank organized a special program to assist the highly indebted countries in SSA, primarily through debt relief and conversion of aid flows from project finance to quick-disbursing balance of payments support linked to SAPs. All the major bilateral and multilateral donors to Africa were invited to participate in the program, which included bi-annual meetings to discuss the status of the highly-indebted low income countries in Africa, closer aid coordination, and support for additional program aid and debt relief. The SPA was influential in inducing the Paris Club to adopt more favorable terms in its reschedulings, in increasing both bilateral and multilateral debt relief, and in mobilizing additional lending to offset debt payments such as the IDA reflows program. The criteria for inclusion in this program for low-income African countries included an unsustainable debt burden, defined as a debt service to export ratio of over 30%, one or more debt reschedulings with the Paris Club, and adherence to a program of structural adjustment supported by the World Bank and IMF. Initially Kenya was not included in the SPA group because the debt service ratio was slightly below 30% and Kenya had neither defaulted on external debt or applied to the Paris Club for rescheduling. Nevertheless, it was agreed by the donor community in 1989 to include Kenya in the SPA, a decision which helped to augment the flow of program aid to the country. In the early 1990s, given the rising debt service ratio and the build-up of arrears on official external debt, Kenya qualified for the SPA on these criteria. However, the status of Kenya's structural adjustment program was in question from late 1991 until mid-1993.

PART II: POLICY REFORMS AND INSTITUTIONAL DEVELOPMENT

A. Background: Political and Economic Trends in Kenya 1963-1980.

(a) Political Developments.

24. Kenya gained independence from Great Britain in 1963. For the next fifteen years the country was led by President Jomo Kenyatta, the foremost leader of the independence movement, and by his political party, the Kenya African National Union (KANU). The Kenyatta government rapidly Africanized the civil service and other public sector appointments in order to consolidate national sovereignty. Since the President's tribe, the Kikuyus, had been the major beneficiaries of education and employment in the formal sector during the colonial period, they were the logical candidates for appointments to public sector jobs. (They were also favored by the new

government in the allocation of agricultural land and credit.) Other tribal groups attempted to organize opposition parties but these either failed or were suppressed; by 1969 Kenya had become a *de facto* single-party state. Nevertheless, within this single-party framework Kenyan politics was relatively democratic, with parliamentary and presidential elections on a regular five-year cycle, open and competitive primary races at the district level, and a high turnover of parliamentary seats. Normally some two-thirds of sitting Members of Parliament, and one-third of those holding Cabinet posts, were voted out of office at each election, a trend which has continued throughout Kenya's history. Following the death of President Kenyatta in 1978 and the accession to the Presidency of Vice President Daniel arap Moi, who comes from one of the smaller tribal groupings, the Kalenjin, there began a gradual reversal of the balance of power within the ruling party which is reflected in the framework of Kenyan politics up to the present day.

25. From the standpoint of economic policy-making, the most significant political factor in the first years of independence was the concentration of decision-making authority in the central government and, in particular, in the Office of the President. The first, 1963, national election decided the basic political question whether Kenya should have a strong central government or should be a federal state (referred to locally as "majimboism"). KANU stood for strong central authority and KANU won. Following from this, a series of 1960s laws and constitutional amendments increased the power of the President vis-à-vis the Cabinet, Parliament, judiciary, civil service, local government and civil society organizations (e.g. labor unions, cooperatives, women's' groups).[12] The President also expanded his political power through the control of institutions inherited from the colonial regime (described below) which could be used for political patronage and provided a source of economic rents for Ministers and other political supporters. Such a concentration of authority meant that the adoption and implementation of any major economic policy initiative would always require the agreement of the President. Thus any analysis of the process of policy formulation and implementation in Kenya must recognize the central role of the President and his circle of key advisers and associates who control access to him. However, despite the existence of this highly centralized and authoritarian structure, in the early years of the Kenyatta presidency the Cabinet, Kenyan technocrats and a small coterie of foreign advisers played an important role in policy formulation. Policy issues were seriously debated, the civil service maintained a reasonable degree of professionalism,[13] the President listened to and followed many of the recommendations of his advisers, and the policy framework was sufficiently predictable to encourage investment.

(b) Economic Developments.

[12] Constitutional amendments 1-7 and 9-10, adopted between 1964 and 1969, abolished the position of Prime Minister, abolished the pre-existing powers of the regional authorities, abolished provincial councils and gave the President more powers in setting provincial and district boundaries, entrenched the Preservation of Public Security Act, expanded the authority of the President in a state of emergency, and the authority to detain without trial, gave the President authority to nominate twelve members of Parliament, and gave the President authority to appoint and dismiss civil servants and to appoint the members of the Electoral Commission, a responsibility previously held by the Speaker of Parliament. For a discussion of these and other changes which strengthened the hand of the President see Towards Indigenizing the Policy Debate, IPAR, 1995.

[13] But the seeds of erosion in discipline and commitment in the civil service were sown by the recommendation of the 1971 Duncan Ndegwa report to allow outside business interests. See p. 26.

26. In the early post-Independence years economic policy making was managed by the Cabinet Economic Sub-Committee which had substantial influence. It was chaired by Minister of Planning Tom Mboya, one of the most creative and dynamic members of the new government. Also beginning to have influence were young Kenyan economists such as Philip Ndegwa and Harris Mule, whose impact on policy continued in the 1970s and 1980s.

27. The framework of the economy in the early post-independence years was influenced both by the prevailing development paradigm of the period and by the economic system inherited from the colonial era. At the time of Kenya's independence most newly-independent African countries were following the path of "African Socialism." The Kenyan Government accepted the label, but opted for a mixed economy which was more market-based, supportive of the private sector, and open to foreign investment than was the strict socialist model followed in other African countries such as Tanzania.[14] [15] Nevertheless, the government did wish to achieve "economic sovereignty;" that is, to expand the participation in economic life and economic benefits of the African population while reducing the role of the former colonialists, resident Asians and multi-national corporations. Given the lack of entrepreneurial and other job-related skills in the indigenous population policy makers believed that this would require, for some time, a strong government role in the economy on their behalf. Such a strong central role was also a natural continuation of the economic policies of the colonial regime.[16] The colonial government had supported the creation of institutions specifically designed to deliver benefits to the settler community. These included public agencies established to control (and sometimes subsidize) economic activities such as the Maize Board, Wheat Board, Dairy Board, Tea Board, Meat Commission, Pyrethrum Board, etc., and producers' organizations established to interact with the government in the interest of their constituents such as the Kenya Farmers' Association and the Kenya Cooperative Creameries. (Several of these had their roots in the economic controls imposed during the Second World War.) Following independence these public institutions were maintained and the private associations or cooperatives were converted into quasi-public bodies. During this early post-independence period the government also expanded its involvement in productive activities through the establishment of new state-owned enterprises (SOEs) and joint public/private ventures in manufacturing and commerce.

28. Government authority over the economy was also increased through the regulatory framework and the steady expansion of controls on domestic prices, interest rates, foreign exchange, imports and exports. Some of these controls were introduced in response to shocks, such as the capital flight which followed the assassination of Minister Mboya in 1969 and the first oil shock in 1973. Finance Minister Mwai Kibaki, who served in that capacity from 1971 to 1982, because of his dirigiste mind-set, addressed these crises primarily through the imposition

[14] See Sessional Paper No. 10 of 1965, African Socialism and its Application to Planning in Kenya.

[15] See Foreign Investment Protection Act of 1964.

[16] "The colonial experience contributed towards the formation of a centralized state bureaucracy that continues to intervene in nearly all facets of economic, social and political life." Howard P. Lehman, "Empowering the African State: Economic Adjustment Strategies in Kenya and Zimbabwe," in Kidane Mengisteab and B. Ikubolajeh Logan, editors, Beyond Economic Liberalization in Africa: Structural Adjustment and the Alternatives, p. 201.

of additional controls and an expansionary fiscal policy. While some circles in government argued that many of these interventions, in particular the commercial SOEs, were temporary,. there were clearly differences of view between technocrats and politicians on the issue of controls vs. economic liberalization. It must also be recognized that controls, regulations, and state ownership of enterprises opened up opportunities for rent-seeking.

29. Another important aspect of Kenyan economic policy in the 1960s and 1970s was the industrialization strategy which, in common with many other developing countries, was based on import substitution—trade protection for domestic "infant industries" which were established to produce substitutes for previously imported consumer goods. The view that developing countries should follow an industrial development policy of import substitution rather than export promotion was grounded in large part in the "export pessimism" argument—that their prospects for breaking into global markets for manufactured products were poor. The policy was promoted, in the 1960s and 1970s, by UN organizations such as UNCTAD and The Economic Commission for Latin America.

30. This overall economic policy framework—significant government intervention in directly productive activities as well as in the management of the economy and the import substitution approach to industrialization—was developed by Kenyan technocrats and politicians, supported by advisers funded by donor technical assistance, and was endorsed by the WB/IMF and the donor community at large. Multilateral and bilateral donor financial support of the strategy is evidenced in the amount of aid channeled to and through SOEs and also in the fact that early WB/IMF program lending in the mid-1970s basically accepted the existing controls on prices, interest rates and foreign exchange and did not impose conditions requiring the divestiture of state enterprises.

31. The Kenyan economy performed well over most of the 1964-80 period. The growth rate of GDP averaged 5.8 percent per annum in 1965-73 and 5.3 percent in 1974-80. The agricultural sector grew at nearly 5%, with growth based primarily on smallholder farmers who benefited from the conversion of former colonial estates to African ownership,[17] and the manufacturing sector expanded at 10 percent per annum, fueled by the growth in domestic rural incomes and the expansion of exports to Tanzania and Uganda under the common market created by the EAC. The domestic savings rate averaged 16 percent in the 1970s. The efficiency of investment was relatively high, with an Incremental Capital/Output Ratio (ICOR) of 3 in the 1960s and 4 in the 1970s. The tax/GDP ratio was rising steadily, from 12 percent in the mid-1960s to 20 percent in 1979/80, and while expenditures were rising equally rapidly, the fiscal deficit was contained in most years to between 3-6 percent of GDP. The overall balance of payments deficit was also manageable, at 3-4 percent of GDP.

32. Within this generally quite positive set of economic trends there were some disruptions. Economic growth slowed in the mid-1970s, to an average of 3.4 percent per annum in 1973-76. One of the principal causes was the negative impact of the five-fold increase in oil prices in 1973; this first oil shock was a serious blow to the Kenyan economy given the country's total

[17] Between 1962 and 1976 almost 2 million hectares were purchased from former white settlers and transferred to African ownership.

dependence on imported petroleum products.[18] Then, in the late 1970s, further severe economic shocks adversely affected Kenya's economic situation and prospects for the future. The first was the boom/bust cycle in coffee and tea prices in 1976-79, which sparked a ratcheting up of both consumer and government spending in the boom (the fiscal deficit rose to 9.5 percent of GDP in 1975/76). The government then proved unable to reduce spending sufficiently when coffee and tea export revenues fell sharply after 1977. The economy was also set back by the break up of the EAC in August 1977 which ended the favored access for Kenyan exporters to the Ugandan and Tanzanian markets, raised infrastructure costs, and forced the Kenyan government to absorb much of the overstaffed work force of the EAC Railways, Ports, and Posts and Telecommunications agencies. A further contributing factor was the second oil shock in 1979. As a direct result of this rapid succession of economic shocks the balance of payments current account deficit rose from 3 percent of GDP on average in 1975-77 to 10-11 percent in 1978-82. While concessional loans and grants from aid donors were rising, some of the deficit was financed with a commercial loan at a floating interest rate,[19] contributing to a rise in the debt service ratio from 2.6 percent of export revenues in 1977 to 14 percent in 1983. Inflationary pressures were also increasing despite the now comprehensive price controls.

