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BY

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SUMMER 2003
STUDENT'S DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

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DATE

27/10/03

This Thesis has been submitted for examination with my approval as University Supervisor

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# ACRONYMS/ABBREVIATIONS

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<tr>
<td>AAF-SAP</td>
<td>Africa Alternative Framework to Structural Adjustment Programmes</td>
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<td>ADB</td>
<td>African Development Bank</td>
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<td>AGOA</td>
<td>African Growth and Opportunity Act</td>
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<td>AMF</td>
<td>African Monetary Fund</td>
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<td>BOP</td>
<td>Balance of Payments</td>
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<td>CBK</td>
<td>Central Bank of Kenya</td>
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<td>CEEWA</td>
<td>Council for Economic Empowerment of Women in Africa</td>
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<td>CG</td>
<td>Consultative Group</td>
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<td>CIA</td>
<td>Central Intelligence Agency</td>
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<td>CJPC</td>
<td>Catholic Justice and Peace Commission</td>
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<td>CLARION</td>
<td>Centre for Law Research International</td>
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<td>COMESA</td>
<td>Community of East and Southern Africa</td>
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<tr>
<td>CPI</td>
<td>Corruption Perception Index</td>
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<td>DAC</td>
<td>Development Assistance Committee</td>
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<td>EAC</td>
<td>East Africa Community</td>
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<td>EDA</td>
<td>Effective Development Assistance</td>
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<td>EEC</td>
<td>European Economic Community</td>
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<td>ESAF</td>
<td>Enhanced Structural Adjustment Facility</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GNP</td>
<td>Gross National Product</td>
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<tr>
<td>HIPC</td>
<td>Heavy Indebted Poor Countries</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>IPAR</td>
<td>Institute for Policy Analysis and Research</td>
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<td>IPPG</td>
<td>Inter Party Parliamentary Group</td>
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<td>KACA</td>
<td>Kenya Anti-Corruption Authority</td>
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<td>KANU</td>
<td>Kenya Africa National Union</td>
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<td>KIPPRA</td>
<td>Kenya Institute for Public Policy Analysis and Research</td>
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<td>KP&amp;T</td>
<td>Kenya Post and Telecommunications</td>
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<tr>
<td>KPL</td>
<td>Kenya Power and Lighting Company</td>
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<td>LCD</td>
<td>Least Developed Countries</td>
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<tr>
<td>Acronym</td>
<td>Description</td>
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<tr>
<td>MDCs</td>
<td>Most Developed Countries</td>
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<td>MNC</td>
<td>Multinational Corporations</td>
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<td>NARC</td>
<td>National Rainbow Coalition</td>
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<td>NCCK</td>
<td>National Christian Council of Kenya</td>
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<td>NCEC</td>
<td>National Convention Executive Council</td>
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<td>NEPAD</td>
<td>New Partnership for Africa Development</td>
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<td>NGO</td>
<td>Non-Governmental Organization</td>
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<td>NIEO</td>
<td>New International Economic Order</td>
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<td>ODA</td>
<td>Official Development Assistance</td>
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<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
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<td>PFP</td>
<td>Policy Framework Paper</td>
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<td>SAC</td>
<td>Structural Adjustment Credit</td>
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<td>SAF</td>
<td>Structural Adjustment Facility</td>
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<td>SAP</td>
<td>Structural Adjustment Programmes</td>
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<td>SDR</td>
<td>Special Drawing Rights</td>
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<td>SGS</td>
<td>Stakeholders Support Group</td>
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<tr>
<td>SOE</td>
<td>State Owned Enterprise</td>
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<tr>
<td>SSA</td>
<td>Sub-Saharan Africa</td>
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<tr>
<td>TA</td>
<td>Technical Assistance</td>
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<tr>
<td>UN</td>
<td>United Nations</td>
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<tr>
<td>UNCIAD</td>
<td>United Nations Commission on Trade and Development</td>
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<tr>
<td>USA</td>
<td>United States of America</td>
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<tr>
<td>USAID</td>
<td>United States Agency for International Development</td>
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<tr>
<td>WB</td>
<td>World Bank</td>
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ABSTRACT
The Research begins with the analysis of the political situation prevailing in the country from the late 1980's to the early 1990's and its causative effects on Kenya's foreign policy vis-à-vis the Bretton Woods Institutions. The analysis then looks at the influence of the IMF (International Monetary Fund) on Kenyan foreign policy from 1991, which marked the end of one-party rule in Kenya and the beginning of multi-partism. It further gives the twists and turns throughout the period till the end of 2002, when Kenyans were going into elections. The research also mirrors the end of president Moi's regime, which was speculated by many as a year of change in Kenyan politics and foreign policy as a whole.

The Research weighs in on the consequences of the aid conditionalities on the political, social and economic landscape of the country. High conditionality in fund lending has led to the creation of a long-term dependency and consequently led to Interference with Kenya's sovereignty. The high conditionality in fund lending involves designing specific set of measures to eliminate a country’s balance of payment problem which are based on narrow accounting data. As a result of this the country affected raises taxes which consequently slows economic growth. IMF's creation of long-term dependency has resulted in declining GDP levels in the recent past as compared to the time when Kenya was not receiving the loans. On the aspect of Kenya's Economic and Political Independence, for example, the Structural Adjustment Programmes (SAP's) instigated by the IMF have undermined Kenya's sovereignty as such the country cannot formulate its own appropriate policies in accordance with its own defined objectives and priorities without constant reference to external agencies and powers.

