Kenya's Reform Experience: What Have We Learnt?

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Abstract

The study analyzes the reform process in Kenya focusing on economic reforms undertaken in the 1980s and 1990s. Despite the economic crises of the 1970s, the government only started market-oriented reforms in the 1980s following donor pressure. The 1980s were characterized by structural adjustment programmes—mainly import liberalization and a shift from import substitution to export-promotion strategy. However, there were minimal achievements in the period due to a lack of commitment to the reforms. Stringent conditionalities leading to suspension of donor funds ensured speedy and broader implementation in the 1990s. The International Monetory Fund and World Bank set the pace and reform agenda. Throughout the process, the civil society helped in pushing for political reforms and good governance.

Weak commitment to reforms strained the relationship between donors and government, leading to stop-go pattern in lending while reform implementation and ownership remained weak. An unsupportive political structure, vested interest groups, lack of consultations and consensus building and inherent uncertainty of the reforms caused resistance and policy reversals.

The government managed to implement several reforms, such as trade liberalization and cost sharing in the social sector, but public sector reforms remained a challenge, given their role in sustaining patronage and the political implications. Despite the reforms, economic growth was dismal, especially in the 1990s. The reforms disproportionately affected the poor, worsening the asymmetries in income. This study concludes that political institutions, stakeholders participation, and proper sequencing are important factors in the reform process.

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Abbreviations and Acronyms

AIDS	Acquired Immune Deficiency Syndrome
BOP	Balance of Payments
CBK	Central Bank of Kenya
EAC	East African Community
ECS	Export Compensation Scheme
ESAF	Enhanced Structural Adjustment Facility
GDP	Gross Domestic Product
HIV	Human Immuno Deficiency Virus
IDA	International Development Association
IEA	Institute of Economic Affairs
IFIs	International Financial Institutions
IFS	International Financial Statistics
IMF	International Monetary Fund
KAM	Kenya Association of Manufacturers
KANU	Kenya African National Union
KIPPRA	Kenya Institute for Public Policy Research& Analysis
NARC	National Rainbow Coalition
PRGF	Poverty Reduction and Growth Facility
SAL	Structural Adjustment Loan

Contents

1. Introduction

Kenya has since independence from Britain in 1963 undergone a number of political and economic phases. Like most African countries, Kenya's economy in the 1960s and 1970s was characterised by controls and a protective, inward-looking trade regime. The economy achieved an outstanding economic growth in the first decade after independence—with an average real Gross Domestic Product (GDP) growth rate of 6.6 percent between 1964-73 (Government of Kenya 2002). The 1970s were, however, marked by a series of economic crises, following terms of trade shocks and fiscal indiscipline, coupled with several structural distortions. The oil crises of the 1970s compounded problems by exposing the country's vulnerability to external shocks. This was a major blow to the import-substitution industrialisation strategy. The government in response tightened the trade regime and sought financial assistance from donors. Despite deterioration in economic management by late 1970s the government was unwilling to implement market-oriented reforms.[1]

As the economic crisis deepened, economic liberalization became the softest option for borrowing from abroad, leading the government to reluctantly embrace reforms under Structural Adjustment Programmes (SAPs) in the early 1980s. Little was, however, achieved until the 1990s when comprehensive reforms were implemented.

This study is an attempt to document an in-depth analysis of the reform process, emphasising on the key economic reforms undertaken. The paper seeks to investigate the reform process by analysing and explaining the motivation factors for reform, the role of stakeholders, especially the donor community, political and economic constraints in the implementation

[1] This paper focuses on market-oriented reforms. These generally emphasize reduction in depth and scope of government participation and favour competitive participation of private agents. For details on definition and measurement of market-oriented reforms, see Loayza and Soto (2003).

process, reform outcomes, and the success and failure of various reform attempts in the 1980s and 1990s.

1.1 Analytical framework

Economic reform is a complex, dynamic and multi-faceted process. Reform process calls for a multi-disciplinary approach, in which, at the very least, conceptual issues from political science, history and economics are involved (Fanelli, 2003). We employ the concepts of institutional and political economy, as well as foreign aid and conditionality, since the latter has been critical to Kenya's reform progress. Reform process often entails an interplay between political and economic forces. On the role of political institutions in shaping economic reform, Rius and van de Walle (2003) distinguish between "medium level" set of rules that regulate the behaviour of agents in the economic sphere and "high level" rules, which determine who has power to make policies or set regulations that influence the functioning of markets (for details see also Rius and van de Walle, 2003; Fidrmuc and Noury, 2003; Liew *et al.*, 2003; and Haggard and Webb, 1993).

The critical role of the International Monetary Fund (IMF) and the World Bank makes it important to analyse how conditionality has influenced the reform process. If the conditionalities are in the interest of the recipient countries, why are they not pursued by the policy makers? Drazen (2002) contends that a political economy perspective may be useful in understanding the issues of ownership and conditionality.

Three key questions guide the analysis: *why reform*? *What kind of reform*? and *how well did the reforms perform*? These questions basically address the context, content and outcome of reforms.

2. Political and Economic Structure Prior to Reforms

2.1 Political structure after independence

Throughout the colonial period, Kenya was seen as a unitary entity in which the colonial centre in Nairobi exercised overwhelming authority on the localities, hence the failure by the outgoing authorities to replace such a system with a loosely organized federal structure. The country had no meaningful experience with power sharing between the centre and localities in the governance process (Oyugi, 1994).

After independece, the Kenya African National Union (KANU), which favoured a unitary system embarked on a deliberate effort to destroy the opposition and the federal constitution (Tamarin, 1978). Opposition politicians—Kenya African Democratic Union (KADU)—found it difficult to operate and ultimately defected to the ruling party. The demise of the opposition was quickly followed with the dismantling of the federal constitution, which had ceased to function by the end of 1964 (Oyugi, 1994). By 1969, Kenya had become a *de facto* single-party state (Throup and Hornsby, 1998). The Kenyatta government quickly "Africanised" the civil service and other public sector appointments in order to consolidate national sovereignty (O'Brien and Ryan, 2001).

Kenyatta, who assumed leadership at an advanced age, surrounded himself with a group of trusted ministers and personalities, drawn largely from his ethnic community, the Kikuyu, who constituted the "kitchen cabinet". The group had vested interest in maintaining the presidency in the Central Province (the president's home province) to protect and perpetuate their political and economic interests, laying the foundation of deep-seated politico-economic client system. The stakes were very high, and the group orchestrated a series of manoeuvres to dilute the independence constitution (Okoth-Ogendo, 1972). The constitution was amended ten times within the first decade to enhance presidential powers over parliament.

The powers were discriminately used and senior civil servants understood they served in their positions at the pleasure of the president (Anyang' Nyong'o, 1989). The civil service, however, enjoyed more powers over routine and technical policy issues then, relative to the subsequent regime.

By the mid 1970s, Kenyatta had grown old and feeble. Without any opposition party, the inner cabinet became dictatorial, resulting to assassinations and detentions of government critics, mainly backbenchers in parliament. Corruption, nepotism and favouritism grew dramatically in Kenyatta administration's sunset years.

Daniel Arap Moi assumed power in August 1978 following the demise of Mzee Jomo Kenyatta. He quickly assured the mourning Nation he would follow his predecessor's footsteps. The new president embarked on leading the country using the same state apparatus and parliament remained subdued. Soon, Moi resorted to issuing populist policy statements and directing civil servants to implement them (Odhiambo-Mbai, 1998). By early 1980s, the constitutional amendments had created an overarching executive with immense interventionist powers in the economy (Gatheru and Shaw, 1998).

2.2 Economic background

At independence, Kenya's colonial heritage provided a variety of rent-seeking opportunities to the country's newly elected government (Ryan, 2004). The new government elites maintained and endorsed colonial institutions so as to capture the consequent privilege when expatriates were replaced by Kenyans. The colonial government had already instituted public agencies such as marketing boards to control economic activities. In the quest for economic sovereignty, the government further expanded its involvement in productive activities through state-owned enterprises (O'Brien and Ryan, 2001), a move largely motivated by *Sessional Paper No. 10 on African Socialism and its Application to Planning in Kenya*, which sought to 'Africanise' the economy and jumpstart industrialization.

There was expansion of output and employment fuelled by expansionary fiscal policy and expansion of exports to Tanzania and Uganda under the East African Community (EAC) common market (Wagacha, 2000). After the first decade's remarkable economic growth, Kenya started experiencing macroeconomic instability in the 1970s, exacerbated by a series of external shocks. In 1971, Kenya experienced deterioration in terms of trade, leading to the first balance of payments (BOP) crisis, accompanied by an expansionary fiscal and monetary policy. Following the first oil shock of 1973, the economy experienced escalating BOP and current account problems. The government's response was to institute import controls. Between 1973-75, inflation rose from 9.3 percent to 19.2 percent (Ndung'u, 1993). Then came a positive shock in the form of commodity (coffee) boom in 1977, which sparked off a spending spree for government and private consumption, leading to a fiscal deficit of 9.5 percent of GDP in 1975/76 (O'Brien and Ryan, 2001). The economy was also set back by the collapse of EAC in August 1977.