33. Entering the decade of the 1980s the Kenyan economy had suffered, within a short span of 3-4 years, a series of economic shocks which were far more severe than any problems previously confronted in the post-independence era. At the same time the country had other problems which compounded the challenges facing economic policy-makers. Economic management had begun to weaken during the policy "drift" of the late Kenyatta years and the corresponding loss of influence of the Cabinet and civil servant technocrats. The productivity of private investment was declining, reflected in a steadily rising ICOR. Manufacturing sector growth was slowing as the limits to import substitution in the local market were reached, access to EAC markets was curtailed, and domestic industries were neither oriented toward, nor competitive in, overseas markets. Formal sector job creation was lagging well behind the growth in the labor force. In the agricultural sector there was little scope for further expansion of land under cultivation. The public sector, and public employment in particular, had been growing much faster than the economy and the rising share of government tax revenue and expenditure, as well as the low productivity of the large SOE sector, were becoming a drag on economic performance.

34. By the end of the 1970s it had become clear to many Kenyan technocrats, if not to politicians, that significant changes in the direction of economic policy would be required to address this complexity of problems. During the 1978-82 period the government, with the help of a few foreign advisers, reviewed virtually all its economic policies; these reviews were incorporated in the 1979 Development Plan[20] and in various working party reports and Sessional Papers. In 1979 Philip Ndegwa. who had close contacts with both President Kenyatta and President Moi, chaired a working party which highlighted the shortcomings of public

[18] See Government of Kenya, Sessional Paper No. 4 of 1974 for the government's policy response to the first oil shock.

[19] US$200 million loan of June 1979 with 7 years maturity and interest of LIBOR plus 1.5%.

[20] The 1978-83 Fourth Development Plan was written prior to the second oil shock and had to be amended subsequently through Sessional Paper No. 4 of 1980 and Sessional Paper No. 4 of 1982.

enterprises.[21] He chaired a second working party on government expenditures in 1982 which addressed the problems of fiscal indiscipline in macroeconomic management.[22] These latter two reports indicate a clear awareness of the adverse consequence of the decline of public sector institutions in the country. As discussed in the following section, these internal reviews did produce a framework for addressing the country's economic crisis, but whether there was sufficient conviction and political will to implement the recommendations in these reports remained to be demonstrated.

B. The Reform Period (1980-present)

(a) Political developments[23]

35. As previously stated, President Kenyatta centralized decision-making authority in the Office of the Presidency. His successor, Daniel arap Moi, who took office in 1978 and has now been President for more than 20 years, has maintained, if not increased, the concentration of power in the executive branch of government. An unsuccessful coup attempt against the Moi government in 1982 severely disrupted political and economic affairs for a time, but did not weaken the President's grip on the reins of authority.[24] A constitutional amendment was adopted in 1982 making Kenya a *de jure* single party state. In 1988 the Constitution was further amended to give the President power to remove members of the Public Service Commission, the Judicial Service Commission and the judiciary, although these provisions were later modified. President Moi also used his authority to reduce the preponderance of Kikuyu civil servants, especially in the higher ranks of the public service. His argument was that Kikuyu domination of institutions was undermining social cohesion, and that their replacement, even with less qualified candidates, was necessary to ensure stability in the country. However, this policy had the unfortunate effect of further under-mining efficiency in the public sector and, to a degree, replacing one group of rent-seekers with another, many of whom lacked the experience to run the organizations they inherited.

36. National elections under the single party regime were held in 1979, 1983 and 1988, but with greater party control over the selection of candidates than in the Kenyatta era. Still, a high rate of turnover of parliamentary seats at each election continued. To further consolidate party control over the election process, the secret ballot was replaced in the 1988 election by a system of queue voting. This proved so unpopular that only 23% of eligible voters participated. While, following a process of nationwide consultations led by Vice President Saitoti during 1990, the government decided to give up the queue voting system and to restore the independence of the judiciary, there was nevertheless growing domestic discontent with the political situation,

[21] See Republic of Kenya, Review of Statutory Boards, Government Printer, Nairobi, May 1979.

[22] See Republic of Kenya, Working Party on Government Expenditures, Government Printer, Nairobi, June 1982.

[23] For an exhaustive treatment of this subject see David Throup and Charles Hornsby, Multi-Party Politics in Kenya, James Curry, Oxford, 1998.

[24] This coup attempt was an additional serious shock to the economy as it caused a massive down-turn in private investment. It also increased President Moi's reliance on members of his own tribe.

essentially with the monopoly of political power held by KANU, culminating in riots in July 1990. The internal pressure for multi-party politics received strong support from the donor community, in particular the outspoken U.S. ambassador, Smith Hempstone.[25] The desire to see a more democratic system introduced in Kenya was one of the principal reasons for the unanimous decision by the donor community in November 1991 to suspend balance of payments support for Kenya.

37. While the leaders of government and of KANU appeared to be adamantly opposed to multi-partyism, the decision was taken in early December 1991, by a KANU national convention and by the all-KANU parliament, to amend the Constitution to allow for the formation of multiple political parties. Whether this move was made in response to donor pressures or to domestic political protests can be endlessly debated; it probably resulted from the combination of forces, but the timing undoubtedly bore some relationship to the outcome of the November 1991 donor meeting.[26]

38. This Constitutional opening led to the first genuine multi-party election in Kenya's history a year later, on December 29, 1992, following a full year of frenetic political campaigning. In the end, because the opposition split into three major and several minor parties along essentially tribal lines, because the government controlled access to the media, and because of KANU's greater access to financial resources, President Moi was reelected with a plurality of 37% of the votes and KANU remained in control of the Parliament with an initial margin of 112 seats (100 elected plus 12 nominated by the President) to 88. In the second multi-party election in December 1997 Moi was reelected with a slightly higher plurality but KANU gained only a narrow majority of Parliamentary seats over an even larger number of still-divided opposition parties.[27] In this new era of multi-party politics the political parties have evolved almost entirely on tribal lines. The inability of contending opposition factions to unite behind a single candidate, whether for the Presidency or for parliamentary seats, has been the primary reason for the continued hold on power of the ruling party. Also, personalities have been much more important than ideology or any other set of issues. While various parties have published manifestos setting out their political, social and economic goals (and generally the opposition parties have been openly in favor of economic liberalization through structural adjustment, criticizing the government for weak implementation of SAP programs) these policy documents have received little notice during the campaigns and have likely had little or no influence on voter behavior.

(b) Macroeconomic developments and growth performance

[25] For an autobiographical treatment of this period and Hempstone's role in the fight for multi-party politics, see his book, Rogue Ambassador,

[26] The decision to remove Minister Nicholas Biwott, the closest associate of President Moi, from the Cabinet and to temporarily place him under arrest in connection with the investigation of the 1990 murder of another Minister, while the November 1991 donor meeting was in progress, can certainly be ascribed to donor pressure.

[27] The smaller Parliamentary majority was due in part to a Constitutional change which provided that nominated seats would be apportioned according to all parties' shares of elected seats, rather than going entirely to the majority party.

39. The record of macroeconomic performance in Kenya since 1980 has been extremely mixed, with fluctuations in the GDP growth rate, fiscal deficit, balance of payments deficit, and inflation. In general, the best macroeconomic performance has occurred during and immediately following the periods of stronger implementation of reform measures (1986-89 and 1993-96), but all the macroeconomic indicators have not necessarily moved in unison.

40. The period begins with the attempts to adjust to the economic shocks of the late 1970s. The fiscal deficit rose to 9.3 percent of GDP in FY 1981, the balance of payments current account deficit reached 11-12 percent of GDP in 1980-81, and the inflation rate—measured by the consumer price index (CPI)—increased from an average of 12 percent in 1977-81 to 18 percent in 1982-83. These economic strains contributed to the pressures that precipitated the coup attempt of August 1982. In response the government undertook a stabilization program with IMF support which succeeded in reducing the fiscal deficit to 3 percent in FY 1983, but at the expense of investment and growth. GDP growth averaged only 2.3 percent per annum during 1982-84, with a severe drought in 1984 also adversely affecting the growth rate. For the entire 1980-85 sub-period the average growth rate was only 3.6 percent. In retrospect it seems clear that the fiscal squeeze was too great and proved unsustainable. The government was pushed by the IMF to adopt an excessively tight demand management policy.

41. Recovery in the second half of the 1980s brought the average GDP growth rate up to 5 percent, but in the 1990s the GDP growth record has been highly erratic. In the early 1990s the economy fell into severe recession, with the growth rate falling from 4.2 percent in 1990 to 0.5 percent in 1992 and 0.2 percent in 1993. With the renewed reform efforts in 1993 the economy began to recover, attaining an average growth rate of 4.2 percent in 1994-96. However, the economy has again fallen into recession in the past two years with the growth rate falling to 2.4 percent in 1997 and 1.8 percent in 1998. It is important to remember that with Kenya's past high rate of population growth—3.9 percent in the 1970s, 3.7 percent in the 1980s, and 2.8 percent in the 1990s, there has been very little improvement in per-capita incomes over the past 30 years; the annual growth in per-capita incomes, which had been a healthy 2.8 percent during 1964-70, averaged only 1.1 percent in the 1970s, 0.6 percent in the 1980s, and has been negative in the 1990s. In addition, with modest per-capita income growth over this entire period, the incidence of poverty has increased since 1980.[28]

42. On the fiscal front the record has also been mixed; it has proven difficult for the government to sustain fiscal stabilization, and there have been substantial swings in the fiscal deficit over the past 20 years. The ratio of total revenue to GDP remained fairly stable at around 22 percent from 1979/80 to 1992/93, but increased sharply to 27 percent in 1993/94, where it has remained through fiscal year 1997/98; however, expenditure growth outpaced that of revenues. Following the stabilization of 1982-84 fiscal management weakened in the second half of the 1980s, with deficits averaging over 5 percent of GDP. In the early 1990s the fiscal position remained difficult, with the average deficit rising to almost 6 percent in FY 1991-94. Inflation was contained in the mid-1980s but began to rise in the last years of the decade before accelerating dramatically in the early 1990s. Fueled by excessive monetary expansion to finance

[28] See World Bank, Kenya: Poverty Assessment, Washington, D.C., 1994.

the fiscal deficit and the 1992 election, the inflation rate rose to 34 percent in 1992 and 55 percent in 1993. But these annual averages do not convey the full severity of the situation. In the second quarter of 1993 the annualized inflation rate reached 101 percent— far beyond anything Kenya had ever experienced in the past. Money supply growth and the resulting inflation were finally brought under control in the second half of 1993, with the CPI reduced to an annualized rate of 16 percent by year's end, through the floating of massive amounts of short-term Treasury Bills at very high interest rates. This, however, has left the government with a heavy overhang of domestic debt that has risen from KSh 40 billion in 1990 to KSh 160 billion in 1998. (Another form of domestic debt is unpaid or "pending" bills for goods and services provided to the government, which have expanded from an estimated KSh 1.2 billion in 1990 to an estimated KSh 7.3 billion in January 1998.)

43. Following the balance of payments crisis of the early 1980s the external accounts were held in reasonable balance until the late 1980s when the deficit rose to around 6% of GDP on average in 1987-90. Then, in the 1991-93 period Kenya faced even more severe balance of payments problems, compounded by the suspension of donor balance of payments support in 1991. Prior to the full liberalization of the trade and exchange regime in 1993-94 the government coped with this crisis primarily by maintaining tight controls on import licenses and on access to foreign exchange, and through the accumulation of arrears on external debt. During the 1993 crisis described above, and following the partial liberalization of the exchange rate, the Kenya shilling fell from 50 to the US dollar at the end of 1992 to 81 in July 1993 before stabilizing and then strengthening dramatically as the liberalization led to a massive inflow of foreign exchange, much of which was of a short-term speculative nature.