Kenya at present has more than 50% of its population living below the poverty line. The IMF and World Bank have been stressing on integrating world economies, with the main issue being trade but whether trade is really going to reduce poverty in poor countries is a subject of debate. The IMF fails to realize that countries like Kenya that are being forced into participating in trade have:
(a) An economy with a primitive industrial base for its economic development.
(b) A thin base of skilled manpower who cannot spur trade within international markets; and

(c) Most of the economy is reliant on primary production. The Kenyan farmer has been exposed to unfair competition from the influx of cheap imported agricultural products introduced via SAP’s through trade liberalization.

This study will involve library research and other appropriate sources of secondary data. Standard procedures will be used in data management and analysis. Descriptive research method will be employed to capture the determinant phenomena and behavioural attitudes together with the description of concepts in my study.

A feasible option to this issue of aid for development would be to acquire semi-independence from the Bretton Woods through Continental Initiatives such as NEPAD and the creation of the equivalent of an African Monetary Fund (AMF). These then would become regional lenders for these countries before approaching IMF or WB. It is envisaged that these Agencies (African) would come up with realistic conditionalities relevant and sympathetic to the African situation.

As we enter into the 21st century, Kenya and Africa as a continent are faced with four dangers: budget deficit, trade deficit, indebtedness and unemployment. How these issues are dealt with so as to make Kenya free from being overly controlled by the Bretton Woods Institutions is the purpose and intent of this thesis.
Acknowledgment

This thesis began as an essay on “the effect of domestic governance on our foreign policy” in the Foreign Policy Class of Prof. Munene. The literature was so absorbing that it triggered my mind to embark on an intellectual journey in the sphere of aid, development and politics. This journey would not have been possible without the tutelage of Dr. Okello and Prof. Munene. A rigorous regime of lectures, tutorials, term papers and presentations from them left me in debt and in awe.

I wish to thank in particular Damiana Kiilu of the USIU library for her meticulous skills and tact in accessing appropriate information on the Internet. She became an integral part of my armoury in the academic battle of formulating, developing and writing this thesis. Lucy Kaigongi and Susan Adhimambo deserve special mention for saving and processing this manuscript several times before it metamorphosed into this final form. I have also benefited from the commentary and camaraderie of my colleagues in the MA (IRL) class’ 2002.

Finally my deep gratitude goes to all members of my family who provided me with a judicious amount of moral and physical incentive that motivated me to get this dissertation done. To Lydia, thanks for the special lunches served at 7.00am in the morning on weekends! They became part of my ritualistic pattern during the entire period of my study at both Kenyatta University (MSC Entrepreneurship) and USIU (MA – IRL), programmes that I undertook concurrently.

To God be the Glory for lighting my path always and for being an ever present Shepherd.
Dedication

The embodiment of this dissertation is dedicated to three people who shaped my life in a very special and lasting way:

Raheri Andia
My loving grandmother and counselor per excellence!

Petro Ngiriemu
My industrious father who dreamt and toiled for my schooling from the humble job of a Government Driver.

and

in an endearing manner to

Ziliba Midika
my late mother who bore it all to ensure that her only son became an impressionable and humane person in life. Your perpetual song “Ohenze ma Ove Mwovo” translated as “Look and Live” has remained deeply entrenched in my psyche and continues to dictate my path in life.

Mama – Rest in Heavenly Peace.
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1.0 INTRODUCTION

1.1 BACKGROUND
The International Monetary Fund (IMF) is a specialized agency of the United Nations established along with the International Bank for Reconstruction and Development at the United Nations monetary and Financial Conference held in 1944 at Bretton Woods, New Hampshire. The IMF began operations in 1947. Accordingly it is sometimes referred to as "a Bretton Woods institution," along with the Bank for International Settlements and the World Bank. Together, these three institutions define the monetary policy shared almost by all countries that pursue capitalism as an economic strategy. Its purpose according to Article 1 of the Articles of Agreement of IMF is to promote international monetary cooperation, facilitate the expansion of international trade for the sake of attaining high levels of employment and real income, promote exchange-rate stability and avoid competitive depreciation, work for a multilateral system of current international payments and for elimination of exchange controls over current transactions, create confidence among member nations and give them the opportunity to correct balance of payments maladjustment's while avoiding measures destructive of national and international prosperity, and make balance of payments disequilibrium's shorter and less severe than they would otherwise be. (McQuillan and Montgomery 1999, p.6). The IMF is a permanent forum for consideration of issues of international payments, in which member nations are encouraged to maintain an orderly pattern of exchange rates and to avoid restrictive exchange practices. The membership includes 182 countries, which is open to all independent nations.

The IMF is responsible for managing the global financial system and for providing loans to its member states to help them alleviate balance of payments problems through borrowing money and paying back with interest.
Kenya joined the IMF in 1964, and the World Bank granted its first loan to Kenya in 1960. In the late 1970’s and early 1980’s, Kenya was among the major aid recipients in Africa, due to the prospects of high returns, and a history of debt repayment. Here aid will be taken to be the sum of all gifts, low-interest and soft loans made by governments or official institutions. (McCarthy, 1994:169).

Though having played over the years a significant role in rescuing Kenya from a collapsing economy, there are still some factors that have reflected negatively IMF’s relation with Kenya. These include:

a) High Conditionality in Fund Lending
b) IMF’s creation of long-term dependency
c) Interference with Kenya’s sovereignty
d) The question of how pragmatic IMF is.

**High Conditionality in Fund Lending**

High conditionality involves designing a specific set of measures to eliminate a country’s balance of payment problem; fund agreement that the program will be adequate for that purpose and the country’s commitment to implement the program. (McQuillan and Montgomery, 1999, p.64).