The second oil crisis of 1978/79 compounded the problems, exposing the country's vulnerability to external factors (Were *et al*., 2001). The government, still reluctant to reform reacted by tightening the trade regime and seeking external financing assistance. However, the financial assistance was not for free—certain conditionalities had to be met.

Despite the shocks, the economy performed fairly well in the 1970s, achieving a real GDP growth rate of 5.6 percent between 1974-1979. The domestic savings rate averaged 16 percent in the 1970s. However, the country had serious problems of unemployment and underemployment, income distribution and land ownership (Ng'ethe and Owino, 1998). It is clear therefore that there was need for reform from as early as the beginning of the 1970s.

3. Economic Reforms in the 1980s

According to Swamy (1994), the SAP period can be classified into two phases: 1980-84 period forms the first adjustment attempt, while 1985-90 period forms the second attempt during which a sectoral approach to reforms was adopted. These will be characterized as phase I and II of the reform process, respectively. We briefly highlight the driving forces of the reform before discussing the economic refroms in the 1980s.

3.1 Driving forces of the reform

By the early 1980s, it was clear that the macroeconomic policies pursued had glaring loopholes. At the same time, economic management had begun to weaken and fiscal indiscipline was rising, leading to inability to manage budgets. The public sector was over-extended. By the end of the 1970s, the government had equity in about 250 commercially-oriented firms (Ikiara, 2000). The large state-owned enterprises lagged behind in economic performance and heavily drained the budget. In the social sector, the overstretched public sector and increased inefficiency became a major challenge to an ambitious programme of free university education and healthcare in public institutions.

Appendix Table 1 shows some of the macroeconomic indicators during the reform process. The Table shows that in the early 1980s, when the reform process was getting initiated, the BOP and current account were hugely in deficit. In 1980, the deficits amounted to US$317 million and US$878 million, respectively. Foreign exchange reserves were scarce as exemplified by the huge negative net foreign reserves. In addition, the ratio of budget deficit to GDP in 1981 and 1982 was over 7 percent and inflation was relatively high. The economy was in a crisis demanding action. This was when International Financial Institutions (IFIs)[2] came in with a reform recipe in the form of SAPs.

[2] Throughout this paper, IFIs largely refer to International Monetory Fund and World Bank.

While initially the government resisted dismantling the control regime, the softest option of borrowing from abroad apparently demanded liberalization. Consequently, with the rising pressure from the IFIs, the government started, reluctantly, to liberalize the economy—a major component was removal of import controls and a shift from import-substitution to export-promotion strategy (Were *et al*., 2002). Kenya was the first sub-Saharan African country to receive structural adjustment lending from the World Bank and later on among the first to receive an Enhanced Structural Adjustment Facility (ESAF) loan from the IMF[3] (O'Brien and Ryan, 2001).

The reform programme was therefore driven by both domestic and external factors. The latter included pressure from IFIs in the form of conditionalities as preconditions for funding.

3.2 Phase I: 1980-84

3.2.1 Economic reforms

The first phase of reforms mainly targeted the BOP, with the removal of import controls. The government presented a structural adjustment programme in *Sessional Paper No. 4 of 1980 on Economic Prospects and Policies*. The programme suggested the need to eliminate quantitative restrictions on imports, replace them with equivalent tariffs, relax industrial protection, and the need for a relatively high interest rate structure.

With the escalating economic crisis, the government urgently needed quick-disbursement, which coincided with the World Bank's decision of medium-term BOP support (programme lending). A planned industrial sector loan was therefore converted into a Structural Adjustment Loan (SAL) by adding conditionalities, which included the replacement of quantitative restrictions with tariffs and their rationalization by 1983 (Mwega 1999).

[3] ESAF replaced Structural Adjustment Facility.

In the 1980/81 budget, some of the proposals were implemented. For example, import controls were relaxed and interest rates adjusted upwards. A new system of licensing was put in place in November 1981. It was, however, proving difficult to contain government spending and to achieve the income policy.

In 1982, the government approached the IMF again, with a request for another SAL from the World Bank. However, by mid 1982 the Central Bank of Kenya credit to the government had exceeded the agreed ceiling and the agreement was therefore suspended. The second SAL was even more ambitious, taking upon trade reforms, grain marketing, interest rates, energy and family planning (Swamy, 1994). However, the trade reforms were largely not implemented and grain marketing was not liberalized. The *Sessional Paper No. 4 of 1982* spelt out further attempts to reform import controls, where items could be removed from quota-based schedules to quota-free ones, at a rate to be determined by the availability of foreign exchange. Implementation was never undertaken because of the growing foreign exchange crisis. The individual scrutiny of import licenses was reintroduced in mid-1982.

Export promotion aimed at reducing anti-export bias and increase industrial efficiency, including simplifying the administration of incentive system, and introducing an export insurance and finance system. These were in addition to the Export Compensation Scheme (ECS) established in 1974 with the aim of compensating exporters of eligible products for the additional input costs due to the imposition of duties on imported inputs. In 1984, compensation was revised upwards from 10 percent to 15 percent for general ECS and downwards from 15 percent to 10 percent for new and additional exports.

3.2.2 Performance with the reforms

By the end of 1983, when the exercise was expected to be complete, minimal achievements and policy reversals had been witnessed. Moreover, to the extent that quantitative restrictions were removed, tariffs were raised on restricted items to even over 100 percent. In addition, with the foreign exchange crises of 1982/84, tariffs were increased by 10 percent across board. The programme was implemented without a consistent framework, such that the imposition of high or low tariffs goods was done in an *ad hoc* manner. Efforts to improve BOP position had very minimal achievements. The fixed exchange rate regime was not conducive for export promotion while the ECS did not function well—their design was flawed, as it left loopholes that could easily be exploited, therefore defeating the purpose of the reform. For example, new exporters would qualify for additional compensation merely by changing the company name. Also, the urban elite added pressure as they were thought to be a political threat if drastic changes were to be implemented.

Swamy (1994) argues that first, liberalization attempt was not successful because it coincided with a period of macroeconomic crisis, followed by rapid stabilization, therefore making trade policy to become hostage to the needs of stabilization. The phase was marked by lack of compliance, partly due to design and timing problems, and lack of government commitment to reforms. The import licensing and regulatory system created enormous opportunities for rent seeking and for executive discretion and commitment to the stated policy changes was limited to a small clique of civil servants. The reform agenda was over-ambitious and underestimated state capacity constraints in undertaking reforms within the stipulated time. Rius and van de Walle (2003) observed that the first generation of reform programmes typically did not view implementation issues as paramount. They rightly argue that state capacity is generally posited to be positively correlated with the level of development, but it would be a mistake to treat state capacity as entirely exogenous to the political system. Ethnicity, patronage, poor economic management, and excessive powers of the President compromised government's capacity to implement reforms. President Moi lacked adequate room for manoeuvre, a broad ethnic political base that Kenyatta enjoyed (Hyden, 1995). He resorted to concentrating power on the presidency and in 1982, a major constitutional amendment made Kenya a *de jure* one-party state. The presidency increasingly dominated the public policy making process, especially through presidential decrees (Odhiambo-Mbai, 1998). 'Presidential decrees' at the implementation stage often contradicted coherent policies made by technocrats in the civil service.

Economically, the first half of the 1980s performed poorly, with real GDP growth rate declining to about 3.4 percent. Although the economy showed some stability between 1982 and 1984, no progress was made towards structural adjustment. Like elsewhere, SAPs mainly helped in macroeconomic stabilization, such as lowering of inflation and fiscal deficits. For instance, the programme undertaken with the IMF support succeeded in reducing fiscal deficit to about 2.4 percent in 1983 at the expense of investment and growth (Appendix Table 1).

3.3 Phase II: 1985-1990

3.3.1 Political developments

In the political scene, Moi's dictatorial tendency intensified and Parliament was subordinated to the ruling party, KANU. In the mid 1980s, Kanu coerced its members to toe the party line and support the policies and reforms undertaken by the government. The security of tenure of the Attorney General and the Controller and Auditor-General was removed, exposing the two to manipulation by the executive.