(c) Overview of economic policy reforms undertaken during the period.

44. The concept of "structural adjustment" comprising a set of economic reform policies, and the promise of donor support for these economic reform programs, was introduced in 1979 [29] The basic objectives of SAPs, as initially conceived, were to restore developing countries to macroeconomic stability following the disruptions of the 1970s, primarily the two oil shocks, and to revive economic growth through increased resource mobilization and improved efficiency of resource utilization. Efficiency gains would be achieved through greater reliance on market forces and on the private sector and, in most developing countries, by reducing the role of government in the economy. This meant "getting the prices right"—eliminating market distortions, increasing competition in the domestic economy through deregulation of the private sector while phasing out public sector monopolies in specific markets such as the supply of agricultural inputs and outputs, credit, and foreign exchange, and privatization of commercial state enterprises. SAPs also called for eliminating barriers to foreign trade and foreign investment—promoting export-led growth instead of import substitution by reducing protection and controls on access to foreign exchange, adopting a flexible exchange rate policy, and possibly providing additional incentives for exporters. As SAPs have evolved from this essentially "quick fix" approach of the early 1980s their scope has expanded to include

[29] World Bank President McNamara announced the Bank's intention to launch a new program of lending in support of structural adjustment at the Manila UNCTAD conference in April 1979.

institutional reforms and the social aspects of adjustment, *e.g.,* the impact of budget rationalization on the allocation of resources to the health and education sectors. However, SAPs have only a medium-term focus, and are not intended to deal directly with more fundamental development priorities such as poverty alleviation, reducing unemployment, and human capital development.

45. Much of aid conditionality in the 1980s was focused on persuading sometimes reluctant governments to adopt and then implement this policy framework of liberalization and reorientation of the government's role. While it was initially assumed by the WB/IMF that SAP programs could be implemented, and growth momentum restored, within three to five years, this proved to be excessively optimistic for almost all developing countries. For such countries, many facing more severe economic crises than Kenya, the total SAP reform agenda proved to be extremely demanding. Undertaking major policy reforms simultaneously across the entire span of the economy proved beyond the capacity of many developing country governments, even if the need for the full package of reforms was generally accepted. Furthermore, even a well designed and faithfully implemented program could be thrown off track by a decline in the terms of trade, adverse weather conditions, public resistance, or political shocks such as the 1982 coup attempt in Kenya.

46. Since 1980 Kenya has been carrying out, with varying degrees of success, a comprehensive SAP program. Virtually all of the macroeconomic and sectoral policy recommendations found in SAPs in other countries can be found in the Kenyan program. In the Kenyan context structural adjustment meant unbundling the pervasive control system and reducing the prominent role of government in the economy. In Kenya there has been much less ideological bias against liberalization than in most other SSA countries. Indeed by the late 1970s, as suggested earlier, technocrats and advisers in the Kenyan government were already advocating greater reliance on markets, removing or reducing controls on key prices, and improving efficiency in the public sector as part of the approach to dealing with the growing economic crisis. The Kenyan government and the World Bank were already working in 1979 on an industrial sector policy operation intended to support the outward-oriented industrial development strategy set out in the 1979-83 Development Plan. This industrial sector operation, with only slight modifications, became the first structural adjustment credit to Kenya (SAC I). The focus was on reducing protection of the manufacturing sector and promoting manufactured exports. The primary policy actions were replacement of quantitative restrictions on imports (QRs) with equivalent tariffs and rationalization of the tariff structure to reduce the wide variations in effective protection to different industries. An IMF program, focused on fiscal and monetary management, was negotiated in 1979 but was canceled because of the government's failure to meet the agreed credit ceilings and replaced by a new program in October 1980.

47. Following these initial operations the government entered into a continuing series of adjustment programs with the World Bank and IMF between 1982 and 1996. The policy framework throughout emphasized macroeconomic stabilization through fiscal and monetary and exchange rate management, the purview of the IMF, and trade liberalization supported by the World Bank. But the policy agenda also encompassed interest rate deregulation; domestic price decontrol; cereals market liberalization; decontrol of markets for agricultural inputs and other

agricultural outputs such as meat, dairy products, cotton, and sugar; export incentive schemes; reform of financial sector management and regulatory reforms, even family planning and financing for reforms in the health and education sectors. Midway through the first decade of structural adjustment the Kenyan government articulated its analytical framework for this comprehensive reform program in SP #1 of 1986, Economic Management for Renewed Growth, referred to earlier. This paper presented the broad outlines of the increasingly liberalized economy that was to take shape in the 1990s.[30]

48. Throughout the entire SAP period the timing and sequencing of the various reform measures varied significantly. For example, in the area of public sector management, while the case was made, in the government working party reports issued between 1978 and 1982, for civil service reforms and SOE reform/divestiture, these problems were not confronted until the 1990s. Also, the pace of implementation of reforms has been extremely uneven, both with respect to different policy reform areas and to time periods, with sub-periods of steady, and sometimes rapid, progress followed by stagnation and occasional reversals. Therefore it is difficult to come to an overall judgment regarding Kenya's performance as a reformer, or to compare Kenya with other reforming countries in SSA. As discussed further below, if one sums up all of the reforms in economic policy carried out over the past twenty years the extent of change is impressive, with backtracking only on trade liberalization (for valid reasons in 1980-82), in cost sharing and in cereals market reforms. However, if one looks at the length of time required to achieve various reforms in relation to the government's own time-table or to the specific conditionalities of adjustment operations, as most critics have done, Kenya can be made to fit the mold of a reluctant reformer whose overall record has been no better than the SSA average.[31] The distinct phases of the reform effort in Kenya are summarized in text Table 3 below.

TABLE 3
STAGES IN KENYA'S STRUCTURAL ADJUSTMENT PROGRAM

PERIOD	DESCRIPTION
1980-83	Loss of fiscal discipline followed by successful, but possibly too abrupt, macro/fiscal stabilization; fiscal control restored by FY 1983; start of flexible monetary and exchange rate policy; beginning attempts at trade liberalization but limited success because not well coordinated with macro policies; little progress in cereals market liberalization.
1984-85	Hiatus in reform efforts and in donor balance of payments support.
1986-91	Government SP#1 of 1986 defines policy objectives. Period of *sectoral* adjustment programs in agriculture, industry, trade, finance with renewed donor support; slow but steady progress in domestic price decontrol and trade liberalization—further elimination of QRs, tariff reform; more active

[30] A precursor of this important policy statement was a speech by President Moi in September 1982, shortly after the coup attempt, in which he admitted that the government had been too involved in economic affairs and stated that the private sector should henceforth assume a greater role.

[31] Kenya,s mixed record on the implementation of policy reforms led Gurushri Swamy to entitle her report on Kenya's adjustment performance, "Kenya: Patchy, Intermittent Commitment." See Swamy in Husain and Faruqee (1994). See also the chapter on Kenya in Mosley, et.al., Aid and Power, Vol II, in which Kenya receives a low score on implementation of reforms in the 1980s.

	exchange rate management; liberalization of interest rates; improvements in management of financial sector; some initial steps in cereals market liberalization; but decay in fiscal discipline.
1991-93	Slowing of reform effort; reversals of cereals market liberalization but continued progress in domestic price decontrol, tariff rationalization plus introduction of ad hoc measures for limited liberalization of foreign exchange market. But weak overall reform efforts, growing political problems and donor concerns over governance and corruption lead to suspension of balance of payments support from November 1991 to mid-1993.
1993-95	Resumption of reform effort, particularly trade and exchange rate policy; complete liberalization of foreign exchange market, end to import licensing, further tariff reform; completion of domestic price decontrol; only limited progress in reform/privatization of state-owned enterprises, civil service reform. Resumption of donor balance of payments support from mid-1993.
1996-98	Again, slowing of reform effort. Government maintains liberalized trade and exchange regime, interest rates, decontrol of domestic prices; fiscal and monetary policy are reasonably well managed, but structural problems in budget, state enterprise sector, civil service, agricultural sector institutions not adequately dealt with. Result is suspension of new IMF ESAF in July 1997, cancellation of WB SAC in June 1998.

(d) The path and sequencing of specific reforms

(i) Macroeconomic management (fiscal policy and inflation)

49. In this section we examine fiscal policy, monetary and interest rate policy, and the decontrol of domestic prices. These were all important components of the government's structural adjustment program throughout the period, and were core elements in the conditionality of World Bank and IMF adjustment operations. Under the implicit division of labor between the WB/IMF the Fund took responsibility for negotiating conditionalities relating to total government spending and the fiscal deficit, credit ceilings and overall monetary policy, while the Bank's programs dealt with the composition of public expenditures, in particular the development budget, budgetary management reforms, monitoring of external debt, and financial market reforms. Interest rate policy was treated jointly.` Normally the Bank would require that the overall macroeconomic situation receive IMF endorsement before releasing structural adjustment funds, particularly for sectoral adjustment operations for which the Bank did not always conduct its own macroeconomic assessment. However, this has not always been the case.

50. The government's growing fiscal problems were thoroughly analyzed by the 1982 Working Party on Government Expenditures led by Philip Ndegwa, which analyzed the expansion in overall government spending, the rising share of the wage bill, and growing inefficiency in the public sector, including the public enterprises. The report made a strong case for improved fiscal management, and recommended that the bulk of the fiscal adjustment should be achieved through expenditure reductions—restricting government functions, limiting

recruitment into the public services, improving efficiency in managing recurrent expenditures, and introducing cost sharing for government services in higher education, health care, roads and agricultural support services. On the side of the development budget the report argued that no project should be included in the budget without an assessment of its recurrent cost and staffing implications, and that no project should receive public funds unless it had been included in the budget. In its comprehensive and frank assessment of public finance issues, and its cogent recommendations, this June 1982 report anticipated virtually all of the issues later raised by the World Bank in its series of Public Expenditure Reviews in the 1990s. The timing of the publication of this report was unfortunate, however, since it appeared only a few months before the August 1982 coup attempt; for this reason as well as other political factors little action was taken on most of these proposals until some years later.

51. As indicated earlier, the government did undertake, with IMF urging, a strong stabilization program during 1982-84 which succeeded in sharply reducing the fiscal deficit. However, in the second half of the 1980s the government was less successful in managing fiscal policy; IMF program targets were often not met, the fiscal balance deteriorated and inflation accelerated. While donor budgetary support covered a substantial part of the annual deficit there was a slow accumulation of domestic debt in the form of Treasury Bills which grew to KSh 40 billion in 1990 as mentioned earlier. Some observers have characterized the first half of the 1980s as stabilization without much structural adjustment and the second half as structural adjustment without adequate stabilization. Fiscal policy weakened further in the early 1990s with the fiscal deficit rising to over 7 percent of GDP in fiscal year 1993. However, since that time the deficit has been substantially reduced, averaging only 1.2 percent over fiscal years 1995-1998. The decision of the IMF to suspend the 1996 three-year ESAF arrangement in July 1997 was not because of disagreements regarding the size of the overall budget deficit.

52. Monetary policy was both rigid and passive throughout the 1960s and 1970s. Interest rates were fixed and the Central Bank of Kenya (CBK) had as its primary function the accommodation of the deficit financing requirements of the government through the sale of Treasury Bills. (For many years the Treasury was heavily subsidized as Treasury Bill rates were pegged well below inflation.) In fact, interest rates have not been utilized as a primary tool for economic management in Kenya. The government imposed fixed minimum or maximum interest rates on the financial sector throughout the period up to 1990. In the 1970s the minimum rate on savings was gradually increased from 3% in 1974 to 10% in 1981-82, but this minimum rate remained negative in real terms throughout the period. Over the same time span regulated maximum lending rates were allowed to rise from 10% to 16%, but were also negative in real terms in most years. Finally, in the 1980s the government and the CBK, under its new Governor, Philip Ndegwa, adopted a more flexible and market-based interest rate policy, with more frequent adjustments in savings and lending rates to reflect inflation. From 1984 real lending rates at least remained positive. One of the objectives of the World Bank's 1989 financial sector SECAL was the full liberalization of interest rates. By 1990 the minimum rate on savings had been raised to 12.5% and the maximum lending rate to 19%, but with banks permitted to charge additional fees which meant that lending rates were *de facto* freed. Treasury Bill rates were allowed to float from November 1990 and in 1991 all interest rates were fully deregulated.