The corollary to these conditionalities has been inappropriate. The IMF has been more focused on narrow accounting data, with its condition to the country in need to reduce its current account deficit, and this results in the borrower restricting imports. As a result of this, the nation affected raises taxes and consequently slows economic growth.

Looking on the other side of the coin, the IMF lacks enforcement to its conditions so much so that when a country violates its agreement, the IMF grants waivers, modifying the offending conditions. Alternatively it suspends the loan, only later on to negotiate a new agreement, with money flowing once again to the borrower and the consequence to this is more violations. An example to such an occurrence is typified
by Kenya. The IMF supposedly ceased lending funds in 1997, but as late as October 2002, the IMF was still continuing offering funds. This tendency has become a habit amongst the borrowing nations, caused by the IMF, with the governments knowing very well that once the IMF holds up payments, it is all a matter of renegotiations and the process begins a new.

**IMF’s Creation of Long-Term Dependency**

IMF lending has formed a kind of cognitive mapping among the borrowers. It has created long-term dependency as compared to its being supposedly of short-term assistance. According to an economist Doug Bandow, most countries have actually become long-term users of IMF loans especially the less-developed countries. (Johnson and Schaefer, 1999, p.55). Instead of IMF helping in economic development, it has generally weakened the world economy. A review shows that most of IMF’s loan recipients have been having a declining GDP than before they received the loans. Kenya exemplifies this predicament and the whole concept of Aid has indeed become a vicious cycle.

**Interference with Kenya’s Sovereignty.**

Among the agreements between IMF and borrowing nations was non-interference with the domestic politics of the nations it is giving the aid. The IMF has not adhered to this and instead has interfered with the day-to-day running of the governments in question to an extent that it appears as if it is the IMF running the show and calling the shots. The Structural Adjustment Programmes (SAP’s) instigated by the IMF have in the recent past undermined Kenya’s sovereignty. Sovereignty that extends to the ability of a state to formulate its own economic policies in accordance with its own defined objectives and priorities, and to do so without constant reference to external agencies and powers.

Kenya’s policies are being dictated by Western authorities, without even inviting Kenyan’s to help in designing the policies. This was evident in the issue of the creation of KACA; IMF ordered under its conditions an anti-corruption unit to be
formed. The government then in the name of avoidance from being exempted from aid formed the unit. But later on parliament and the constitutional court found its creation to be illegal.

Kenyans on the other hand share part of the blame for the issues mentioned above. This is as a consequence of:

a) Allowing Bad Governance and Corruption to prevail during the period under review
b) Falling victim to the Big lie of foreign aid.

Bad Governance and Corruption.
Relations between the IMF and Kenya were almost breaking down due to bad governance and corruption. The funds and program were in limbo owing to the lack of progress in the economic and political reforms stipulated as a condition for aid. This was evident in 1997, when IMF suspended a $220 million loan to Kenya because of what they termed as the countries refusal to clean up pervasive bribery and self-enrichment. This move came after the IMF had made new guidelines stating that, “financial assistance from the IMF … could be suspended or delayed on account of poor governance…. If there is a reason to believe it could have significant macroeconomic implications that threaten the successful implementation of the program, or puts in doubt the purpose of the use of IMF resources.” (Chidanad, 1999). A policy to which president Moi is said to have responded to with outrage describing it as “purely political.”

The Big Lie of Foreign Aid
The article in the Daily Nation entitled “The Aid Circus is back in town, tread carefully” (Daily Nation, June 8, 2003 p. 16) clearly brings out the mirage nature of foreign aid. According to World Bank figures, Kenya received an annual average of $200 million in foreign aid in the 1970's; over $600 million in the 1980's; and nearly $1 billion in the early 1990's. At the peak of our aid-fest, we were receiving net aid inflows of $40 per person per year – 14% of our Gross Domestic Product and a
staggering 45% of the Government budget. We were a wash with aid and were receiving it from all corners. What on earth did we do with it? The collapsed infrastructure; the crisis in the education sector; the health care in intensive unit; multiple abandoned white elephant projects; 100 corrupt Billionaires among 30 million starving masses?

In the end run, the people get hurt and it affects foreign policy. In essence, our leaders are the ones who cash in on whatever comes in as aid and the average Kenyan sinks deeper in the wells of poverty.

1.2 STATEMENT OF THE PROBLEM
In the late 1970’s and early 1980’s, Kenya was among the major aid recipients in Africa, two decades later, the countries GDP is declining and its citizens are poorer than they were at independence.

The country is embroiled in an Aid-dependency syndrome with stringent conditionalities from IMF and WB leading to a dangerous decline in economic performance. The challenges of a huge budget deficit, trade deficit, indebtedness and poverty require a serious reflection on both the past and the future. It is therefore imperative that the country seeks alternative routes of development outside the monetary framework of the Bretton Woods Institutions albeit the monopolistic tendencies of the institutions on world economics.

The practabilities of good democratic governance, prudent economic programmes, and frugal financial management will be necessary in order to address the economic/social gap that has led to the Aid-dependency syndrome in this country.

1.3 OBJECTIVES
(a) To evaluate the causes that led to the Bretton Woods Institutions imposing stringent lending policies to Kenya.
(b) To assess the magnitude of the aid package extended to Kenya since 1990 by the donors and its consequent utilization and impact on the economic development of Kenya.

(c) To deliberate on Macro-Economic structures and determinants at global level.

(d) To propose alternative strategies of Aid sourcing and utilization so as to enhance support and economic development of Kenya.