The government increasingly became sensitive to criticism, resorting to intimidation, harassment and detention of its opponents. Press freedom was curtailed, and human rights abuses became common—measures geared towards manipulating the political system in a bid to consolidate Moi's hold on power (Munene *et al*., 1995). Brazen rigging in the 1988 general elections caused protests over KANU's continued monopoly over political power, intensifying the clamour for political pluralism. Moi responded by clamping down on the oppositionists. The business community remained silent fearing retribution by the state, but some members quietly financed small publications that critically examined the regime's policies. Harassment of government critics was perpetrated with the complicity of an acquiescent judiciary and the brutality of the regime caught the attention of international human rights bodies. The system was defended by sycophants who had amassed fortunes through state power (Munene *et al.*, 1995), and who had by now become predatory parasites, manipulating patronage to personal advantage, but to the detriment of the Kenyan economy.

Emboldened largely by the end of the Cold War in 1989, disillusioned by poor governance and wanton abuse of basic human rights, western powers demanded the liberalization of the political system and the economy. Besides the IFIs, the United States represented by its outspoken Ambassador Smith Hempstone, Germany and the Scandinavian countries were in the forefront in demanding for reform (Hempstone, 1997; Munene *et al.,* 1995). The pressure forced a constitutional amendment, restoring the independence of the judiciary which, however, continued to serve the executive's interests. Pressure for democratic change in the 1990s culminatied in riots in Nairobi.

3.3.2 Economic reforms

Lack of adequate commitment to the reform process and limited implementation in the first phase made international funding agencies slow down the pace of an otherwise ambitious reform programme. The government prepared a long term policy document—*Sessional Paper No.1 of 1986 on Economic Management for Renewed Growth* – thereby demonstrating that it had a clear reform strategy. In the document, the government committed itself to adopt an outward-looking development strategy and proposed several measures to liberalize the economy. Also, the government acknowledged the need to limit its primary role in the development process to facilitating growth of private sector. The document marked a major policy shift towards liberalizing the economy, and was later used as the basis for sectoral reforms. It was a major departure from *Sessional Paper No. 10 of 1965* that emphasised government participation in economic activities.

With minimal achievement having been made in the implementation process, there was a shift in the implementation strategy from broad to sectoral basis. The World Bank moved into Sectoral Adjustment Lending as a way of focusing structural transformation into narrower areas, while the IMF was to continue monitoring the macroeconomic balances—based on limited implementation capacity of the government and the need to build greater consensus in support of the reform process (Swamy, 1994). Therefore, adjustment programmes were developed in agriculture (supported by two sector loans in 1986 and 1990), industry (1988), financial sector (1989), export development (1990), and education (1991) (O'Brien and Ryan, 2001; Swamy, 1994).

Import liberalization reforms aimed at first reclassifying imports into five categories: schedule I (unrestricted licensing), II, IIIA, IIIB, and IIIC, with progressively stricter licensing requirements (Swamy, 1994). Over time, automatic or unrestricted licensing was extended to schedules II, IIIA and IIIB. Trade liberalization had started with conversion of quantitative restrictions to tariffs equivalent in the early 1980s, though less successful. The tariff reform made some progress as depicted by a declining trend in the economy-wide average tariffs in Table 1 below. In 1990, the government embarked on phased tariff reductions and rationalization of tariff bands. The highest tariff rate was reduced from 135 percent to 60 percent, while tariff rates on non-competing imports were lowered.

Table 1: Economy-wide average tariffs, fiscal years 1985-92 (in percent)

All schedules	1985	1988	1989	1990	1991
Unweighted	40	39.6	41.3	41.0	38.8
Import-weighted	.	29.6	27.3	24.5	22.0

Source: Swamy, 1994

Under the export promotion strategy, various export incentive and promotion programmes were initiated, including Manufacturing under Bond, Export Processing Zones, revival of the Kenya Export Trade Authority, Export Promotion Council and the Export Promotion Programmes Office. In addition, the general rate under ECS was increased from 15 percent to 20 percent while additional compensation was abolished following concerns over its sustainability.

Other efforts included decontrolling domestic prices. To implement this politically unpopular policy, a strategy to break it up incrementally into the smallest possible pieces was agreed upon, in order to avoid substantive shock in the system (Ryan, 2004). In 1988, the Kenya Association of Manufacturers (KAM) commissioned a study on the experiences of price controls, which revealed deleterious effects such as time-consuming procedures for presenting requests for price changes, bureaucratic hassles and administrative delays (KAM 1988). They used the survey results to lobby the government for price decontrols. Although the government had acknowledged the need to decontrol prices and liberalize trade, KAM managed to conquer resistance from the monopolies created under the import substitution strategy, perhaps because they were not formally organized. However, according to Ryan (2004), the study results had no effect on the adoption of the policy. KAM has been one of the most vocal business associations in the policy arena. Most stakeholders in Kenya are often unorganized and inarticulate (Ryan, 2004). In several instances, farmers calling for reform of a controlling (monopoly) parastatal as in the case of milk, maize, coffee, tea or sugar would usually be bought off by releasing money to enhance crop payments rather than giving in to institutional changes.

In the financial sector, amendments were made to the Banking Act and interest rates adjusted. The shift to indirect monetary policy instruments was initiated in 1988 while the Treasury bill rate was liberalized in November 1990. The government was also under pressure to implement cuts in expenditure on social sectors, particularly health and education. Through donor-funded studies, use of "friendly" terminologies such as "cost sharing" and "participant support" the government finally introduced user charges in public hospitals and health centres on 1st of December 1989. However, no consensus had been reached about their probable effect on service demand by the time of implementation (Mwabu, 1995). The poor and the vulnerable were exempted from paying the fees on production of evidence of inability to pay, and government dispensaries continued to provide outpatient services free of charge. The policy was, however, reversed in September 1990 by suspending the outpatient fee, only nine months after its inception, following public outcry through the press that the poor were being denied access to services and there was no improvement in quality (Collins *et al.*, 1996). This shows how sensitive the government was about the public response, and was not fully confident despite having implemented the reform.

3.3.3 Performance with the reforms

Though some progress was made, the extent of reform and pace of implementation was unsatisfactory, as most of the conditionalities were not met. By 1991, the last year of the ESAF, three out of the four quantitative performance criteria were not satisfied, including the ceilings on net domestic assets of the domestic banking sector, government borrowing from the banking system and net official international reserves. Swamy (1994) observes that in the second phase commitment was patchy. Macroeconomic management was deteriorating due to lack of budgetary control on expenditure and slow progress in other areas of economic reform. The reform effort was characterized by policy reversals, delays and failure in implementation of planned activities, leading to donor dissatisfaction, occasionally resulting into a halt in adjustment lending.

Implementation of the reform strategy was sporadic and limited to selected issues undertaken on the periphery. Those reforms with a direct impact on the electorate, such as retrenchment in the civil service, removal of maize marketing controls and user fees in the social sector were deferred or reversed. The Sessional Paper N0. 1 of 1986 remained silent on the issue of parastatal reforms, implementation capacity notwithstanding. Major reforms were basically deferred or avoided because of political uncertainty of the effects of reforms and fear of losing patronage.

Fidrmuc and Noury (2003) note that if individuals are highly risk-averse, they may resist changes because of the inherent uncertainty. External pressure apparently coincided with strong domestic patronage and rent-seeking interests especially by state elites, thereby ensuring that government was still able to keep enough elements of control. This confirms Rius and van de Walle's (2003) observation that when governments oppose the reform but feel compelled to undertake partial implementation, they are likely to choose undertaking the least onerous, the most easily reversible component of the reform, or the one that has the least impact on the *status quo*.

Most policies were a secret of top government officials but would be well known in the circles of development partners who, after all, were the main driving force and initiators of policy reforms. Ministries had no clear understanding of the broader picture; the Cabinet was not given copies of the agreements but a synthesised version by top civil servants. The decision-making process also meant that the reform process was subject to manipulation by vested interest groups such as political elites. This limited the scope of consensus building about the design and implementation of reforms with relevant stakeholders. Societal groups have been argued to assert their social power and influence during the implementation phase, well after policies have been decided upon (Rius and van de Walle, 2003). This was manifested in the case of user fees reform in the health sector, and later on witnessed under the civil service reform.

Senior civil servants served at the pleasure of the President and therefore owned their loyalty to him. The situation was further aggravated by a constitutional amendment in 1988 that gave the President power to fire members of the Public Service Commission, Judicial Service Commission and the Judiciary. President Moi used the powers to reduce the preponderance of Kikuyu civil servants, especially in the higher ranks of the civil service, replacing them with members of his community under the pretext of promoting social cohesion (O'Brien and Ryan, 2001). Parastatal jobs became an opportune avenue for this venture—a policy that undermined efficiency in the public sector as many of them lacked the experience to run the organizations (Throup and Hornsby, 1998). They became conduits of patronage and the government was in no hurry to undertake parastatal reforms.