53. Despite the progress made on interest rate deregulation, other aspects of monetary policy and monetary management deteriorated in the late 1980s and early 1990s, following the replacement of Philip Ndegwa as Governor of the CBK by Eric Kotut in 1988. The quality and effectiveness of bank supervision declined, adherence to prudential regulations was lax, a number of smaller banks failed and had to be put into receivership, or were propped up with public funds, and growth in the money supply began to outpace demand. In the second half of 1992 the money supply expanded at an annualized rate of 63 percent (for the full year growth was 34 percent) against an IMF program target of 10 percent, fueling the inflation that peaked at an annualized rate of 101 percent in the second quarter of 1993. As the money supply/inflation situation appeared to be spiraling out of control in early 1993 the government initially rejected IMF advice to mop up excess liquidity by selling Treasury Bills at a fixed interest rate of 45 percent, but two months later opted to auction Treasury Bills at market-determined rates which briefly soared to over 80 percent. By late 1993 the financial crisis was contained and Treasury Bill rates had declined to the 20-30 percent range where they remained for a long period before falling further to a range of 7-15 percent in 1999.

54. Another policy variable treated here is decontrol of prices. As discussed earlier, pervasive price controls had become an important part of Kenyan economic life in the 1970s and early 1980s. The prices of almost all goods were controlled under either the General or the Specific Price Control Orders (GPCO and SPCO) established under regulations dating as far back as 1956 and amended in the Price Control Act of 1972. The coverage of the SPCO was extended four times during the 1970s; the GPCO was first introduced in 1971 as a temporary measure but was made permanent in 1974. The system was complex and bureaucratic; businesses often experienced long delays in obtaining clearance to raise prices. At the same time, the cost-plus principles employed in justifying price increases did not promote economic efficiency. Price controls were one of the two primary concerns of the business sector, the other being the import and foreign exchange control system. By the 1980s there was growing sentiment even within government for reducing or eliminating price controls, although the 1979 and 1982 working party reports did not explicitly mention price decontrol, and SP #1 of 1986 only made reference to "streamlining" of price controls. However, following the publication of SP #1 quite rapid progress was made in reducing the number of goods controlled under both general and specific orders, usually by listing the goods to be decontrolled in the Finance Minister's annual budget speech. By 1994 all price controls had been eliminated. This was one of the more successful efforts at policy reform which was possible because of a small group of technocrats within the key Ministries who continued to chip away at the issue year after year, and because of the strong support for decontrol from the private sector.

(ii) Trade Policy

55. Trade policy has been a central aspect of structural adjustment reforms in Kenya since 1980. While progress in liberalization of the trade regime has been sporadic, with periods of significant progress followed by slower movement and even reversals, the final position achieved following the major reforms of 1993-94 has brought Kenya firmly into the group of developing countries with the most liberal trade and foreign exchange regimes. In contrast to the pervasive controls maintained through the 1970s and 1980s and even into the early 1990s, and the

inefficiencies and rent-seeking which the control system perpetuated, the current situation can be regarded as a revolutionary change.

56. As with other aspects of the structural adjustment program, there was a division of labor between the World Bank and IMF in dealing with the external trade and payments system. Conditionalities relating to the overall balance of payments gap and its financing, and the exchange rate, were incorporated in IMF programs, while quantitative restrictions on imports, tariffs, and foreign exchange licensing were incorporated in policy agreements with the World Bank. This did not always lead to perfect coordination of policy advice or the timing of policy actions. As mentioned earlier, the Bank's SAC I in 1980 evolved out of a proposed industrial sector operation, the objective of which was to support the policy shift from import substitution to export expansion enunciated in the 1979-84 Development Plan. This decision was initially made operational in November 1981 with the adoption of a program for the removal of "no-objection certificates" from domestic producers, a phased replacement of QRs with equivalent tariffs, and subsequent tariff reductions and rationalization. At the same time the level of export compensation, intended to offset tariffs and other taxes on imported inputs, and established in 1974 at 10 percent, was raised to 20%. However, with the fiscal and balance of payments deficits not yet under control, trade liberalization had to give way to macroeconomic stabilization and the program was suspended in mid-1982. Export compensation was restored in December 1982, but at the original rate of 10 percent. The remaining components of the trade liberalization program were reinstated in late 1983 but progress from that point was slow; QRs still applied to approximately 50 percent of imports in 1986 and rates of effective protection had been modified only slightly. The removal of no-objection certificates was the one clear success of SAC I.

57. In retrospect it was unwise for the Bank to push for a rapid pace of import liberalization in the face of large macroeconomic imbalances, and at a time when the exchange rate was not yet being used to close the trade gap. (More active exchange rate management, urged by the IMF, had begun from 1982 under new CBK Governor Philip Ndegwa, with the introduction of a crawling peg in 1983, but the early, modest nominal devaluations were overwhelmed by domestic inflation.) The response to this initial effort at trade liberalization was disappointing. The share of exports of goods and services in GDP, which had declined steadily from 45 percent in the mid-1960s to around 30 percent in 1980-81, fell further during 1980-85. This weak response was undoubtedly due in large part to the global recession of the early 1980s, but must also be attributed to the limited amount of import liberalization and export incentives actually implemented and the on-off nature of the reform process.

58. The second push to liberalize the trade regime began in 1988 and was more successful. SP #1 of 1986 made a strong case for export-promotion over import-substitution. Another reason for success may be the fact that a World Bank study on the structure of industry and of effective protection provided a better information base for setting tariffs than had previously existed. In the event, steady progress was made in eliminating QRs and in reducing tariffs; between 1987/88 and 1997/98 the maximum tariff was reduced from 170 percent to 25 percent, the number of tariff bands was reduced from 24 to 4, and the average tariff was lowered from 49 percent to 17 percent. Also, a more active exchange rate policy was implemented in the second half of the 1980s. Kenya's terms of trade declined by about 50 percent from the mid-1970s to 1990, and this

was partially offset by a 40 percent depreciation in the real exchange rate in 1985-90. Export compensation was raised again to 20 percent in 1985 and manufacturing under bond was introduced in 1988. In this period there was a strong supply response to liberalization; between 1986 and 1991 the quantum index of exports rose on average by 10 percent per year. (Horticultural exports, which remained relatively free of any government interference, expanded seven-fold during the 1980s.)

59. The area which proved most difficult to reform was the import and foreign exchange licensing system. The licensing procedures, involving both the Ministry of Commerce and the CBK, were cumbersome and open to rent-seeking. Long delays in issuing both import and foreign exchange licenses led to a build-up in the queue of applications in the late 1980s and to the defensive reaction in the business community of submitting multiple applications for the same imports. The inability of the authorities to meet all legitimate requests for foreign exchange forced business firms to hold large inventories which raised costs. And the inability to obtain foreign exchange for remittance of dividends to foreign shareholders was a constant source of frustration for foreign investors.

60. The World Bank financed EDP, introduced in 1990, set as an objective only improvement in the management of the import and foreign exchange licensing systems, not their elimination. And little progress was being made in achieving even this limited goal during the difficult years 1991-92. Still, while the government was moving slowly and reluctantly to meet the EDP conditionalilties, it did take independent steps to open a legal parallel market for foreign exchange. In October 1991 foreign exchange bearer certificates which could be resold to private parties were introduced and currency declaration forms were abolished in November 1991. In August 1992 100 percent export retention accounts were permitted for exporters of non-traditional goods and the import licensing regulations were revised to permit automatic issuing of import licenses to those holding their own foreign exchange. In November 1992 the export retention scheme was extended to provide 50 percent retention for traditional exporters, and was further expanded to cover the services sector in February 1993. These partial liberalization measures, while welcomed by the business community, did not attack the fundamental structure of the import and foreign exchange licensing system. This fundamental reform came about as part of the wave of trade and domestic market liberalization and financial sector reforms that began in mid-1993, on the heels of the financial crisis in the first half of the year. Within a year from the initiation of these new reforms virtually all transactions in both the current and capital accounts of Kenya’s balance of payments had been fully liberalized.

(iii) Public Sector Management

61. In this section we focus briefly on two reform areas within public sector management—civil service reform and the reform and privatization of state-owned enterprises. These are adjustment issues which the Kenyan government has only begun to address in the 1990s; they did not feature at all in the policy dialogue or conditionality surrounding the structural adjustment program during the first decade of reforms.

62. **Civil Service reform**. In the 1960s and 1970s the Kenyan public service was relatively well paid and the government could attract qualified staff. In addition, following a recommendation a 1970/71 Commission of Inquiry, civil servants were permitted to have private business interests so long as these were publicly declared.[32] This controversial measure has over its lifetime been subject to much criticism on the grounds of conflict of interest, despite the adoption of a code of ethics for civil servants in 1979. However, permitting outside sources of income did provide a limited offset to a long-term decline in public sector real wages, which fell by some 65% between 1970 and 1994. The falling real wages were a direct result of much more rapid growth in public sector employment than in available resources. Throughout the 1970s and 1980s public employment grew much faster than the economy or the government budget. For example, in the 1980s, despite uneven growth of the economy and increasing fiscal constraints, civil service employment continued to grow at 7.4 percent per year, rising from 160,000 in 1979 to a peak of 277,600 in 1989. The overall share of the public sector in total wage employment rose from 32 percent in 1964 to 50 percent in 1991. Contributing factors to the excessive growth in the civil service were a government guarantee of employment to anyone passing through a government training institute and a *de facto* guarantee of a public sector position to all university graduates. (This latter policy was discontinued in the late 1980s, when it was clearly no longer sustainable in the face of a government decision to implement a five-fold expansion in university enrollment.)

63. While the Kenyan government in the 1980s was facing growing budget pressures arising from the total civil service wage bill, at the same time that falling real wages made it more difficult to fill professional and managerial positions, the problems was less serious for Kenya than for most other SSA countries. The large amount of budgetary and balance of payments support which the government was receiving in the second half of the 1980s also made it easier to avoid confronting the problem in any fundamental way. Furthermore, retrenchment, or even the cessation of new hiring, was politically sensitive given the high and growing urban unemployment problem. Instead the government used workshops, task forces, review commissions, etc., essentially as a means of buying time and avoiding action.

64. By 1993, however, action on this issue had become imperative, in large part due to the fiscal dimensions of the economic crisis that erupted in the first half of that year. A civil service reform program was launched in 1993, supported by the World Bank, UNDP and several bilateral donors, but progress to date has been limited. A central component of the program has been the retrenchment of workers in the lower wage categories through a voluntary retirement incentive scheme; some 50,000 low-wage employees have been retired between FY1993 and FY1998, contributing to a reduction in the overall civil service rolls to 214,000 in 1998. However, in terms of total public sector employment these retrenchments in the civil service have been largely offset by expansion in the employment of teachers. The civil service reform program has also achieved the computerization of the employment rolls and the payroll and has been fairly successful in eliminating "ghost workers." Other, other more fundamental components of the program, such as a comprehensive review, Ministry by Ministry, of the

[32] See Republic of Kenya, Report of the Commission of Inquiry (Public Service Structure and Remuneration Commission), Government Printer, Nairobi, 1971. This Commission was chaired by then CBK Governor Duncan Ndegwa.

appropriate role and functions of government, have lagged. Finally, as a corollary to civil service reform the government has moved some critical public functions, such as revenue collection under the Kenya Revenue Authority, outside the public service system in order to offer better pay and other incentives and, hopefully, to enforce performance standards.