1.4 RESEARCH QUESTIONS

(a) What factors led to the Bretton Woods Institution imposing aid-conditionalities on Kenya?

(b) What is the magnitude of the total aid given to Kenya over the last one and half decades; how has it been utilized and what are the indicators of its benefit to the country?

(c) What are the determinant factors and indicators of economic performance at global level?

(d) What alternative sources of funding are available and which approaches can be adopted for effective utilization of these funds so as to attract support and enhance economic development of Kenya?

1.5 JUSTIFICATION AND SIGNIFICANCE

Though having played a significant role in rescuing Kenya from a collapsing economy over the years, there are negative factors that have come out of the relationship between the IMF/WB and Kenya. These include; high conditionality in fund lending; long-term dependency; interference with sovereignty; and lack of a clear rational basis for aid provision.

It is therefore necessary for the country to strive to come out of this quagmire so as to realize positive indices in economic development, which in turn will see to the improvement of the livelihoods of the 50% of the population currently living under the poverty line.
This can be achieved by the IMF adopting the following approaches:

- Solving the conditionality quandary by debt waiver
- The catalytic effect by giving the country less strict conditions to access fund resources
- Disbursement of funds to other organizations e.g. churches and NGO’s.

Or the Kenyan government needs to look for alternative sources of funding for its economic development. It is hoped that this research will attempt to make suggestions that will improve our relations with the Bretton Woods and also spur debate and research into other options towards economic development.

1.6 CONCEPTUAL FRAMEWORK

That as a consequence of bad governance, foreign aid intended for development has been misappropriated leading to stiffer lending conditions and demands for transparency and accountability. Due to these conditionalities the country has a huge budget deficit and untold poverty as reflected in our level of indebtedness and the declining GDP. A dependency – syndrome has therefore set in. IMF lending has created long-term dependency instead of the supposedly short-term assistance. According to an economist Dong Bandow, most countries have actually become long-term users of IMF loans especially, the less developed countries. Instead of the IMF helping in economic development, it has generally weakened the world economy. A review shows that most of IMF’s loan recipients have been having a declining GDP than before they received the loans. Prudence therefore dictates that alternatives be formed to overcome this situation. These can be in the form of new agreements with IMF/WB that will allow for the country to move out of economic stagnation or looking for new sourcing and frugal management of its resources.

1.7 SCOPE AND LIMITATIONS

- The study will rely essentially on secondary data.
- The globalization phenomenon hinders any aggressive posturing economically by a small nation like Kenya.
The Hegemony of the USA and its dominant position in the IMF and WB will continue to be a hindrance for any perceived economic independence for Kenya.
That our economic base is still primitive and its industrial base heavily relying on primary products.

DEFINITIONS OF TERMS


International Monetary Fund: A specialized United Nations Agency whose purpose is to promote International Monetary Corporation and facilitate the expansion of International trade. The IMF is responsible for managing the global financial system and for providing loans to its member states to help them alleviate balance of payments problems.

Aid Conditionality: Specific set measures that have to be met by countries in order to attract donor aid support.

Sovereignty: The right of a nation to self-determination and preservation.

Structural Adjustment Programmes (SAPs): A means of providing financial assistance to low-income member states undertaking medium-term macro-economic programs. They were designed to overcome protracted balance of payments problem and foster economic growth.

AID: Is taken to be the sum of all gifts, low-interest and soft loans made by governments or official Institutions.

Nyayoism: The philosophy of governance under President Moi (1978-2002).

Cold War: The Bipolarity era of the Soviet-American superpowers.

Multinational Corporation: A Huge Business Enterprise that owns and controls productive activities in more than one country.

1.9 METHODOLOGY
This study was carried out using the following methods:
(a) Library Research
(b) Informal Interviews
(c) Descriptive Statistical Analysis

Library Research:
The data used in this study was obtained from available relevant literature. This enabled for an evaluation of the past performance of the economy and the subsequent debt accumulation, resulting in the aid conditionalities. The IMF, WB, and Ministry of Planning and Economic Development proved to be an invaluable source of data.

This research method enabled the researcher to have an in-depth perception into the phenomena of aid conditionalities and the existing global economic trends.

The three main sub-groups of secondary data used included: documentary data, survey-based data and those compiled from multiple sources. Factors put under consideration while utilizing secondary data included:
➢ That the data was relevant to providing answers to the research questions.
➢ There was access to the data.
➢ The suitability of the data had a measurement of validity.
➢ The suitability criterion on coverage that the data cover the population about which data is needed was taken into consideration.
Informal Interviews:
Informal interviews were carried out with the Ministry of Planning Officials and Ministry of Foreign Affairs desk officers on Funding and Donor Agencies. Continuous discussions and contact were maintained with the IMF/WB Libraries and staff.

Descriptive Statistical Analysis:
Given that much of the data used was drawn from written works I adopted a descriptive statistical analysis research design in this study. Descriptive research design aims at describing a problem as accurately as possible. This is particularly with respect to the relationship between Aid, development and the poverty index. It attempts to show an accurate picture of a situation analysis.
CHAPTER TWO

2.0 LITERATURE REVIEW

The literature review is categorized under the following sub-topics:

1. The International Monetary Fund – Establishment, functions and modes of operation.

2. Existing models of economic development approaches – Liberal structuralists and the politics of International Economic Relations.

   - Cold War disillusionment
   - Nyayoism
   - Opposition Initiatives

4. The conditionalities of Aid support to Kenya since 1991.
   - Reasons for aid conditions
   - Type of conditionalities
   - Responses by the Government to the demands.