The average real GDP increased from 3.4 percent for 1980-84 period to 5.2 percent during 1985-89, but dropped to 2.3 percent in 1991. There was improvement in BOP and current account deficit (see Appendix Table 1). The notable improvement in 1986 was occasioned by a mini-coffee boom, resulting into a BOP surplus. Export orientation in the 1980s remained weak, largely due to very high effective rates of protection, exchange rate bias, high cost of imported inputs, foreign exchange controls accompanied by administrative delays, despite export promotion efforts (Were *et al*., 2002).

The first generation of reform in the 1980s benefitted from a dramatic build up in nominal aid flows (both gross and net) during the 1980s, while the government's pro-west stance during the Cold War period also ensured a continuous inflow of bilateral aid from the West. However, it was not until the 1990s that a comprehensive reform programme was implemented.

4. Reform in the 1990s

4.1 Driving forces of the reform

In the 1990s, reforms were initiated or progressed in virtually all the key sectors: trade, social sector, agriculture and public sector. Development partners exerted immense pressure as tight conditionalities became the major factor in defining the flow of funds to support the reform process.

The reform period was shaped by the supremacy of the Washington Consensus ideology, deeply rooted in the belief of markets and limited government intervention; the rapid wave of globalization and the so called 'second generation of reforms' which incorporated good governance, democratization and need for building institutional infrastructure besides market liberalization policies.

Domestically, the economic reform period coincided with a growing discontentment about the monopoly powers of the one party political establishment. Kenya's image in international circles was dented by corruption, human rights abuse, and oppression of political activists agitating for multi-partyism. Pressure for more democracy and good governance became a key agenda of the donor community—multilateral and bilateral funding institutions alike. This culminated in the suspension of BOP support in 1991 and domestic agitation for multi-partyism that forced the government to relent and repeal Section 2A of the constitution in December 1991, allowing for multi-party political system. However, the repeal left intact all other amendments that had concentrated power on the executive. As a result, the civil society and the opposition parties made constitutional reform their main agenda in the post-1992 elections[4].

[4]To date the Constitutional debate rages on even with the National Rainbow Coalition (NARC) government, which came to power on the platform of constitutional reform. Efforts to introduce a new constitution failed when voters rejected a government-backed draft constituion in a referendum held in November 2005.

The curtailment of aid flows was one of the greatest challenges the country faced. While in the 1970s and 1980s the government responded to external shocks by increased borrowing and aid inflows, expansionary fiscal policy and instituting controls, it no longer had the luxury of using these options in the 1990s. Unlike in the earlier periods, there was slackened donor support, resulting in a sharp decline in inflows since the peak in 1990. With the disintegration of the Soviet Union and the end of Cold War, Kenya's strategic role was not so necessary and therefore the government could be induced to undertake reforms.

A number of bilateral donors concerned about the abuse of their funds began avoiding the central government by channeling funds through Non-Governmental Organisations. Declining aid flows caused external debt arrears problem for the first time. Net resource flow remained negative for the better part of the 1990s (see Appendix 2). The debt burden became so acute that Kenya had to reschedule its debt in 1994 for the first time. Net foreign exchange reserves were negative in the early 1990s, and the GDP growth rate was quite low, falling from 5 percent in 1989 to 2.1 percent and 0.5 percent in 1991 and 1992, respectively (Appendix Table 1).

The economic performance deteriorated, budgetary crisis deepened and access to financial resources was curtailed, giving IFIs an upper leverage to push for reform implementation. Citing Grindle and Thomas (1990), Rius and Walle (2003) note that policy reform has typically occurred during periods of intense economic crisis, as states delay difficult economic policy reform decisions until the old economic policy regime has brought about a non-sustainable economic disequilibria. Liew *et al*.(2003), make similar observations by arguing that economic crises can tighten economic constraints to the extent that some countries are forced to reform notwithstanding the political interest of the ruling party. This description augurs well in the Kenyan case as implementation of reforms was intensified and the reform agenda broadened. Funds were only disbursed when there were signs that the government was back on track with the reforms. Donors therefore became key stakeholders in spearheading the reform process.

Domestic actors— the media, opposition and the civil society—also played a critical role.

4.2 Economic reforms

Most of the economic reforms were implemented in the first half of the 1990s when bold measures were taken in trade, civil service, agriculture and social sectors.

4.2.1 Trade reforms

Trade liberalization had started with conversion of quantitative restrictions to tariffs equivalent in 1980s. By 1991, quantitative restrictions affected only 5 percent of imports compared with 12 percent in 1987 (Swamy, 1994). The average unweighted tariff rate declined from 41.3 percent in 1989/90 to 34 percent in 1992/93. In June 1995, the maximum tariff rate was reduced to 40 percent and the bands to six (Mwega, 1999).

The foreign exchange market was rapidly liberalized. In October 1991, Foreign Exchange Bearer Certificates (Forex-Cs) were introduced, marking the first step towards liberalization of foreign exchange market (Were *et al*., 2001). The Forex-Cs could be used for automatic import licensing while currency declaration forms were abolished. In April 1992, a secondary market for Forex-Cs was established and retention schemes were introduced in August, allowing 100 percent retention of foreign exchange earnings from non-traditional exports. In February 1993, foreign exchange allocation by the Central Bank of Kenya (CBK) was abolished. However, in March of the same year, retention accounts were suspended and import licensing and exchange controls reinstated. Apparently, this led to unsuccessful negotiations between the government and IMF for the resumption of quick-disbursing loan. Consequently, in May 1993, import licensing was again abolished and retention accounts reintroduced for all exporters of goods and services at 50 percent rate.

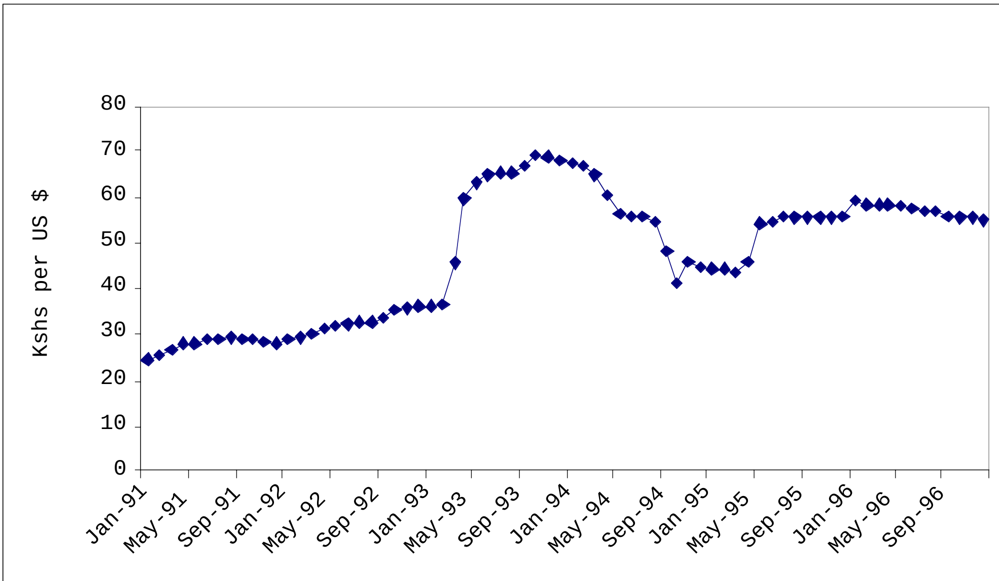
The export incentive schemes, particularly the ECS and pre-shipment export financing scheme that had been put in place to promote exports were not being utilized effectively. These schemes were also highly abused as other issues such as vested interests and patronage cropped in. Both schemes were linked to what came to be known as the "Goldenberg Scandal," in which the government was swindled off billions of shillings, leading to one of the country's biggest financial scams.[5]

The Goldenberg scandal took effect despite stringent donor conditionalities, illustrating how powerful vested interests, clientelism and access to political power can be. With the freeze on donor funding, the extra compensation and the other monies involved must have largely been sourced domestically. Most likely, this partly explains the observed surge in the domestic stock of debt (Appendix Table 2), particularly around 1993. Only in September 1993 was a decision made to end the much abused export compensation scheme.

The resultant economic crisis forced the government to hurriedly implement some of the donor demands, such as liberalizing the foreign exchange market. Unfortunately, with looming financial crisis and the sky rocketing inflation, that was wrong timing. The shilling depreciated to unprecedented levels against the dollar (see Figure 1). In a bid to minimize the resultant short run cost of the reforms the President reinstated foreign exchange controls and import licensing in March 1993. A hasty implementation without the necessary preconditions such as macroeconomic stability worsened the situation, leading to policy reversal. The temporary backtracking seems to have averted further adverse effects of the reform.

[5] Goldenberg scandal arose when government acceded to a request to pay additional export compensation to a company that claimed it would buy and export gold and ostensibly assist with the foreign exchange and BOP problems Kenya was experiencing due to donor freeze. A judicial Commission of Inquiry was set up by President Kibaki to investigate irregular payment of billions of Kenya shillings to Goldenberg International Limited and associated companies in early 1990s, and whether any gold and diamond jewellery were actually exported and export remittances made to the Central Bank of Kenya.