65. **State-Owned Enterprises (SOEs).** The 1982 Report of the Working Party on Government Expenditures discussed at some length the problems of SOEs, characterizing them as highly inefficient, due to government pressure to carry out public, non-commercial functions and to employ an excess labor force, to protection from competition, declining standards of management and financial control, and to lack of proper budgetary review. The report recommended the formation of a committee to oversee the divestiture of commercial enterprises. Such a committee was established in 1983 and continued to operate until 1987, but it failed to divest anything and only produced papers that provoked a hostile reaction from the Office of the President. This was one issue on which the then Chief Secretary Simeon Nyachae[33] was not prepared to push a reform agenda. SP #1 of 1986, while emphasizing the preeminent role of the private sector, did not deal explicitly with SOEs beyond suggesting that they would have to become more efficient. The authors of SP#1 recognized that there was as yet no political support for divestiture, given the strong vested interests of leaders in continued control over these enterprises as sources of political power and jobs for constituents, as a direct source of income from appointments to the boards of corporations, and for the widespread opportunities to exploit the SOEs as a source of rents. Consequently, the SOE sector continued to expand in the 1980s rather than contract, accounting for 11% of GDP by 1990.

66. A program of enterprise reform and privatization was finally announced in 1991. Prior to that time efforts to reform or divest individual enterprises, primarily in the agricultural sector, had been incorporated in some of the sectoral adjustment credits of the late 1980s, but with very limited results. The 1991 program was the first acknowledgment by the government that the problem was a comprehensive one, involving the entire sector that had by then expanded to include some 240 enterprises. Of these 240 enterprises, 207 were to be divested with the remaining 33 retained by government as “strategic.” A policy-making board was set up under the chairmanship of Vice President and Minister of Finance George Saitoti and a privatization unit was created with competent leadership but with very limited staff. Later a unit was established in the Ministry of Finance to deal with the reform of the strategic enterprises—their arrears on taxes or other debts to government, performance plans, phasing out explicit and implicit subsidies, etc.—and later these two units were merged under a single manager. Initial progress was slow because full agreement was lacking among politicians over the objectives of the exercise and because of powerful vested interests in favor of retaining enterprises in the public sector. In subsequent years the pace of privatization picked up, with a substantial number of transactions completed, mainly for smaller firms and for those joint ventures where the private partner held a preemptive right to buy the government shares. More recently the pace of privatizations has slackened again. And badly needed reforms in the major strategic enterprises, especially the railway, port, post and telecommunications, and power company, have proven extremely difficult

[33] Nyachae’s full title was Chief Secretary, Secretary to the Cabinet and Head of the Civil Service. In this composite role during the mid-1980s he was extremely powerful.

to carry out. Within this mixed picture the one outstanding success was the reform and privatization of Kenya Airways during 1991-95.

(iv) Agricultural Pricing and Marketing

67. Another important area of Kenya's adjustment program analyzed in this report is the attempted reforms of agricultural pricing and marketing. This has been perhaps the most difficult and contentious area of policy reform throughout the entire period of structural adjustment, the area of economic policy which has created the most misunderstanding and ill will between donors and government, and probably the area where the gap between agreed policy conditions and implementation has been the greatest. However, given that the extensive interventions of government in agricultural pricing and marketing are long-standing, and are tightly linked to the basic structure of the Kenyan economy, and given that prior efforts at reducing the government role had proven unsuccessful, it is not surprising that the problems encountered during the structural adjustment period proved so difficult for all parties involved.

68. As described earlier, the government had established a number of public or quasi-public institutions that operated as monopolies or regulatory bodies in agricultural markets. Many of these evolved from organizations created in the colonial period, such as the Wheat Board, which were established to serve the interests of the large-scale settler farmers. The most deeply entrenched of all of these institutions has been the National Cereals and Produce Board (NCPB), established in 1979 as the successor to the Maize and Wheat Boards, which has been for many years the monopoly buyer of maize, the basic food grain of the Kenyan diet, produced by large, medium and small-scale farmers. The NCPB monopoly was sustained by tightly restricting inter-district movement of cereals by private traders. NCPB paid a high fixed price, normally in excess of export parity, and guaranteed to purchase all maize supplied. The government controlled the price of maize at producer, wholesale and retail levels. In order to maintain "affordable" prices for urban consumers the government subsidized the price of maize in urban markets, in effect covering NCPB's losses in purchasing, storing and marketing maize and smaller amounts of wheat and other food crops. This usually unpredictable drain on the exchequer subverted efforts to maintain fiscal discipline. On the other hand, because of its dependence on government subventions through the annual budgets, NCPB often suffered cash flow problems. Despite these problems, NCPB made every effort to assure prompt payment to large-scale farmers in order to maintain their political support. But small farmers might have to wait months for payment, or might have to pay a bribe or sell at a distress price to larger farmers. This was often a critical problem for poor farmers who needed immediate cash to purchase inputs, pay debts, purchase other foodstuffs, and pay school fees.

69. Because NCPB was inefficient its losses were often heavy, and frequently exceeded the amounts included in the annual budgets for subventions to NCPB. By 1987 the accumulated debts of NCPB were equivalent to 5% of GDP. For these and other reasons, including corruption within the organization and the desire within parts of government, particularly in the Ministry of Finance, to reduce the direct cost to government of maintaining the cereals monopoly and to promote the private sector's role in agricultural marketing, there were frequent proposals to downsize, privatize, or end the life of NCPB. In fact, seven studies of the cereals market were

carried out by special commissions of inquiry between the end of World War II and the 1980s, and all of them recommended reducing the role of the state in grain marketing, but these recommendations were not followed; inter-district movements of maize continued to be tightly controlled. The World Bank had attempted to promote limited deregulation of the cereals market through agricultural projects in the 1970s, but without success.

70. Liberalization of the grain market became stated government policy in the 1979-84 Development Plan and in a 1979 Sessional Paper on National Food Policy. On the basis of these policy statements dedicated officials in the Treasury such as Harris Mule encouraged the World Bank to make another effort at supporting liberalization, and cereals policy became a component of SALs I and II. When the straightforward approach did not work in SAL I the Bank and government agreed, in SAL II, that the government "would undertake a review of maize marketing and implement its recommendations." When this was not accomplished by the time of anticipated second tranche release the Bank held up the release for nine months, finally agreeing to release the tranche on government assurance that the agreement would be carried out. It was, but only to the letter, and subsequently controls were reimposed. It was primarily this failure that led to the decision by the World Bank not to proceed with a SAL III.

71. The Bank returned to this issue in both ASAO I and II. ASAO I called for the restructuring of NCPB but this was not carried out.[34] ASAO II called for the introduction of annual performance contracts for NCPB, and provided for the gradual liberalization of inter-district maize movements, starting with waiver of the permit requirement for movements of up to 44 bags (one lorry load), then moving to 88 bags, and so forth. Permission to move 44 bags without a permit was announced in April 1991 by the Ministry of (Agricultural) Supplies and Marketing, but was revoked in July 1991 by NCPB. The gradual deregulation was put back on track in early 1992 but canceled in November by a decree of the President that cited the fear of a worsening drought as the rationale. At this point the World Bank canceled the second tranche of ASAO II.

72. Both the Bank and the government have been criticized for the failure to achieve meaningful reforms in cereals marketing during most of the SAP period.[35] On the other hand, Paul Mosley suggests that the result should have been expected, given the record of past experience with this policy issue.[36] Since 1992 some progress has been made in opening up the cereals trade to private traders and in reducing the role of NCPB. But it is legitimate to ask whether the final achievement is commensurate with the efforts expended over so many years by the World Bank and reformers within the Kenyan government. In retrospect it might be questioned why the World Bank in particular was so consumed with cereals market liberalization, or indeed the liberalization of other agricultural markets in Kenya, given that the

[34] One problem was that while the World Bank and USAID were trying to influence the Kenyan government to reduce the role of NCPB other donors were financing a major expansion of its facilities and staff. NCPB expanded its staffing three-fold between 1980 and 1987.

[35] Paul Collier comments, "Consider, for example, the astonishing story of relations between the Government of Kenya and the World Bank. During a fifteen year period, the Government of Kenya sold the same agricultural reform to the World Bank four times, each time reversing it after the receipt of the money." Collier, 1997, p. 60.

[36] "The World Bank was attempting, from outside the country, a feat of political muscle which had defeated all liberalizing pressures from inside for over 40 years." Mosley, Harrigan and Toye, Aid and Power, Vol. 2, p. 284.

government-introduced distortions in such markets in Kenya were much less serious than in many other SSA countries.

(e) Origins of Reforms: who were the reformers?

73. The first question to be considered here is the origin of the reform proposals that have been incorporated in Kenya's adjustment program over the past twenty years. There is no doubt that policy dialogue with both multilateral and bilateral donors, during the cycle of primarily project lending prior to 1980 and during the post-1980 era of SAPs, was important in highlighting problems and indicating approaches to their solutions. Technical assistance was also important, not least for the exposure to neoclassical economics which it provided to large numbers of Kenyan technocrats, including most of the key actors mentioned below. Technical assistance was also responsible for providing a cadre of economic advisers to the core economic Ministries and agencies throughout the post-independence period. Individual advisors or advisory teams in the key economic bodies—Finance, Planning and the CBK—have been funded during more than thirty years by the Ford Foundation, UNDP, SIDA, the UK, the World Bank, and a few other bilateral donors. While they were always few in number, several of these advisers, having gained the full confidence of their counterparts in government, have remained involved with the country over a span of many years and have thereby had a continuing influence on the direction of policy thinking. An important point to be made, so far as economic policy reform is concerned, is that is not the total dollar amount of technical assistance that the country has received which is important. Rather it is whether within this overall total there has been funding for needed advisory personnel in the central economic agencies, whether these funds have been employed to engage competent and committed advisers, and whether their advice has been effectively utilized. While the overall record of Kenya and its aid donor partners in utilizing TA across the full range of government functions can be criticized, a few influential advisors have had a positive impact on the economic policy making process in the Kenyan government.

74. While the priority given to various economic policy issues may have been influenced by outsiders, it is nevertheless clear that most of the reform agenda which has been under implementation over the past twenty years has been developed internally. Despite the progressive weakening of the civil service over a long period due to falling real wages and politicization, Kenya has always had a core of competent technocrats who could analyze the country's economic problems and propose solutions. And the economic crises at key points in Kenya's post-independence economic development have provided openings for these technocrats, supported in their analysis by trusted advisers, to propose fundamental changes. The analysis and policy recommendations of these technocratic teams, on the full range of macroeconomic and sectoral issues, have been circulated within government in a continuing series of working party reports, reports of Commissions of Inquiry, Sessional Papers, annual budget speeches, national Development Plans and the like. Key technocrats in this process, when new policy agendas were being articulated, have included Harris Mule in Treasury and Philip Ndegwa at the Central Bank in the early 1980s, and Nyachae, Mule, Ndegwa[37] and Ryan in 1984-1986 when the second phase

[37] Philip Ndegwa, who died in 1996, was at the center of policy making in Kenya for more than 30 years. He was Permanent Secretary of Planning under Minister Mboya in the 1960s, Permanent Secretary of Finance under Minister Kibaki in the 1970s, as well as CBK Governor in the 1980s. Even after leaving the CBK in 1988 for the

of the reform effort was initiated with the preparation and publication of SP#1 of 1986. In the 1993-95 trade and domestic market liberalization and financial sector reforms key actors included Governor Cheserem at the CBK, Ryan as Economic Secretary to the Treasury, and Benjamin Kipkulei, both as a supporter of education sector reforms under the EDSAC and later of the entire reform agenda as Permanent Secretary of the Ministry of Finance.