2.1 THE INTERNATIONAL MONETARY FUND (IMF)

Background

The IMF is an international organization of 184 member countries. It was established to promote international monetary cooperation, exchange stability, and orderly exchange arrangements; so as to foster economic growth and high levels of employment. It was also intended to provide temporary financial assistance to countries to help ease balance of payments adjustment.

Since the IMF was established its purpose has remained unchanged but its operations – which involve surveillance, financial assistance, and technical assistance – have developed to meet the changing needs of its member countries in an evolving world economy.

The purposes of the International Monetary Fund are:-
(i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

(ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

(iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

(v) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

Members undertake to keep the IMF informed about economic and financial policies that impinge on the exchange value of their national currencies so that other members can make appropriate policy decisions. On joining the fund, each member is assigned a quota in special drawing rights (SDRs), the fund’s unit of account, whose value is based on the weighted average value of five major currencies (In June 1998, the SDR was worth about U.S. $1.34.) Each member’s quota is an amount corresponding to its relative position in the world economy. As the world’s leading economy, the United States has the largest quota. The amount of the quota subscription determines how large a vote a member will have in IMF deliberations, how much foreign exchange it may withdraw from the fund, and how many SDRs it will receive in periodic allocations.
In March 1986, the structural adjustment facility was started, better known as the SAP’s – Structural Adjustment Programs.

The SAP’s were introduced as a means of providing financial assistance to low-income member states undertaking medium-term macro-economic programs. They were designed to overcome protracted balance of payments problems and foster economic growth. (McQuillan and Montgomery, 1999, p.64). The typical IMF stabilization measures involve:

- General commitment to cooperate with the IMF in setting policies.
- Ending government monopolies i.e. privatization.
- Deregulating industries and reforming the banking sector.
- Redirecting domestic credit from the public to the private sector.
- Raising real interest rates to market levels.
- Devaluation of local currencies.
- Restriction of money supply.
- Pursuing fiscal adjustment (in particular, cut government spending).
- Trade liberalization i.e. removing barriers to export growth.
- Lowering tariffs, ending quotas, and removing exchange controls and discriminatory exchange rates.
- Maintaining adequate levels of international reserves.
- Adjusting income policies (in particular restraining wages).

To alleviate poverty, IMF recommends the following measures to be undertaken: (Osunsande 1993).

- Increasing agricultural producer prices.
- Improving extension services, marketing, credit availability, and transportation services in the rural sector.
- Encouraging labour-intensive public works projects that provide employment and income for the poor.
- Increasing outlays on public health and education services that directly benefit the poor and rural areas.
• Well-targeted transfers to vulnerable groups, such as the poor being exempted higher user fees for health and education, and
• Providing severance pay and/or retraining programs when adjustment involves a retrenchment of employment in the civil service or public enterprises.

2.2 EXISTING MODELS OF ECONOMIC DEVELOPMENT

2.2.1 The Nature of Development Economics

Traditional economics is concerned primarily with the efficient, least-cost allocation of scarce productive resources, and with the optimal growth of these resources over time so as to produce an ever-expanding range of goods and services. By traditional economics encompasses the classical and neoclassical economics taught in introductory textbooks. Traditional neoclassical economics deals with an advanced capitalist world of perfect markets, consumer sovereignty, automatic price adjustments, decisions made on the basis of marginal, private profit, and utility calculations, and equilibrium outcomes in all product and resource markets. It assumes economic “rationality” and a purely material, individualistic, self-interested orientation towards economic decision making.

Political economy goes beyond traditional economics to study, among other things, the social and institutional processes through which certain groups of economical and political elites influence the allocation of scarce productive resources now and in the future, either exclusively for their own benefit or for their own benefit plus that of the larger population. Political economy is therefore concerned with the relationship between politics and economics, with a special emphasis on the role of power in economic decision-making.

Development economics has an even greater scope. In addition to being concerned with the efficient allocation of existing scarce (or idle) productive resources and with their sustained growth over time, it must also deal with the economic, social, political, and institutional mechanisms, both public and private, necessary to bring about rapid (at least by historical standards) and large-scale improvements in levels of
living for the masses of poverty-stricken, and malnourished peoples of Africa, Asia, and Latin America. Unlike the more developed countries (MDCs), in the less developed countries (LDCs), most commodity and resource markets are highly imperfect, consumers and producers have limited information, major structural changes are taking place in both the society and the economy, and “disequilibrium situations” often prevail (i.e., prices do not adequately supply and demand). In many cases economic calculations are dominated by political and social priorities such as building a new nation in Africa, replacing foreign advisors with local decision makers, resolving tribal or ethnic conflicts, or preserving religious and cultural traditions. At the individual level, family, clan, religious, and/or tribal considerations may take precedence over private, self-interested utility or profit maximizing calculations.

Thus, development economics, to a greater extent than traditional neoclassical economics or even political economy, must be concerned with the economic, cultural, and political requirements for affecting rapid structural and institutional transformations of entire societies in a manner that will most efficiently bring the fruits of economic progress to the broadest segments of their populations. (Low and Howe 1989). As such, a larger government role and some degree of coordinated economic decision-making directed towards transforming the economy are usually viewed as essential components of development economics.