Figure 1: National exchange rate (Ksh/US$), Jan 1991-Dec 1996



In October 1993, the official exchange rate was abolished, paving way for a freely floating exchange rate. Other controls on foreign exchange were eased in December 1993. Capital controls were relaxed for offshore borrowing in February 1994 subject to quantitative limits and over 1993-94, all current account and virtually all capital account restrictions were lifted. By 1995, all the foreign exchange restrictions had been eliminated—foreign exchange bureaux were permitted and the Exchange Control Act was repealed.

The petroleum market was liberalized in October 1994 but price liberalisation of basic commodities like cereals, especially maize and maize flour was highly sensitive given that these were commodities consumed by the majority of the population. Given the political uncertainty of such a reform, it was not surprising that some policy reversals were witnessed. Trade reforms, particularly liberalization of the foreign exchange market were largely successful1,[6] making Kenya one of the countries to

[6] Success in this context is evaluated in reference to implementation; not whether the reform outcomes were bad or good for the economy.

comprehensively open up the economy in the region. However, it could be misleading to conclude right away that big-bang approach works better than gradualism since, as pointed out, the rushed implementation had some undesirable effects in the short run, causing a temporary halt to the reform. Also, liberalizing the foreign exchange market and foreign trade before liberalizing the capital account not only showed some consistency but also created synergy between these reforms. Arguably, these reforms were less sensitive politically since they affect the economy in entirety rather than specific population segments, and were therefore, less politically costly. Floating exchange rates have been the most successful reforms throughout Africa (Seck and Phillips, 2001).

4.2.2 Financial sector reforms

Achievements in the financial sector reforms included liberalization of interest rates, removal of credit controls, and streamlining of the money market trading system. Interest rates were liberalized in July 1991, a month after the introduction of open market operations. However, the reform efforts were thwarted by political interference. The politically-connected got unsecured loans from some banks, especially state-owned and politically-connected banks just before the first multiparty elections. The first multi-party general elections of December 1992 saw a heightened activity of financial transactions. All of sudden, a number of banks that were politically at the centre flourished. KANU devised several schemes to finance its election bid, including printing lots of money. Inflation rose drastically to over 50 percent (see Figure 2). This had immediate repercussions in the exchange rate market and by April 1993, a financial crisis was imminent, causing a major drawback to the reform effort by IFIs.

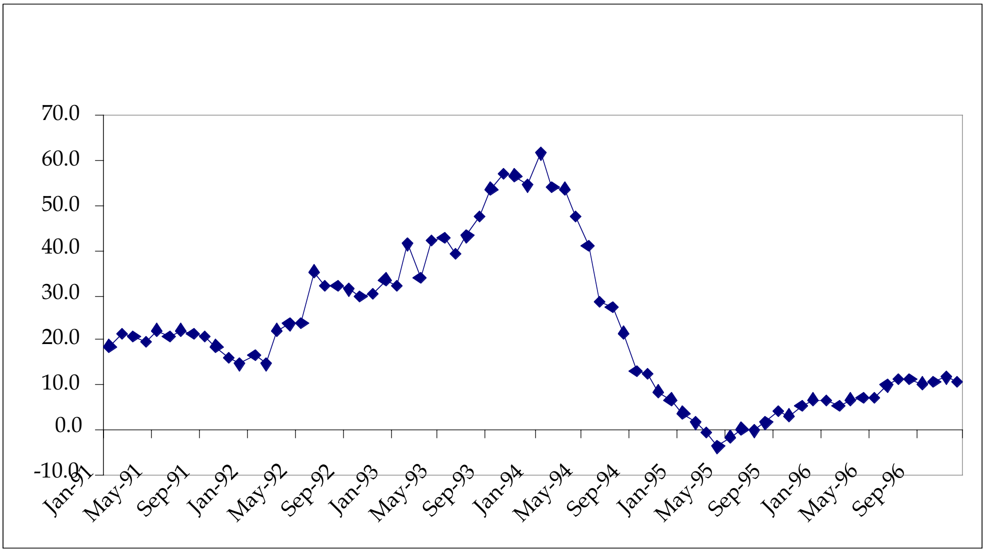
Donors, particularly the IMF pointed to the need to restore financial prudence; in particular, the situation created by Exchange Bank and other political banks was of great concern. The political banks and the huge unsecured loans amounting to billions of Kenya shillings triggered a financial crisis and eventual collapse of most of the political banks. Most of the troubled banks were put under liquidation. In December 1993, several banks and non-bank financial institutions were eventually closed down in a banking crisis.

The year 1993 is unique in Kenya's economic history. There was a major turbulence in many macroeconomic variables, particularly monetary variables (see Figure 1 and 2 and Appendix Table1), which can be explained in the context of a political business cycle. The literature on political business cycle postulates that parties in power will manipulate policy in the short run in order to maximize their electoral chances (Haggard and Web, 1993).

To aggressively mop up the excess liquidity, Treasury bills were issued, and this created another problem of a soaring Treasury bill rate, which also acts an anchor for other forms of interest rates. At one point, the Treasury bill rate was over 70 percent. This was one of the bases of the high interest rate structure, which became almost a permanent feature of the economy. The lending interest rate has been overly high, reaching over 30 percent in some years (Appendix 1). Critics of the IMF argue that the Fund could have advised the government to deal effectively with the crisis. In any case, it was wrong for IMF to have insisted on financial liberalization at a time when the banking legislation and bank supervision were inadequate (Stiglitz, 2002). Furthermore, until the amendment of the Central Bank Act in 1996, the independence of the CBK, and therefore monetary policy, had been grossly compromised (CBK, 2000). For example, the Act allowed the Minister of Finance to override the decisions of the Bank, and there was no maximum limit on CBK advances to the government, encouraging fiscal indiscipline and high budget deficits.

Rolling over the Treasury bills and selling more kept interest rates high and the Kenya shilling strong. The situation evolved into what economists refer to as a "ponzi" game, with the government issuing attractive debt to repay old ones. The beneficiaries were financial institutions, especially commercial banks, which held over 50 percent of total stock of Treasury bills. The

Figure 2: Inflation rate (monthly), Jan 1991-Dec 1996



dramatic build in domestic debt and domestic interest rates was also precipitated by domestic financing following the curtailment in donor funding.

Five banks were put under statutory management by the CBK in 1998 after failing to meet their financial obligations due to poor lending practises, conflict of interest, loans to non-viable projects, insider lending to directors and under-capitalisation. The state-owned National Bank of Kenya had a huge amount of non-performing loans. To arrest the waning confidence in the banking sector, CBK was given increased power to censure commercial banks that failed to comply, and penalties for non-compliance were also raised.

Some financial stability was witnessed in 1999. Three out of five banks under statutory management were restructured and re-opened. During the 2000/2001 period, measures undertaken included amendment of the Banking Act to restrict insider lending and enforcement of banking laws especially in regard to lending and provisioning for non-performing loans. That notwithstanding, the experience with the banking crises and high interest rates attest to the fact something was not right in the reform process.

Financial market liberalization is based on the believe that competition among banks will lead to lower interest rates. However, that has not been the case. Pill and Pradhan (1997) observe that the success of financial liberalization depends on the appropriateness of macroeconomic policy, institutional development and structural reforms. Leite (1993) adds that strong banking regulatory and supervisory policies ensure viability and health of the industry and, enhances effectiveness of interest rate liberalization. The hurried financial market liberalisation saw a situation where such measures were undertaken after reform implementation.

4.2.3 Public sector reforms

Public sector reforms[7] were perhaps the most difficult, as the government kept on employing delaying tactics. Other than mere job creation, public service employment was also a means for political mileage and ethnic or tribal considerations. Due to a bloated public sector, the wage bill became unmanageable, accounting for about 10 percent of GDP and about 70 percent of the recurrent budget by the late 1980s. This left very little for operations and maintenance, as well as development expenditure. Part of the reform was to reduce the number of ministries as part of cost containment.

Civil service reform

In 1992, the civil service reform programme, which was to be implemented in three stages or phases, was launched after much pressure from development partners. The reform was to cover only those civil servants paid directly by the exchequer, excluding teachers. In his budget speech of 1993/94, the Minister of Finance pledged to prune 16,000 civil servants in a three-year period. In five months, over 3,900 employees had been pruned through natural attrition (retirement) while 13,954 job vacancies that had

[7] For purposes of this paper, the discussion of public sector reforms mainly focuses on civil service and parastatal reforms.

been budgeted for were cancelled. The retrenchment programme was restricted to the civil servants, who, for lack of a formal labour union, would relatively be easier to deal with. Although teachers were a major contributor to the huge wage bill, they were untouched, largely because of their strong union (Kenya National Union of Teachers) and the fact that they formed a strong political base in terms of votes. Also, the retrenchment programme was not extended to parastatals. In fact, some of the retrenchees in the civil service could find their way to parastatals with even higher salaries, therefore defeating the purpose of the reform.