75. An important point to emphasize is that the economic policy-formulation circle has always been of quite limited size and concentrated in the Finance and Planning Ministries and the CBK. Even within these agencies of government the policy-formulation group has been small and the internal discussion has been highly controlled and closed rather than open. Decisionmaking has been highly centralized with limited dialogue and interaction with other branches of government. For example, when SP# 1 of 1986 was under preparation in the Ministry of Finance and Planning, although there was consultation there was little interaction with other branches of the government in the later development of the policy paper due to the generally passive response to earlier consultations, with the exception of the Agriculture and Energy Ministries. While SP#1 received Cabinet approval and was presented to Parliament it was approved by Parliament with little debate. This closed and often non-transparent approach has been due in part to the desire of the core policy-makers to prevent those, either within or outside government, who were potential losers from future policy actions from mobilizing opposition in advance. To a considerable degree Kenya has been successful in this strategy of introducing and implementing policy reforms through surprise or “stealth.” But such an approach also has costs. When other branches of government, outside of the central economic agencies, have to be involved in policy implementation the failure to include them in the policy development stage could dilute their sense of “ownership” of the policy measure in question. And this failure to obtain full ownership across the government can explain some cases of good policies poorly implemented (or not implemented at all.)

76. Another limitation in the policy formulation process has been the reluctance of government to involve “stakeholders” in the development of policy options. It was mentioned above that in the era of multi-party politics since 1991 there has been little or no response of government to the economic and social policy position papers prepared by opposition political parties or political action groups. The same can be said in general about government responsiveness to the private business community, the key stakeholder group for most of the policies discussed in this paper. The business sector has made repeated efforts over the years to engage the government in economic policy dialogue, but with little or no success until recently. The key concerns of the business community for many years were price controls, foreign exchange rationing and import licensing, and taxes. The major business organizations, the Kenyan Association of Manufacturers and the Federation of Kenyan Employers, do transmit ideas from their membership to government on a regular basis, primarily by making annual submissions to the Finance Ministry in advance of the budget presentation. However, these and other stakeholder representatives have not always been satisfied that their views received an

private sector, he continued to advise President Moi and other senior officials, and served as Chairman of the Board of Kenya Airways during the period of rehabilitation and privatization of the national airline. He became active in politics in KANU in the final years of his life. He was not always a strong reformer but was an outstanding analyst of Kenya’s economic problems.

adequate hearing. Many Kenyan officials feel that the government should not discuss proposed policy changes with the business community; rather they view the private business sector as a group which is always lobbying for its own vested interests, against whom it is the government's responsibility to represent the general public interest. In 1980 a joint government-business consultative council was set up, co-chaired by Harris Mule, then Permanent Secretary of the Ministry of Finance, and Joe Wanjui, the then Chairman of the Kenyan Association of Manufacturers. While Mule was an excellent choice as chief government representative, the forum was not treated with sufficient seriousness by the rest of government, and its effectiveness soon evaporated. Only with the formation in 1992 of the Export Promotion Council, a body funded by government but with majority private sector membership on its board, including the chairman and a competent staff, has the business sector had an effective channel of communication for policy dialogue with government.

77. Another aspect of the policy-making process in Kenya has been the very limited use made of local consultants, university researchers or research institutes. Kenya has many qualified individuals working outside government who could be involved in advising government but they have been almost irrelevant in the policy-making process. This assessment can be generalized to many other areas of government activity besides economic policy. Efforts have been underway in recent years to remedy this situation with regard to economic policy analysis through the creation of new research institutions such as the Institute of Policy Analysis and Research (IPAR) and the recently established Kenya Institute for Public Policy Analysis and Research (KIPPRA) which is government sponsored but independent. Both of these institutions have received funding from the African Capacity Building Foundation.

78. Policy proposals designed by technocrats and advisers must be "sold" to politicians if they are to be adopted. In Kenya the circle of key political actors for economic policy decisions is also small. At the center obviously is the President, who must be persuaded not only of the economic feasibility but also of the *political* soundness of any policy reform proposal. The Finance Minister is also critical, of course, as would be the relevant sector Minister for policy reforms in agriculture, commerce, energy, etc. In the mid-1980s Simeon Nyachae played both technocratic and political roles as Head of the Civil Service and also Secretary to the Cabinet. He was able to use his position and his access to the President to push adoption of the 1986 SP #1 and to outflank Cabinet opposition to its implementation by ensuring that Permanent Secretaries reporting directly to him carried out the policies that were agreed for their Ministries. George Saitoti, who came into government from the University of Nairobi in 1983 as an appointed Member of Parliament and Minister of Finance and Planning, aligned himself with the reform agenda in the mid-1980s. At that time he was quite prepared to address the problems of inefficiency and high cost of government without regard for the rent-seeking privileges that had handicapped his predecessors. However, when he had to stand for election in 1988 and assumed responsibilities vis-à-vis a constituency, and then was appointed Vice President in the following year, he was able to give less of his attention to the economic reform agenda. His diminished support contributed to the slackening pace of reforms after 1989. In the 1993-95 reform episode it was clearly the new Finance Minister Musalia Mudavadi who carried the burden of confronting the 1993 financial crisis in his first months in office and then pushing through a major trade liberalization and full deregulation of domestic prices. He came into the Finance Ministry in

January 1993 without previous experience which would prepare him for the challenges he would face, but he listened carefully to his advisers, took stands on principle in support of reforms, and was not discouraged by occasional set-backs. His hand as a reformer was strengthened significantly by bringing Permanent Secretary Ben Kipkulei from the Ministry of Education to Finance, not so much because of Kipkulei's technical capacity as an economist but because of his access to the President and the President's confidence in him.

79. A question that must be considered regarding reformers and the policy reform process in Kenya is why the circle of political support for reforms has been so small. The key economic reformers have been confined largely to the Finance and Planning Ministries and the CBK. It is much easier for this group to handle reforms in their own areas—fiscal and monetary policy, financial sector management, public debt, price controls, exchange and trade policies—than it is to deal with structural issues of agricultural marketing reforms, SOE reforms and privatization, or institutional capacity building for reform implementation across the government. For success in these areas they require sustained support from counterparts in other Ministries and Departments. And this support did not develop as hoped for in response to successful reforms in the macroeconomic, trade and finance areas and the resulting positive economic outcomes. Put another way, there has not been a significant "bandwagon" effect in Kenya. Periods of stronger reform efforts have brought positive economic results, yet these results do not seem to have won sizable numbers of converts to the cause of economic liberalization. The business community has been generally but not always supportive, while the political class within government appears to have preferred guarding its options and not lining up squarely behind the reforms. One reason may be the inadequate consultation process referred to above; another may be the fact that sector Ministers and their staffs seldom see the direct benefits of donor balance of payments support in the form of additional resources for their own Ministries. In any event, Kenya's failure to build a broad constituency for reform within the government simply mirrors the experience of other SSA countries.

PART III: CONCLUSIONS: AID AND POLICY REFORMS

80 Results in Kenya. The economic results from almost twenty years of structural adjustment in Kenya must be considered disappointing. There have been periods (1985-90 and 1994-96) of reasonable recovery and respectable GDP growth, but overall the economic record has been mediocre. Structural adjustment has failed to create the conditions for a sustained recovery of GDP growth to the levels attained in the 1960s or early 1970s. Even more worrying, with the slow growth of the economy poverty has been increasing and social indicators (*i.e.,* life expectancy, child mortality, primary school enrollment, among others) have shown negative trends in recent years.

81. Underlying the ups and downs in the economic growth record since 1980 has been the failure of structural adjustment to promote a sustained recovery of private investment or exports. This finding holds for both domestic and foreign investment. One of the stated objectives of the government, following periods of lagging reforms, has been to regain the confidence of donor countries both to restore the flow of aid and to win the confidence of overseas investors, who

come predominantly from the aid-giving countries. That this has not happened is illustrated in text Table 4, which gives annual data on foreign direct investment in Kenya since 1980. Several facts stand out in this data series. First there has been a marked decline in the volume of foreign investment over this period, from an annual average of US$38 million in 1980-84 to only US$11 million in the last five year period 1992-96. It is also striking that the major reforms in the trade and exchange area in 1993-95, which should have been of particular interest to foreign investors, elicited such a weak response.

TABLE 4
FOREIGN DIRECT INVESTMENT IN KENYA 1980-1996
US$ millions

YEAR	AMOUNT	YEAR	AMOUNT
1980	79	1989	62
1981	61	1990	57
1982	13	1991	19
1983	24	1992	6
1984	11	1993	2
1985	18	1994	4
1986	33	1995	32
1987	43	1996	13
1988	0		

Source: World Bank, Global Development Finance (formerly World Debt Tables,) various years.

82. On balance there appears to be little correlation between the periods of better than average reform performance and the inflow of foreign private investment. This can almost certainly be attributed to the fact that overseas investors are also concerned with factors other than the status of a country's SAP. While overseas investors might welcome the economic liberalization which Kenya has achieved, especially in the trade and exchange field, and may be reasonably confident that reforms will be sustained, they would also be conscious of the potential instability of the exchange rate, given Kenya's high degree of aid dependency. Other factors influencing investor decisions, besides the predictability and sustainability of the policy framework, include political stability, the quality of infrastructure, and the incidence of corruption. On most of these factors Kenya has suffered from a deteriorating image in recent years. Thus, while Kenya's record of implementation of structural adjustment measures has been mixed, the disappointing economic track record of the 1980s and 1990s must also be attributed to deficiencies in these other essential prerequisites for higher investment and growth.

83. Despite shortcomings in performance and disappointing outcomes, it must nevertheless be acknowledged that Kenya has made major strides in economic reform over this period—decontrol of all prices, total liberalization of the trade and foreign exchange regime, decontrol of interest rates and progress in reforms of the financial sector and of financial institutions, to mention the major reform areas. In some areas the government has moved farther and faster than anticipated or stipulated in the conditionalities negotiated with aid donors. And these

unanticipated reforms have been “home grown” in the sense that they were developed and implemented independently. This applies to the limited foreign exchange liberalization measures introduced in 1991-92 at a time when relations with donors were strained, and the full extent of the trade liberalization measures adopted in 1993-94. However, fiscal problems have not been fully resolved, and the areas of structural or institutional reforms—civil service, judiciary, public enterprises, agricultural production and marketing agencies—have proved much more difficult.

84. While recurring economic crises over the past twenty years have provided the opening for Kenyan reformers to propose far-reaching policy changes, Kenya has proven more efficient at articulating policy reforms than in implementing them. Some of this gap may be explained by lack of adequate competence at middle and lower levels of the bureaucracy, and some by the lack of adequate internal consultation across the government. Admittedly, advanced consultations with either stakeholders or implementors is not required in every situation, and some of the most effective reforms in Kenya’s experience have been introduced by “stealth,” but the effectiveness of this approach is essentially limited to those “one-shot” reforms which can be carried out by decree and do not require an institutional structure for continuing implementation. However, some of the implementation problems can be attributed to unrealistic assessments of the feasibility of certain reforms by Kenyan politicians and technocrats and by donors. Sometimes, even when agreements were negotiated in good faith, they could not be fully implemented because of unanticipated political resistance, economic shocks or similar factors. However, in a few cases implementation problems have resulted from Kenyan officials making commitments in the full knowledge that failure to meet the agreed conditions was inevitable. Finally, some of the short-comings in Kenya’s implementation of structural adjustment measures in the past decade may be attributable to the introduction toward the end of the 1980s of the tripartite (government, IMF, WB) Policy Framework Paper (PFP) as the prerequisite for accessing the IMF’s SAF or ESAF resources. While these documents were supposed to be a statement of government policy, it is well known that in the early years of their existence they were drafted by IMF and WB staff and presented to governments for review and acceptance. It is certain that some degree of government ownership was lost in this drafting process. However, while the regularly updated PFP is still a basic document underlying a country’s adjustment program, a more participatory approach is taken today to its preparation than was the case a decade ago.