The study and practice of development economics must therefore be sensitive to the uniqueness and diversity of Third World societies. It must also recognize that there are few, if any, truly “universal” principles or “laws” of economics – that is, economic relationships that are immutable at all times and in all places. There are at best only “tendencies.” For example, increased consumer demand tends to elicit a greater quantity supplied. But, it is evident that there are conditions in many developing countries where this positive supply-response may not operate.
Because of the heterogeneity of the Third World, there also can be no single “development economics,” no universal “Third World Economics” applicable to any or all LDCs. Rather development economics must be eclectic in nature – attempting to combine relevant concepts and theories from traditional economic analysis along with new models and broader multidisciplinary approaches derived from studying the historical and contemporary development experience of Africa, Asia, and Latin America. (Soedjatmoko 1995). Today development economics is a field that is on the crest of a newly breaking wave, with new theories and new data continuously emerging. These theories and statistics sometimes confirm and sometimes challenge traditional ways of viewing the world. The ultimate purpose of development economics, however, remains constant – namely, to enable us to better understand Third World economies in order to help improve the material lives of three-quarters of the global population.

2.2.2 **Economics as Social Systems**

Economics and economic systems, especially in the Third World, need to be viewed in much broader perspective than that postulated by traditional economics. They need to be analyzed within the context of the overall social system of a country and, indeed, within an international, global context as well. (Tadaro 1993). By a “social system” it reflects the independent relationships between so-called economic and noneconomic factors. The latter include attitudes towards life, work and authority, public and private bureaucratic and administrative structures, patterns of kinship and religion, cultural traditions, systems of land tenure, the authority and integrity of government agencies, the degree of popular participation in development decisions and activities, and the flexibility or rigidity of the world to another, and from one culture and social setting to another. At the international level, it is important to also consider the organization and rules of conduct of the global economy – how they were formulated, who controls them, and who benefits most from them.

Resolving development problems and achieving development is a much more complicated task than some economists would lead us to believe. Increasing national
production, raising levels of living, and promoting widespread employment opportunities are all as much a function of the values, incentives, attitudes and beliefs, and the institutional and power structure of both the domestic and the global society as they are the direct outcomes of the manipulation of strategic economic variables such as savings, investment, product and factor prices, and foreign-exchange rates. As Indonesian intellectual and former rector of the United Nations University, Soedjatmoko, has to aptly put it:

*Looking back over these years, it is now clear, that, in its preoccupation with growth and its stages and with the provision of capital and skills, development theorists have paid insufficient attention to institutional and structural problems and to the power of historical, cultural, and religious forces in the development process.*

Just as some economists occasionally make the mistake of confusing their theories with universal truths, so they also sometimes mistakenly dismiss these noneconomic variables as "nonquantifiable" and therefore of dubious importance. Yet they often play a critical role in the success or failure of the development effort.

### 2.2.3 Leading Theories of Economic Development

The literature of economic development over the past 40 years has been dominated by four major and sometimes competing strands of thought:

1. the linear stages of growth model
2. theories and patterns of structural change
3. the international dependence revolution and
4. the neoclassical, free market counter-revolution.

The thinking of the 1950s and early 1960s focused mainly on the concept of stages of economic growth in which the process of development was viewed as a series of successive stages through which all countries must pass. It was primarily an economic theory of development in which the right quantity and mixture of saving, investment, and foreign aid were all that was necessary to enable Third World nations to proceed along an economic growth path that historically had been followed by the
more developed countries. Development thus became synonymous with rapid, aggregate economic growth. (Rostow 1960).

The linear stages approach was then replaced in the 1970s to a great extent by two competing economic (and indeed ideological) schools of thought. The first, which focuses on theories and patterns of structural change, uses modern economic theory and statistical analysis in an attempt to portray the internal process of structural change that a “typical” developing country must undergo if it is to succeed in generating and sustaining a process of rapid economic growth. The second, the international dependence revolution, is more radical and political in orientation. It views underdevelopment in terms of international and domestic power relationships, institutional and structural economic rigidities, and the resulting proliferation of dual economies and dual societies both within and among the nations of the world. Dependence theories tend to emphasize external and internal institutional and political constraints on economic development. Emphasis is placed on the need for major new policies to eradicate poverty, to provide more diversified employment opportunities, and to reduce income inequalities. These and other egalitarian objectives are to be achieved within the context of a growing economy, but economic growth per se is not given the exalted status accorded to it by the linear-stages and the structural-change models. Finally, throughout much of the 1980s, a neoclassical counter-revolution in economic thought took place—one that emphasized the beneficial role of free markets and the heavy economic costs of government intervention in promoting development. Let's now look at each of these alternatives approaches in greater detail.

**The Linear Stages Theory**

When the interest in the poor nations of the world really began to materialize following the Second World War, economists in the industrialized nations were caught off guard. They had no readily available conceptual apparatus with which to analyze the process of economic growth in largely peasant, agrarian societies characterized by the virtual absence of modern economic structures. But they did
have the recent experience of the Marshall Plan in which massive amounts of U.S. financial and technical assistance enabled the war-torn countries of Europe to rebuild and modernize their economies in a matter of a few years. Moreover, was it all true that all modern industrial nations were once undeveloped peasant agrarian societies? Surely their historical experience in transforming their economies from poor agricultural subsistence societies to modern industrial giants had important lessons for the "backward" countries of Asia, Africa and Latin America? (Chenery 1979). The logic and simplicity of these two strands of thought – the utility of massive injections of capital and the historical pattern of the now developed countries – was too irresistible to be refute by scholars, politicians, and administrators in rich countries to whom people and ways of life in the Third World were often no more real than UN statistics or scatter chapters in anthropology books.