Failure to make significant moves in fulfilling governance conditions led to suspension of ESAF in August 1997. Largely driven by the government's needs for new funding from donors, and the IFIs' pressure for a leaner and efficient government, the second phase of the civil service reforms was re-launched in 1998. The target was to reduce the civil service by 30 percent and a target of 32,000 staff was agreed upon. Although there was a criteria to be followed, this was never circulated to the civil servants. This left civil servants guessing who was to leave next and created anxiety and suspicion among officers. However, the right-sizing was halted by Parliament before the target had been achieved. Expectedly, it was argued that there was no enough consultations about the policy, which was viewed to have been implemented as a directive from donors. Parliament argued that a Sessional Paper should have been done before implementing the policy and, therefore lobbied to stop the process. Compared with the first phase, it was difficult implementing the second phase.

Following the suspension of funding in 1997, much of the reform effort was geared towards fulfilling conditionalities on governance (read corruption) issues. The President put up a team in July 1999, with technocrats mainly drawn from the private sector, to occupy key public office positions, including Head of the Civil Service[8] . The team, dubbed 'dream team' was

[8] The team was headed by Dr Richard Leakey (a renown conservationist and one of the leading lights in the opposition then), who was appointed Head of Civil Service and Secretary to the Cabinet.

expected to spearhead reforms that would put the country back to economic recovery path and fight rampant corruption in government. However, the reform suffered another setback when the sacking of over 25,700 civil servants was halted, after the civil servants sued the government, accusing it of contravening the Employment Act by terminating employment contracts without adequate notice. Complicating things further, many civil servants had still not received their redundancy packages, which, it was felt, were not even adequate. At least 19,000 civil servants had received retirement letters after the programme resumed in September 2000. The implementation of reform was less successful in terms of meeting the targets, consistency and sustainability. Civil service reforms are still in force to date.

Parastatal reforms

Parastatals had become avenues of perpetuating predatory behaviour by public officials and for a long time, the government was reluctant to divest from some of the enterprises. The reforms basically entailed restructuring and privatization of public enterprises, with the aim of enhancing the role of the private sector, reducing the claims on the budget, rationalizing the public enterprise operations, improving regulatory environment and broadening the base of ownership (Government of Kenya, 1998). In 1990, the Department of Government Investment and Public Enterprises was created to oversee the parastatal reform programme. A Parastatal Reform Programme Committee, a high-level policy-making body, was set up under the chairmanship of the Vice-President and Minister for Finance. A further arm, the Executive Secretariat and Technical Unit, was created to manage, coordinate and implement the programme while approvals were to be made by the Committee. After internal consultations at Cabinet level, the government drew a privatization programme whose strategies and objectives were spelt out in *Policy Paper on Public Enterprises Reform and Privatization*. However, the privatization framework was inadequate as it lacked legislative principles to be followed—basically in the form of privatization law. The procedures and institutional framework in the policy paper were not entrenched in the law.

The government categorised public enterprises into strategic (33) and non-strategic (207). The former were to be restructured to improve efficiency and profitability while non-strategic parastatals would be privatized. However, the implementation encountered resistance and laid down procedures were often disregarded by implementing institutions. The government kept dragging its feet and by the end of 1998 had sold shares in only 25 enterprises in which it had direct ownership out of the 165 (Anyang' Nyong'o, 2000). Privatization proceeded without a privatization law, therefore leaving loopholes for manipulation.[9] Moreover, the government avoided privatizing some of the parastatals that caused a major drain on the budget, therefore bringing to fore the question of whether the objectives of parastatal reforms have all been met. During 1999/2000 fiscal year, a number of state-owned corporations were to be restructured and privatized but none of the planned privatizations were undertaken. The then Kenya Posts and Telecommunications Corporation, which had become highly inefficient and corrupt, was split into three separate entities: the sector regulator (Communications Commission of Kenya), the public postal operator (Postal Corporation of Kenya) and the public telecom utility (Telkom Kenya). Fear of privatizing some of the state corporations due to vested interests such as business contacts and patronage led to resistance to the reforms. Nevertheless, others like Kenya Airways have been successfully privatized and privatization reforms are still going on.

As Stiglitz (1999) observes, if privatization is conducted in ways that are largely viewed as illegitimate and in an environment that lacks the necessary institutional infrastructure, the longer-run prospects of a market economy may be undermined. The privatization process lacked both functional and

[9] There has been a Privatization Bill which is yet to be turned into law.

legal autonomy from executive and as such, privatization did not weaken patronage as one would expect (Gatheru and Shaw, 1998)

Fiscal reforms

A major component of fiscal reforms came in 2000, with the adoption of the Medium Term Expenditure Framework to budgeting, which replaced the previous forward-rolling budgeting system. The aim was to move revenue and expenditure more closely into balance and achieve fiscal discipline. The stock of pending bills, which stood at Ksh 2,227 million as at 30th June 1991, had significantly increased to Ksh 10,976 million by June 1999 (Kirira, 2002). Pending bills was one of the loopholes for fiscal indiscipline. Projects and programmes were initiated without taking into consideration their financial implications and at times without seeking parliamentary approval, which is constitutionally illegal (Kirira, 2002). The new budgeting approach was to be directly linked to the priorities contained in the *Poverty Reduction Strategy Paper*. However, with no specific targets, sanctions and incentives where necessary, fiscal discipline remained elusive. This was exacerbated by weak institutional structures. For example, although budget execution is a prerogative of parliament, mechanisms to control discretionary spending within the executive remain weak. Only the Office of the President can discipline the Permanent Secretaries, who also act as accounting officers in their respective ministries (Kirira, 2002). The high turnover of Permanent Secretaries to the Treasury and ministers for finance intimidated holders of this office in their firmness for prudent financial management.

4.2.4 Social Sector Reforms

The major component of the social sector reforms[10] in health and education was implementation of cost sharing. Cost sharing in public universities was

[10] This section focuses on the health sector reform.

introduced in 1991. In the health sector, the government announced a phased re-introduction of user fees in April 1992. The outpatient fee was reintroduced as a fee to be paid only after receiving treatment. Unlike in the initial attempt, some effort was made to develop the institutional capacity. This included development of the Health Financing Secretariat; new management systems; a cost sharing operations manual and new accounting and reporting systems. Revenue collection targets were also set. The revised policy was introduced in phases and on pilot basis (Collins *et al*., 1996). The re-introduction was sequenced, starting with the national referral hospital, provincial hospitals, district hospitals and health centers. No fee was charged for services offered at the dispensaries, and groups of the population exempt from the fees had been expanded to include civil servants, the military and the unemployed (Owino and Were, 1998). The new (revised) reform came with other reforms, notably the decentralization of management.

The successful implementation of the revised policy can be attributed to consultation and consensus building among stakeholders (e.g. senior medical and administrative staff); gradual and sequenced implementation; and the relatively stronger institutional framework. The broad range of automatic exemptions to compensate losers was also helpful in gaining political and public acceptability of the user fees, although the revenue foregone was high. Therefore, after achieving acceptance, the exemptions for civil servants and children between 6 and 15 years were removed, since there was no clear public health benefit (Collins *et al*., 1996).

4.3 Government-donor relationship

The 1990s were characterized by stop-go relationship with donors[11] , leading to aid embargos and intense pressure from donor agencies to undertake various reforms. In 1991 for instance, funds were suspended due to

[11] It is worth noting that use of the term 'donors' is misleading since the bulk of the money is mainly on loan basis, even if on concessionery terms.

corruption, fiscal indiscipline, and slow implementation of public sector and political reforms.

By then, the instability in macroeconomic framework was becoming apparent. To help restore economic stability, a shadow programme was agreed upon between the government and the IMF in April 1992. However, the government quickly veered off-track as political concerns overwhelmed economic management issues. The IMF/IDA mission in 1992 and 1993 found evidence of significant violation of monetary targets due to abuse of the pre-shipment export financing scheme[12] and access of certain commercial banks to CBK overdraft and rediscount facilities, part of which had some links with the Goldenberg scandal, straining relationship with the donors.

Measures were expediently undertaken after aid was withheld, including replacing key government officers who were in office when the Goldenberg scandal started. In January 1993, Musalia Mudavadi replaced Professor George Saitoti as the Minister for Finance, while Micah Cheserem replaced Eric Kotut who resigned as Governor of the Central Bank of Kenya. The new officers gained good will from donors and a Consultative Group meeting was held to discuss Kenya's case in Paris in November 1993. This was followed by IMF's approval of US$ 63 million credit under ESAF in December 1993, half of which was to be disbursed immediately. Other donors, including bilateral ones followed suit. In February 1995, an IMF team arrived in Nairobi to open talks on new a three-year ESAF worth US$200 million. However, in September 1995, IMF announced that talks with the government on the ESAF had effectively stalled because the Fund needed to convince itself that the government was vigorously prosecuting public officials and others accused of the Goldenberg scam. Complicity of some key government officials in the scam made it difficult for government to deal with the issue.