85. Donor conditionality. Kenya’s economic reform efforts, ongoing but with slow-downs and re-starts over the past twenty years, have encompassed virtually all sectors of the economy. This is true also for the donor-supported adjustment lending agreements which the Kenyan government has negotiated. Given the scope and complexity of the successive adjustment phases it is perhaps not surprising that the conditionalities attached to adjustment operations have been numerous, highly detailed and challenging. Donors, and especially the World Bank, have been criticized for the breadth of conditionality applied in adjustment operations in many developing countries, including Kenya. This overloading of conditions is often referred to as the “Christmas Tree” effect. While it has been stated over and over, and generally accepted, that conditionality should be focused on a few priority measures, putting this into practice has proven difficult.[38]

[38] An example of this problem of overloading of conditionality arose in the preparation of ASAO II. The World Bank organized a workshop with Kenyan authorities for the sole purpose of reaching an agreement on a small

When there are too many conditions it is often difficult to evaluate performance and determine whether a tranche of an adjustment support loan should be released, when, say, most conditions are met but a few are only partially met or not met at all. Other defects in conditionality include the specification of conditions in a form which is too general or too weak. For example, conditionality often focuses on studies or on developing "action plans". This approach often delays getting to any concrete action.

86. In the case of Kenya, follow-up on compliance with conditionality has been at times lax or erratic, at least in the 1980s, when release of funds sometimes occurred despite only partial or non-fulfillment of agreed conditions. The willingness of the World Bank to waive or accept partial implementation of certain conditions in SAL II and various of the late-1980s SECALs, and similar actions on the part of the IMF and other donors, almost certainly led the government to believe that full commitment to negotiated conditionalities was not required. Thus the government did not expect that something like the November 1991 aid freeze could ever occur, or if it did, it would only be a warning that would be quickly rescinded. Of course, in the 1980s Kenya represented a relative success story in Africa for the donor community, as was Ghana at the same time and as Uganda is seen today. The donor community did not want to unduly penalize one of the better African performers. However, with the end of the Cold War in 1989 and increased donor attention to good governance, human rights issues, political freedoms and corruption, the donor community came together to close ranks against Kenya in 1991. The expectation now is for full compliance with agreed conditions, with suspension or cancellation of funds as the penalty for failure, as evidenced in the IMF and World Bank actions in 1997-98. Thus, while Kenya today appears to fall at least in the middle rank of reforming countries in SSA, in terms of the full extent of reforms introduced since 1980, it is currently experiencing a sharp curtailment in total donor aid, and a virtual cessation of structural adjustment lending, due in part to weakening in the economic reform effort, but more to donor perceptions about political and governance issues.

87. Aid and reforms. Has donor financial support to Kenya given the donor community the leverage to influence strongly the shaping of Kenya's economic and social policies? Certainly Kenya has received massive amounts of aid over a sustained period of time—more than US$15 billion between 1970 and 1996. This substantial flow of financial and technical assistance has given donors leverage, but much less than the aggregate numbers might suggest. One important reason is that the amount of money which the donors disburse, through grants and loans, is greater than the amount of money which the government receives or "sees," for reasons partially explained in Appendix 2. If aid flows into the country outside the government budget, or the government has less control over the utilization of the funds provided to it, the government is presumably less influenced by aid in these cases.

88. However, the more focused question to ask is whether one specific type of aid, conditional balance of payments financing tied to the implementation of a structural adjustment program, has had a significant impact on the timing, strength and sustainability of Kenya's reform efforts. Did such aid induce the Kenyan government to adopt reforms that might not

set of meaningful conditions; however, the final document prepared in Washington was, in the eyes of the Kenyan officials, another "Christmas Tree."

otherwise have been undertaken? Certainly Kenya received massive amounts of aid in return for policy reform agreements—almost US$3 billion over the entire 1970-96 period. How effective was this aid in "buying" reforms? We would argue that at times of severe economic crisis, as in 1980-82 and 1993, the government's need for financial support was sufficiently desperate that the promise of financial support did induce the government to come to agreement relatively quickly on far-reaching reform programs. However, as already stated more than once, these agreements were not always implemented. Sometimes the probability of successful implementation was low from the outset. Other times the lenders or donors may have aligned themselves with well-intentioned technocrats who wished to achieve the results contracted for but lacked the political support to do so. It is our view, therefore, that donor aid can have an influence on the form of agreement reached and on the agreed timetable for implementation, but whether implementation is carried out depends in the end much more on domestic political and economic factors than on donor money.

89. If aid has had only limited impact on the implementation of reforms, is it possible that a large volume of aid could make it easier for a government to ride out a crisis without undertaking needed reforms? It is probable that the heavy infusion of budget support which Kenya received during the 1980s helped the government in financing the budgetary cost of civil service overmanning and public enterprise inefficiencies, thus enabling the government to defer reforms in these areas until the 1990s. Finally, can the threat or actuality of an aid cut-off induce a government to re-start a reform effort which has stalled or gone into reverse? In such circumstances the pressure of debt obligations on past ODA or commercial loans would presumably give added leverage to the donor/creditor community to induce a return to the reform program. In the early 1990s Kenya faced exactly such pressures, with mounting debt arrears to donors and commercial creditors. Yet in this case, as in other instances of weakening or backtracking on reforms, the government did not quickly respond with a renewal of reforms. Rather, a significant time lag intervened. The first hiatus in adjustment lending, following the disappointing results from SALs I and II, lasted from the beginning of 1984 to 1986. The second, the freeze in balance of payments support following the November 1991 CG meeting, lasted until mid-1993, and the mid-1997 suspension of the IMF ESAF program has persisted for over two years without a new agreement. On balance, we conclude that government ownership and political will have more to do with the timing, extent and sustainability of the reform program than does the volume of donor aid.

APPENDIX I

CHRONOLOGY OF POLITICAL AND ECONOMIC DEVELOPMENTS

May 1963	First national election, won by KANU.
December 12, 1963	Kenya’s independence from the UK.
1965	Sessional Paper No. 10 of 1965, African Socialism and its Application to Planning in Kenya.
1996	Central Bank of Kenya established.
October 1969	Banning of KPU; Kenya becomes a *de facto* single party state.
October 1973	First oil crisis.
1976-77	Coffee boom resulting in erosion of fiscal discipline; subsequent decline in coffee prices worsened balance of payments deficits.
August 1977	Break-up of East African Community and common currency area linking Kenya, Tanzania and Uganda.
August 1978	First President Jomo Kenyatta dies; succeeded by Vice-President Daniel arap Moi.
1979	Second oil crisis.
January 1980	Launch of Structural Adjustment Program, first Structural Adjustment Credit from World Bank.
May 1982	Constitution amended to make Kenya a *de jure* single party state.
August 1, 1982	Attempted coup against Moi government led by members of the Air Force.
1984	Severe drought due to failure of rains requiring massive food grain imports.
January 1986	Sessional Paper No. 1 of 1986, Economic Management for Renewed Growth.
1986-87	Coffee boom, of lesser impact than 1976/77.
November 25/26, 1991	Consultative Group meeting in Paris at which decision is taken by donors to suspend balance of payments aid.
December 10, 1991	Constitution amended to permit formation of multiple political parties.
December 29, 1992	First multi-party election since independence. President Moi reelected with 37% plurality of votes; KANU wins 100 of 188 contested Parliamentary seats (plus 12 nominated MPs appointed by President.)
December 1995	Repeal of Exchange Control Act to complete liberalization of trade regime.

December 1997	Second multi-party election. Moi reelected with larger plurality than in 1992 but KANU holds smaller majority in Parliament.

APPENDIX 2

DATA: SOURCES, DEFINITIONS AND CONSTRAINTS

The concept of aid used in this study is that for “Official Development Assistance” (ODA) as defined by the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD). ODA comprises both direct financial aid and technical cooperation or technical assistance (TA). The latter consists largely of grants to nationals of aid-receiving countries for education or training, often conducted outside the national’s country, and the cost of consultants, advisers, administrators, teachers, etc., hired to work in the aid-recipient country, as well as equip-ment furnished to facilitate the transfer of skills, technology and experience. ODA comprises both grants and concessional loans for development purposes; the DAC considers concessional loans to be those having a grant element of at least 25 percent based on a discount rate or opportunity cost of 10 percent. Gross ODA measures total disbursements of aid, both grants and loans, to a country from all aid-giving sources in a given calendar year, as reported to the DAC by the donor country or agency. Net ODA measures disbursements minus amortization payments on past ODA loans.

In this study loan data are taken from the reports of the recipient countries to the World Bank’s Debtor Reporting System; grant data are from the OECD/DAC. This enables us to break down the loan data into the purposes of the loan, *i.e.*, for projects in various sectors or for balance of payments support—structural adjustment lending. The DAC data for grants can only be subdivided into financial aid and technical cooperation. While this mix of dual sources for loan and grant data is reasonably consistent with the DAC data for gross and net ODA, including both grants *and loans* reported to the DAC by donors, there are problems presented for the analysis carried out in this paper. The first is that because we cannot break out grant aid for balance of payments support our estimate of the total amount of structural adjustment or policy-based lending is an understatement. It is likely that in addition to the US$2.8 billion of multilateral and bilateral *lending* for structural adjustment over the past 25 years there has been several hundred million dollars of *grant* assistance for this same purpose from bilateral donors. However, we do not feel that this lack of information negates our basic conclusions regarding the influence, or lack of influence, of donor aid on policy reforms. Second, and possibly offsetting to some extent the lack of data on grant support for policy reforms, we have included under balance of payments aid all loans not linked to projects in specific sectors. This includes loans categorized as “Balance of Payments Support” and as “Contribution to Financing Current Imports.” It is possible some of the lending in this latter category, amounting in total to some US$140 million over the entire 1970-96 period, may not have been linked directly to economic policy reforms. However, this represents only 5 percent of the total of balance of payments support, so the possible bias introduced is small. Thirdly, we have included *all* IMF drawings under balance of payments support, both the more concessional lending under the SAF and ESAF programs, and the conventional Standby programs.

It has not been possible to reconcile the DAC data from donor sources with the aid figures in the Kenyan fiscal accounts. This is unfortunate, since it could have been one way to establish the volume of grant aid support for structural adjustment. One reason is the difference in reporting periods—calendar year reporting by the DAC and World Bank and fiscal year (July 1 - June 30) for the Kenyan government. However, the problem is greater than this difference in timing. Consistently over the entire period of this study the Kenyan fiscal accounts record a significantly smaller aid inflow, particularly for project-related investments, than donors are reporting to the DAC. There are several possible explanations for this discrepancy. First, much assistance for TA does not pass to the Kenyan government but is paid directly to Kenyan students abroad, to overseas training institutions, or to the offshore bank accounts of resident advisers. Even if the donor agency is supposed to report the amount of such assistance to the Kenyan government, it is likely that a significant share of this is missed. Secondly, in the case of project aid a similar problem arises, since donor countries may procure goods offshore or pay contractors directly for work performed on behalf of the Kenyan government. Again, this should be recorded as aid furnished to Kenya, but some of it could be unreported or underreported. Third, as bilateral donor countries have converted an increasing proportion of their aid programs to a grant basis, for which they no longer require any government guarantee of repayment, they are providing a growing share of their assistance directly to non-government agencies, including churches, citizens' associations, women's groups, the private business sector, and individuals. Much of this grant aid may not be reported to the host government. Fourth, donors report to the DAC as grant aid any debt relief provided on past ODA loans; it is quite likely that the aid-receiving country does not include this as new aid received. Finally, there may simply be a tendency of donors to overstate what they are providing and for the recipient to undervalue what has been received. (This could be cited as one reason why aid has not had as much influence as might have been anticipated. If such is the case it would reinforce rather than undermine our principal thesis.)