**Rostow's Stages of Growth**

Out of this somewhat sterile intellectual environment, and fueled by the cold war politics of the 1950s and 1960s with the resulting competition for the allegiance of newly independent nations, came the doctrine of the stages of economic growth. Its most influential and outspoken advocate was the American economic historian W.W. Rostow. According to the Rostow doctrine, the transition from underdevelopment to development can be described in terms of a series of steps or stages through which all countries must proceed. As professor Rostow wrote in the opening chapter of his *Stages of Economic Growth*:

> This book presents an economic historian's way of generalizing the sweep of modern history.... It is possible to identify all societies, in their economic dimensions, as lying within one of five categories: the traditional society, the pre-conditions for take-off into self-sustaining growth, the drive to maturity, and the age of high mass consumption.... These stages are not merely descriptive. They are not merely a way of generalizing certain factual observation about the sequence of development of modern societies. They have an inner logic and continuity.... They constitute, in the end, both a
theory about economic growth and a more general, if still highly partial, theory about modern history as a whole.

The advanced countries, it was argued, had all passed the stage of “take-off into self-sustaining growth,” and the underdeveloped countries that were still in either the traditional society of the “pre-conditions” stage had only to follow a certain set of rules of development to take off in their turn into self-sustaining economic growth.

One of the principal tricks of development necessary for any takeoff was the mobilization of domestic and foreign saving in order to generate sufficient investment to accelerate economic growth. The economic mechanism by which more investment leads to more growth can be described in terms of the Harrod-Domar growth model.

**Structural Change Models**

The theory of structural change focuses on the mechanism by which underdeveloped economies transform their domestic economic structures from a heavy emphasis on traditional subsistence agriculture to a more modern, more urbanized, and more industrially diverse manufacturing and service economy. It employs the tools of neoclassical price and resource allocation theory and modern econometrics to describe how this transformation process takes place. (Leys 1975). Two well known representative examples of the structural-change approach are the “two-sector surplus labour” theoretical model of W. Arthur Lewis and the “patterns of development” empirical analysis of Hollis Chenery.

**The Lewis Theory of Development**

The Basic Model. One of the best known early theoretical models of development that focused on the structural transformation of a primarily subsistence economy was that formulated by Nobel Laureate W. Arthur Lewis in the mid 1950s and later modified, formalized, and extended by John Fei and Gustav Ranis. The Lewis two-sector model became the received “general” theory of the development process in labour surplus Third World nations during most of the 1960s and early 1970s. It still has many adherents today—especially among American development economists.
In the Lewis model, the underdeveloped economy consists of two sectors:

1. a traditional, overpopulated rural subsistence sector characterized by zero marginal labour productivity – a situation that permits Lewis to classify this labour as “surplus” in the sense that it can be withdrawn from the agricultural sector without any loss of output and

2. a high productivity modern urban industrial sector into which labour from the subsistence sector is gradually transferred. The primary focus of the model is both on the process of labour transfer and on the growth of output and employment in the modern sector. Both labour transfer and modern sector employment growth are brought about by output expansion in that sector. (Bauer 1984). The speed with which this expansion occurs is determined by the rate of industrial investment and capital accumulation in the modern sector. Such investment is made possible by the excess of modern sector profits over wages on the assumption that “capitalists” reinvest all their profits. Finally, the level of wages in the urban industrial sector is assumed to be constant and determined as a given premium over a fixed average subsistence level of wages in the traditional agricultural sector. (Lewis assumed that urban wages would have to be at least 30% higher than average rural income to induce workers to migrate from their home areas.) At the constant urban wage, the supply curve of rural labour to the modern sector is considered to be perfectly elastic.

*Structural Change and Patterns of Development*

Like the earlier Lewis model, the “patterns of development” analysis of structural change focuses on the sequential process through which the economic, industrial, and institutional structure of an underdeveloped economy is transformed over time to permit new industries to replace traditional agriculture as the engine of economic growth. (Myint 1996). However, in contrast to the Lewis model and the original “stages” view of development, increased savings and investment are perceived by “patterns of development” analysts as necessary but not sufficient conditions for economic growth. In addition to the accumulation of capital, both physical and
human, a set of interrelated changes in the economic structure of a country are required for the transition from a traditional to a modern economic system. These structural changes involve virtually all economic functions including the transformation of production and changes in the composition of consumer demand, international trade, and resource use as well as changes in socioeconomic factors such as urbanization and the growth and distribution of a country's population.

Empirical structural-change analysts emphasize both domestic and international constraints on development. The domestic ones include economic constraints such as a country's resource endowment and its physical population size as well as institutional constraints such as government policies and objectives. International constraints on development include access to external capital, technology, and international trade. Differences among developing countries in their level of development are largely ascribed to these domestic and international constraints. However, it is the international constraints that make the transition of currently developing countries differ from that of the now industrialized countries. To the extent that developing countries have access to the opportunities presented by the industrial countries as sources of capital, technology, and manufactured imports as well as markets for exports, they can make the transition at an even faster rate than those that were achieved by the industrial countries during the early periods of their economic development. Thus, unlike the earlier stages model, the structural-change model recognizes the fact that developing countries are part of a highly integrated international system that can promote (as well as hinder) their development. (Seers 1989).

The most well-known model of structural-change is the one based largely on the empirical work of Harvard economist Hollis Chenery, who examined patterns of development for numerous third World countries during the post-war period 1950 to 1973. His empirical studies, both cross-sectional (i.e., among countries at a given point in time) and time-series (i.e., over long periods of time), of countries at different
levels of per capita income led to the identification of several characteristic features of the development process.

**The International Dependence Revolution**

During the 1970s international-dependence models gained increasing support, especially among Third World intellectuals, as a result of a growing disenchantment with both the stages and the structural change models. (Owens 1992). Essentially, international, political and economic rigidities, both domestic and international, and caught up in a dependence and dominance relationship to rich countries. Within this general approach there are three major streams of thought: the neocolonial dependence model, the false paradigm model, and the dualistic development thesis.