[12]After much abuse, commercial banks were advised not to enter into new commitments under the facility in March 1993.

In April 1996, the long awaited ESAF was finally approved after the government reiterated its commitment to reform in the *Policy Framework Paper 1996-1998.* The key issue was transparency in the public sector. Meanwhile, bilateral donors were more concerned with transparency in the forthcoming elections. The IMF decided to withhold the second tranche of the approved EASF until various conditions including those set out in the policy framework were met.

Failure to make significant moves on governance reforms led to suspension of funding in 1997. There were concerns about widespread corruption and poor human rights record and the politically instigated tribal or ethnic clashes witnessed in the run up to the general elections in December 1997.

The IMF team visiting the country in March and July 1999 was still dissatisfied with governance reforms, and deferred any decision about re-establishing the ESAF. This came as a bitter blow to the government, which had already factored donor support in the budget. President Moi made a swift move and appointed the 'dream team' in a bid to improve credibility and Kenya's badly dented image in the eyes of donors and international community. However, when the IMF team visited the country in early 2000, there was no indication of aid resumption. By this time, the economy was in doldrums. In fact, it was in 2000 when the economy recorded a negative real GDP growth rate of –0.3 percent. With no money coming despite his initiatives, president Moi accused the donors of shifting goal posts. However, back home, a coalition of opposition politicians, civic leaders and professionals was busy appealing against assistance to Kenya because the government had not fulfilled its pledges to implement constitutional reforms.

The IMF set tough terms when it lent Kenya US$198 million credit under Poverty Reduction and Growth Facility (PRGF), which had replaced the EASF, opening the door for funds from other donors such as the World Bank, African Development Bank, European Union, United Kingdom and Japan. Unfortunately, the relationship between the government and the IFIs went sour again at the beginning of 2001. IMF's major areas of concern included the stalled privatization bill, failure by Parliament to enact the pending civil service code of ethics and economic crimes bill. Consequently, in March 2001, the IMF decided to withhold lending to Kenya again, citing insufficient progress in the proposed reforms.

Reforms became a donor agenda and could be hurriedly implemented in a bid to appease donors to release funding. As it turned out, this often left little or no room for consultation with stakeholders. Ryan (2004) points out that conditionalities or reforms agreed upon with an external funding body may not necessarily be seen as policies, and sometimes continuing with the *status quo* is in itself a policy decision. The IFIs took institutional capacity and political will for granted, leading to inconsistency and policy reversals in the reform process.

The fact that implementation of reforms was reactive rather than proactive not only undermined local ownership but also affected the sustainability of reforms. There has been lack of a clear long-term vision as IFIs have preoccupied themselves with setting and re-setting short-term targets, which the government strives to achieve if only to access funding. The problem is that, as Stiglitz (2002) contends, many of the reform policies became ends in themselves rather than means to more equitable and sustainable growth

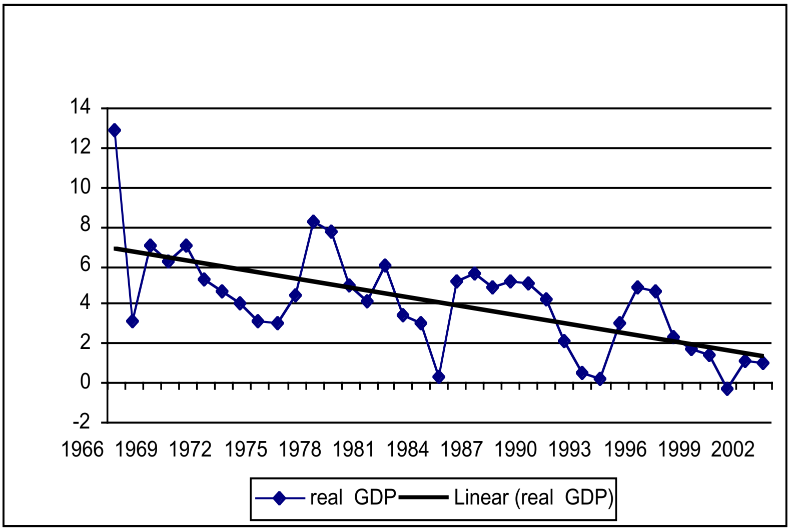
4.4 Economic outcomes

Economic reforms are often undertaken with the aim of promoting high growth and improved welfare in the long-run. For instance, trade liberalization was undertaken on the assumption that they will eventually improve exports and economic growth (Mwega, 1999). Following liberalization of the foreign exchange in 1993, there was an immediate positive response in imports and exports. In particular, the export response seems to have been combined with a price effect due to a steep devaluation of the shilling in 1993. The total effect was a rise in export earnings from about 13 percent of GDP in 1992 to over 20 percent between 1993 and 1996.

However, export growth has generally been highly erratic, based on fluctuations in earnings from a few traditional primary commodity exports and the tourism sector. While certain non-traditional exports such as horticultural products have experienced rapid growth in the last few decades, manufactured goods make only a small proportion of total exports. Kenya's trade share (value of imports plus exports in GDP), which is a commonly used indicator of openness, shows no clear trend but has been over 50 percent since the 1970s, reaching the peak in the first half of the 1990s following liberalization of the foreign exchange market. The value of exports of goods and services as a percentage of GDP has been below 30 percent except for a few years, particularly 1993 following the steep depreciation of the shilling.

In general, the real GDP growth rate has been highly erratic, but depicts a declining trend over time (Figure 3 and Appendix 1). Growth performance has remained depressive in the 1990s and in the new millennium, with a declining growth in volume of investments (both private and public) and exports. The value of total investment to GDP ratio has remained below 25 percent while total savings as a proportion of GDP has been about 11 percent. Given the population growth rates of about 2 percent per annum in recent decades, it is evident that real per capita income has been on decline since the mid-1990s. This partly accounts for the declining wage employment in the formal sector, leading to a surge in the informal sector employment. Poverty remains widespread, and by 2000, 56 percent of the population was estimated to be below the poverty line (Mwabu *et al.*, 2002). The population of about 31 million exhibits a high dependency ratio (107 dependants for every 100 active persons), with almost half of the population below age 15. With Kenya's key potential in spearheading economic development in the region, the challenges that lay ahead cannot be overemphasized.

Figure 3: Trend in real GDP growth, 1966-2002



5. Winners and Losers

Although the ultimate goal of reform is a better-off society, reform also has distributive consequences, resulting into winners and losers in the process (Fidrmuc and Noury, 2003). The multiplicity and dynamism of reform makes it hard to identify winners and losers. Reform might benefit one sector or group while hurting another . It is also possible that over time, those who originally lost may benefit and visa versa. In general, the beneficiaries of economic liberalization were largely the capitalists, traders, firms and exporters that were able to compete domestically or internationally. Trade liberalization for instance affected the textile industry, which collapsed due to cheap imports. The resultant unemployment affected a wide range of people but created an opportunity for small-scale traders who proliferated the industry with sale of imported secondhand clothes. Arguably, the poor and low-income earners benefited to the extent that they could easily access cheaper imported secondhand clothes and other domestic products. The manufacturing sector benefited to the extent that manufacturing firms were able to easily and cheaply access imported capital and intermediate goods, but they had to compete with cheap imports.

Non-traditional agricultural exports such as horticulture benefited from liberalization. On the losing front were smallscale farmers who lacked credit, particularly after removal of subsidies and, with lack of technological skills to access the world markets. Since a protective trade regime provided avenues for rent seeking, losers included rent-seekers.

The financial sector saw a concentration of banks in the urban areas targeting upper and middle-income earners, therefore shutting out the majority of rural population, low-income earners and the working poor in urban areas. With lending rates overly high, potential borrowers were denied access to credit facilities. Reforms in other sectors like health, education and civil service disproportionately affected the vulnerable groups. Cost sharing or user fees in public institutions resulted in poor families being unable to give their children better healthcare and basic education, while the HIV/

AIDS pandemic worsened matters. Free primary education under President Kibaki's new government has seen a surge in primary school enrolment. The victims of the retrenchment programme—mainly lower cadre employees in civil service, with the little compensation package and massive unemployment exacerbated by poor economic performance—often joined the pool of the poor. Overall, it can be argued that distributional consequences of reforms deepened the asymmetries in incomes and access to resources.