In recognition of the fact that the DAC definition of concessional loans is arbitrary on several counts, including the use of a fixed 10 percent discount rate for all loans, and the inclusion or exclusion of the total value of loans based on the 25 percent grant element threshold, staff at the World Bank have developed an alternative concept of Effective Development Assistance (EDA).[39] EDA incorporates only the grant component, not the total loan value, of a development loan, without regard to any grant element threshold such as the DAC-specified 25 percent, but with the grant element calculated based on an appropriate discount rate related to the cost of capital in the lending country. Annual data for total aid flows to Kenya during 1970-96, measured according to both ODA and EDA concepts, are shown in Appendix 3, Table 1. It can be readily seen that EDA is substantially lower than ODA; this is because the recalculated grant element is lower for most loans than the total value of those loans which qualify under the DAC 25 percent rule.

[39] For a description of the methodology employed see Chang, Charles C., Eduardo Fernancez-Arias and Luis Serven, "Measuring Aid Flows: A New Approach, " World Bank Policy Research Working Paper No. 2050, February 1999.

APPENDIX 3

TABLE 1

TOTAL AID FLOWS TO KENYA 1970-1996 (US$millions)

YEAR	TOTAL ODA	TOTAL EDA
1970	66.1	31.8
1971	80.0	49.6
1972	141.5	92.8
1973	141.2	84.5
1974	150.7	105.1
1975	187.6	109.2
1976	258.7	147.4
1977	253.6	148.4
1978	343.4	226.6
1979	432.0	297.0
1980	480.9	370.1
1981	535.8	396.0
1982	578.0	406.1
1983	519.6	354.3
1984	655.6	416.4
1985	526.5	397.8
1986	637.1	452.0
1987	752.6	515.8
1988	954.4	737.7
1989	1091.9	798.2
1990	1615.0	1442.2
1991	1102.1	863.1
1992	987.1	798.3
1993	869.7	749.3
1994	731.3	611.9
1995	1020.9	727.1
1996	743.3	575.0
TOTAL	15856.6	11876.7

Sources: All data in current prices. Total ODA includes both concessional loans (those with a grant element of at least 25 percent according to the DAC definition) and grants. Grants include both technical cooperation and debt relief on previous ODA loans. Loan data from World Bank debt reporting system; grant data from OECD/DAC. Effective Development Assistance (EDA) from Chang, *et.al.*, “Measuring Aid Flows, A New Approach.”. EDA includes all grants plus the grant element of all development loans recalculated according to the methodology in Chang, *et.al.*

APPENDIX 3

TABLE 2

LOAN AND GRANT COMPONENTS OF ODA FLOWS TO KENYA 1970-1996

(US$millions)

YEAR	LOANS	GRANTS	TOTAL	%GRANTS
1970	35.5	30.6	66.1	46.3
1971	42.2	37.8	80.0	47.3
1972	55.7	85.8	141.5	60.1
1973	87.1	54.1	141.2	38.3
1974	77.8	72.9	150.7	48.4
1975	98.2	89.4	187.6	47.7
1976	148.8	109.9	258.7	42.4
1977	139.9	113.7	253.6	44.8
1978	168.8	174.6	343.4	50.8
1979	213.1	218.9	432.0	50.7
1980	232.1	248.8	480.9	51.7
1981	237.1	298.7	535.8	55.7
1982	317.8	260.2	578.0	45.0
1983	242.6	277.0	519.6	53.3
1984	373.5	282.1	655.6	43.0
1985	215.0	311.5	526.5	59.2
1986	287.9	349.2	637.1	54.8
1987	352.5	400.1	752.6	53.2
1988	387.3	567.1	954.4	59.4
1989	538.3	553.6	1091.9	50.7
1990	429.7	1185.3	1615.0	73.4
1991	461.2	640.9	1102.1	58.2
1992	327.5	659.6	987.1	66.8
1993	317.6	552.1	869.7	63.5
1994	227.5	503.8	731.3	68.9
1995	557.5	463.4	1020.9	45.4
1996	342.8	400.5	743.3	53.9
TOTAL	6915.0	8941.6	15856.6	56.4

Sources: See Table 1 for sources and definitions. . All data are in current prices.

APPENDIX 3

TABLE 3

GROSS AND NET ODA FLOWS TO KENYA

1970-1996
(US$millions)

YEAR	GROSS ODA	DEBT RELIEF	ODA EXCL. DEBT RELIEF	NET ODA	NET ODA IN 1995 PRICES
1970	66.1			57.5	
1971	80.0			67.0	
1972	141.5			72.3	
1973	141.2			95.8	
1974	150.7			119.4	
1975	187.6			130.6	
1976	258.7			160.0	
1977	253.6			165.2	
1978	343.4			242.5	
1979	432.0			350.6	
1980	480.9			396.5	771
1981	535.8			449.3	
1982	578.0			484.9	
1983	519.6			397.3	
1984	655.6			411.1	
1985	526,5			438.3	919
1986	637.1	14.0	623.1	458.0	775
1987	752.6	60.0	692.6	572.0	842
1988	954.4	13.0	941.4	809.0	1107
1989	1091.9	433.0	658.9	967.0	1336
1990	1615.0	84.0	1531.0	1053.0	1473
1991	1102.1	66.0	1036.1	873.0	1100
1992	987.1	30.0	957.1	894.0	1000
1993	869.7			911.0	1046
1994	731.3			677.0	743
1995	1020.9			732.0	732
1996	743.3			606.0	626
TOTAL	15856.6	700.0	15156.6	12590.3	

Sources: Gross ODA from Table 1. Debt relief data from World Bank, World Debt Tables, various years. Net ODA includes repayments of previous ODA loans. Net ODA in current and constant prices from OECD/DAC Annual Reports, Development Cooperation: Efforts and Policies of the Members of the DAC, various years.

APPENDIX 3

TABLE 4

DISTRIBUTION OF ODA TO KENYA BY SOURCE (MULTILATERAL AND BILATERAL DONORS)

US$millions

YEAR	TOTAL MULTILATERAL	TOTAL BILATERAL	MULTILATERAL PERCENTAGE	BILATERAL PERCENTAGE
1970	10.0	56.1	15.1	84.9
1971	11.0	69.0	13.7	86.3
1972	27.5	114.0	19.4	80.6
1973	33.4	107.8	23.7	76.3
1974	27.4	123.1	18.3	81.7
1975	57.4	130.2	30.6	69.4
1976	88.0	170.7	34.0	66.0
1977	73.2	180.4	28.9	71.1
1978	84.1	259.3	24.5	75.5
1979	90.3	341.7	20.9	79.1
1970-79	502.3	1552.3	24.5	75.5
1980	159.8	321.1	33.2	66.8
1981	122.1	413.7	22.8	77.2
1982	205.9	372.1	35.6	64.4
1983	157.4	362.2	30.3	69.7
1984	198.5	457.3	30.2	69.8
1985	144.7	381.8	27.5	72.5
1986	124.5	512.6	19.5	80.5
1987	188.1	564.5	25.0	75.0
1988	273.3	681.1	28.6	71.4
1989	434.8	657.1	39.8	60.2
1980-89	2009.1	4723.5	29.8	70.2
1990	333.9	1281.1	20.7	79.3
1991	242.5	859.6	22.0	78.0
1992	221.1	766.0	22.4	77.6
1993	272.8	596.9	31.4	68.6
1994	190.5	540.8	34.3	65.7
1995	280.5	740.4	27.5	72.5
1996	217.1	525.9	29.2	70.8
1990-96	1758.4	5310.7	24.9	75.1
1970-96	4269.8	11586.5	26.9	73.1

Source: See Table 1 for sources and definitions.

APPENDIX 3

TABLE 5

SHARE OF MAJOR AID DONORS/LENDERS IN ODA TO KENYA

DONOR/LENDER	1970-79	1980-89	1990-96	1970-96
World Bank/IDA	19.9%	20.4%	16.2%	18.5%
Japan	4.0	8.6	17.0	11.8
Germany	11.3	6.6	12.6	9.8
UK	17.9	9.3	5.5	8.7
USAID	6.5	9.7	8.1	8.1
Netherlands	5.8	6.6	5.0	5.8
Canada	4.9	4.7	3.8	4.3
Sweden	8.6	3.7	2.3	3.7
Eur.Comm.	1.3	4.1	4.1	3.7
Denmark	4.1	3.6	2.6	3.2
AfDB/ADF	0.9	3.0	2.7	2.6
Norway	4.2	3.7	0.6	2.4
Others	10.6	16.0	19.5	17.4
TOTAL	100.0	100.0	100.0	100.0

Sources: See Table 1 for sources and definitions.

APPENDIX 3

TABLE 6

GRANT AID TO KENYA FOR TECHNICAL ASSISTANCE
1970-1996
US$millions

YEAR	GRANTS FOR TA	TOTAL GRANTS	% FOR TA
1970-79	576.8	987.7	58.4
1980	128.0	248.8	51.4
1981	128.0	298.7	42.9
1982	116.8	260.2	44.9
1983	122.1	277.0	44.1
1984	109.6	282.1	38.9
1985	116.9	311.5	37.5
1986	156.3	349.2	44.8
1987	154.5	400.1	38.6
1988	178.4	567.1	31.5
1989	174.7	553.6	31.6
1980-89	1385.3	3548.3	39.0
1990	208.3	1185.3	17.6
1991	222.9	640.9	34.8
1992	281.5	659.6	42.7
1993	260.3	552.1	47.1
1994	192.6	503.8	38.2
1995	221.4	463.4	47.8
1996	192.4	400.5	48.0
1990-96	1579.4	4405.6	35.8
1970-96	3541.5	8941.6	39.6

Source: See Table 1 for sources and definitions.

APPENDIX 3

TABLE 7

BALANCE OF PAYMENTS AID TO KENYA
Bilateral, Multilateral and IMF Loans
1970-1996
(US$millions)

YEAR	MULTILATERAL LOANS	BILATERAL LOANS	IMF LOANS	TOTALS
1970	-	-	-	-
1971	-	-	-	-
1972	-	-	-	-
1973	-	-	-	-
1974	-	6.6	38.0	44.6
1975	16.7	3.4	59.0	79.1
1976	13.3	-	31.0	44.3
1977	5.0	0.6	-	5.6
1978	-	1.8	-	1.8
1979	-	7.1	111.0	118.1
1970-79	35.0	19.5	239.0	293.5
1980	68.4	18.5	94.0	180.9
1981	1.7	23.9	36.0	61.6
1982	83.7	18.2	166.0	267.9
1983	-	6.1	139.0	145.1
1984	50.0	59.3	47.0	156.3
1985	-	4.2	125.0	129.2
1986	-	15.6	-	15.6
1987	30.0	11.2	-	41.2
1988	95.5	5.1	176.0	276.6
1989	181.6	40.3	103.0	324.9
1980-89	510.9	202.4	886.0	1599.3
1990	145.2	5.2	136.0	286.4
1991	124.6	0.7	48.0	173.3
1992	1.2	-	-	1.2
1993	160.6	-	32.0	192.6
1994	14.6	-	32.0	46.6
1995	79.7	44.4	-	124.1
1996	79.8	-	36.0	115.8
1990-96	605.7	50.3	284.0	940.0

TOTAL	1151.6	130.4	1409.0	2832.8

Source: For multilateral and bilateral loans see Table 1 for sources and definitions. IMF loans from IMF, Annual Reports, various years, and World Bank, World Debt Tables, various years.

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