6. Conclusion and Lessons Learnt

Kenya's path to reforms was largely driven by external pressure from donors, particularly the IFIs, and domestic economic factors. Continued borrowing from abroad was predicated on conditionalities. Little was achieved in the 1980s, and only in the 1990s were comprehensive reforms implemented. Donor conditionalities were broadened to include political democracy and good governance besides the traditional economic policies. The economic reforms coincided with political reforms, mainly the change to multi-partyism and agitation for constitutional reform. Development partners exerted pressure, adopting carrot-and-stick approach to ensure reform implementation although the government sometimes undertook reforms to hoodwink donors. The civil society and religious groups played a critical role, particularly in pushing for political reforms.

Weak commitment to the reform process strained the relationship with donors, leading to stop-go pattern in lending and reform implementation. The government often outlined policy reforms but implementation was often characterised by delays, policy reversals or backtracking. The political structure was not supportive of both political and economic reforms because of the vested interest groups.

Policy reversals and uncertainty about the reform can be attributed to lack of a clear analysis of the reform impact, poor preparation, limited consultation in the design and implementation, with issues of timing and sequencing often not considered. In some cases, the reversals were made to minimize the short run cost of the reforms or inherent political uncertainty.

The reform process was reactive rather than proactive, resulting in weak ownership of reforms. There was no specific attempt to coordinate and prioritise reforms. Therefore, the reform agenda failed to spell out a clear long-term path. The IFIs lacked a clear focus, preoccupying themselves with short-term targets, therefore failing to view reform as a whole. They also took institutional capacity and political constraints for granted.

However, Kenya still managed to implement several market-oriented reforms ahead of other countries in the region, but with varying degree of ease and success. Trade liberalization, including liberalization of the foreign exchange market was perhaps the easier reform. Others such as cost-sharing in health and down-sizing of the civil service were more sensitive and politically costly to implement. The losers were bound to be majority of voters, and hence the delays and reversals in policy implementation. The government also procrastinated on privatization of parastatals, and in the financial sector, sequencing problems and political interference affected the implementation of successful reform.

Despite the market-oriented reforms, there were marginal gains with economic growth and investment, especially in the 1990s. Generally, reforms disproportionately affected the poor and other vulnerable groups, deepening the asymmetries in income and access to resources.

What can we learn from the reform process so far? Economic reform is deeply interwoven with political dynamics. Although International Financial Institutions remain major actors, political institutions wield immense power in that process. Future economic reforms need to consider the self-seeking interest groups; patron-client relations and political elites interested in pursing personal welfare functions; and the timing of reform implementation in terms of political climate, macroeconomic environment and synergy with reforms in other sectors. Putting in place the necessary preconditions such as regulatory and legal framework is also necessary for successful reform. There is need for home-grown solutions to complement the standard reform prescriptions by IFIs in order to promote ownership and sustain development efforts. This implies that all stakeholders need to be involved because they could be assertive enough to thwart or sustain the process, depending on the extent of their influence and power.

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Appendices

Appendix Table 1: Macroeconomic indicators

PERIOD	GDP	INVEST	NETRES	RES	BOP	CAB	DEF	LEND	TBILL	EXR	INF
1971	5.23	25.3	1,200	1,230			-2.6	9	1.42	7.143	
1972	4.62	23.2	1,331	1,416			-5.7	9	3.45	7.143	
1973	4.01	21.2	1,546	1,603			-4.4	9	1.92	6.9	8.89
1974	3.06	30.8	962	1,347			-3.0	9.5	4.63	7.143	17.33
1975	2.89	20.5	534	1,427	(43)	(220)	-6.0	10	6.08	8.26	16.06
1976	4.40	23.0	1,446	2,301	84	(120)	-6.1	10	5.54	8.31	10.47
1977	8.13	27.0	3,610	4,259	269	35	-3.1	10	2.13	7.947	13.53
1978	7.66	34.3	1,954	2,732	(220)	(661)	-2.4	10	4.29	7.404	14.77
1979	4.92	26.1	3,275	4,780	72	(495)	-6.1	10	6.01	7.328	7.80
1980	3.99	35.4	1,830	3,784	(317)	(878)	-2.5	10.58	5.26	7.569	13.16
1981	5.97	33.3	128	2,577	(306)	(563)	-7.5	12.42	7.61	10.286	12.23
1982	3.40	26.4	(2,167)	2,957	(160)	(308)	-7.7	14.5	12.58	12.725	22.30
1983	3.04	25.0	(1,027)	5,459	98	(50)	-2.4	15.83	14.15	13.796	12.83
1984	0.35	25.5	(374)	6,444	62	(130)	-3.7	14.42	13.24	15.781	9.75
1985	5.13	25.5	(1,975)	6,807	(52)	(118)	-3.7	14	13.9	16.284	12.25
1986	5.54	21.8	(411)	7,115	137	(47)	-4.8	14	13.23	16.042	5.16
1987	4.87	24.3	(2,159)	4,753	(25)	(503)	-7.5	14	12.86	16.515	6.25
1988	5.14	25.0	(3,651)	5,558	(44)	(472)	-3.7	15	13.48	18.599	9.91
1989	5.09	24.7	(2,370)	7,310	122	(590)	-3.8	17.25	13.86	21.601	11.09
1990	4.21	24.3	(5,450)	6,630	(93)	(527)	-4.3	18.75	14.78	24.084	13.31
1991	2.08	21.3	(7,945)	5,339	(44)	(213)	-5.0	19	16.59	28.074	17.55
1992	0.48	16.9	(5,975)	6,315	(257)	(180)	-1.3	21.07	16.53	36.216	25.01
1993	0.24	17.6	30,146	34,527	412	71	-4.5	29.99	49.8	68.163	43.46
1994	3.03	19.3	15,903	28,227	62	98	-5.8	36.24	23.32	44.839	29.80
1995	4.82	21.8	23,546	25,683	(142)	(400)	-1.3	28.8	18.29	55.939	0.50
1996	4.64	20.4	47,434	47,266	39	(74)	1.2	33.79	22.25	55.021	7.87
1997	2.36	18.5	55,669	44,499	120	(377)	-2.2	30.25	22.87	62.678	10.91
1998	1.77	17.3	53,787	47,103	74	(363)	-0.8	29.49	22.83	61.906	5.44
1999	1.42	16.1	55,121	57,816	87	(90)	-0.7	22.38	13.87	72.931	4.48

Source: IFS and KIPPRA

Key: GDP is real gross domestic product growth rate; INVEST is investment rate defined as the ratio of gross investment to GDP; NETRES is net foreign reserves; RES is foreign reserves; BOP is balance of payment (US$M); CAB is current account balance (US$M); DEF is the ratio of budget deficit to GDP; LEND is nominal lending rate; TBILL is the nominal Treasury bill rate; EXR is the exchange rate (Kshs/US$); INF is the inflation rate.

Appendix Table 2: Analysis of domestic and external debt (millions of Kenya shillings)

Fiscal years	Total Domestic Debt*	Domestic Interest	Growth in Domestic debt(%)	Domestic debt/GDP	Total External Debt**	External Interest	Total repayment (external debt)***	Total disbursement	Net Resource Flow
1989/90	52,521	6,786.60		28.6	68,380	3,217.80		16760.6	
1990/1	63,597	10,462.40	21.09	30.5	89,179	4,460.00	12,900.94	23027.9	10,126.9
1991/2	70,809	10,920.20	11.34	29.7	123,157	4,777.00	12,929.17	8913.0	-4,016.1
1992/3	112,295	23,775.80	58.59	38.1	267,423	4,077.40	9,991.82	25007.9	15,016.0
1993/4	162,843	44,448.80	45.01	44.4	238,809	10,310.80	33,152.17	45420.8	12,268.6
1994/5	119,446	25,897.00	-26.65	27.6	266,271	9,471.00	30,115.48	19515.1	-10,600.4
1995/6	120,356	29,320.80	0.76	24.2	262,024	10,670.40	32,589.33	23987.1	-8,602.2
1996/7	159,077	25,544.20	32.17	27.6	242,174	8,101.20	28,870.71	18903.7	-9,967.0
1997/8	171,730	32,037.14	7.95	26.1	257,018	7,775.74	31,523.22	23450.5	-8,072.7
1998/9	174,305	27,903.20	1.50	24.4	337,026	8,186.40	32,580.76	16645.9	-15,934.9
1999/00	206,127	21,409.40	18.26	27.0	303,972	7,508.40	35,064.65	16707.2	-18,357.4
2000/01	213,772	20,576.91	3.71	24.6		3,848.58	14,501.92		-14,501.9

Sources: Treasury, CBK publications and Analytical Data Compendium

Table notes: *Generally, the domestic debt has a tendency to vary depending on the source. **The increase in 1992/3 was principally due to the steep depreciation of the Kenya shilling against the dollar. ***Total repayment includes interest and principle.