**The Neocolonial Dependence Model**

The first major stream, which we call the "neocolonial dependence model," is an indirect outgrowth of Marxist thinking. It attributes the existence and continuance of Third World underdevelopment primarily to the historical evolution of a highly unequal international capitalist system of rich country-poor country relationships. Whether because rich nations are intentionally exploitative or unintentionally neglectful, the coexistence of rich and poor nations in an international system dominated by such unequal power relationships between the center (the developed countries) and the periphery (the LDCs) renders attempts by poor nations to be self-reliant and independent in their development efforts difficult and sometimes even impossible. Certain groups in the developing countries (e.g., landlords, entrepreneurs, military rulers, merchants, salaried public officials, and trade union leaders) who enjoy high incomes, social status, and political power constitute a small elite ruling class whose principal interest, whether knowingly or not, is in the perpetuation of the international capitalist system of inequality and conformity by which they are rewarded. Directly and indirectly, they serve (are dominated by) and are rewarded by (dependent on) special interest international power groups including multinational corporations, national bilateral aid agencies, and multilateral assistance organizations like the World Bank or International Monetary Fund (IMF), which are
tied by allegiance and/or funding to the wealthy capitalist countries. The elites’ activities and viewpoints often serve to inhibit any genuine reform efforts that might benefit the wider population and in some cases actually lead to even lower levels of living and to the perpetuation of underdevelopment. In short, the neo-Marxist, neocolonial view of underdevelopment attribute a large part of the Third World’s continuing and worsening poverty to the existence and policies of the industrial capitalists countries of the Northern Hemisphere and their extensions in the form of small but powerful elite or comprador groups in the less developed countries. Underdevelopment is thus seen as an externally induced phenomenon as opposed to the linear stages and structural-change theories that stressed internal constraints such as insufficient savings and investment or lack of education and skills. (Morris 1989). Revolutionary struggles or at least major restructurings of the world capitalist system are therefore required to free dependent Third World nations from the direct and indirect economic control of their First World and domestic oppressors.

One of the most forceful statements of the international dependence school of thought is that of Theotonio Dos Santos:

"Underdevelopment, far from constituting a state of backwardness prior to capitalism, is rather a consequence and a particular form of capitalist development known as dependent capitalism... dependence is a conditioning situation in which the economies of one group of countries are conditioned by the development and expansion of others. A relationship of interdependence between two or more economies or between such economies and the world trading system becomes a dependent relationship when some countries can expand through self-impulsion while others, being in a dependent position, can only expand as a reflection of the expansion of the dominant countries, which may have positive or negative effects on their immediate development. In either case, the basic situation of dependence causes these countries to be both backward and exploited. Dominant countries are endowed with technological, commercial, capital and socio-political predominance over dependent countries – the form of this predominance varying according to the
particular historical moment – and can therefore exploit them, and extract part of the locally produced surplus. Dependence, then is base upon an international division of labour which allows industrial development to take place in some countries while restricting it in others, whose growth is conditioned by and subjected to the power centers of the world.

Curiously enough, a very similar but obviously non-Marxist perspective was expounded by Pope John Paul II in his widely quoted 1988 Encyclical Letter (a formal, elaborate expression of papal teaching) Sollicitude Rei Socialis (The Social Concerns of the Church), in which he declared that:

One must denounce the existence of economic, financial, and social mechanisms which, although they are manipulated by people, often function almost automatically, thus accentuating the situation of wealth for some and poverty for the rest. These mechanisms, which are maneuvered directly or indirectly by the more developed countries, by their very functioning, favour the interests of the people manipulating them. But in the end they suffocate or condition the economies of the less developed countries.

The Neoclassical Counter Revolution

In the 1980s the political ascendancy of conservative governments in the United States, Canada, Britain, and West Germany brought with it a neoclassical, free-market counter-revolution in economic theory and policy. This counter-revolution took the form of supply-side macroeconomics and the privatization of public corporations in developed nations and the call for dismantling of public ownership, planning, and regulation of economic activities in developing countries. (Hicks & Streeten 1991). With their controlling votes on the board’s of the World’s two most powerful international financial agencies – The World Bank and the International Monetary Fund – and with the simultaneous erosion of influence of organizations such as the International Labour Organization (ILO), the United Nations Development Programme (UNDP), and the United Nations Conference on Trade and Development (UNCTAD), which more fully represents the views of Third World
delegates, it was inevitable that the neoconservative, free market challenge to the interventionist arguments of dependency theorists would gather momentum.

The central argument of the neoclassical counter-revolution is that underdevelopment results from poor resource allocation due to incorrect pricing policies and to too much state intervention by overly active Third World governments. Rather, the leading writers of the counter-revolution school such as Lord Peter Bauer, Deepak Lal, Ian Little, the late Harry Johnson, Bela Balassa, Julian Simon, Jagdish Bhagwati, Anne Krueger, and others argue that it is this very state intervention in economic activity that slows down the pace of economic growth. By permitting free markets to flourish privatizing state-owned enterprises, promoting free trade and export expansion, welcoming foreign investors (i.e., from developed countries), and eliminating the plethora of governmental regulation and price distortions, in factor, product, and financial markets, the neoconservatives argue that both economic efficiency and economic growth will be stimulated. Contrary to the claims of the dependency theorists, the neo classical counter-revolutionaries argue that the Third World (although many don’t even accept this terminology) is underdeveloped not because of the predatory activities of the First World and the international agencies that it controls, but rather because of the heavy hand of the state and the corruption, inefficiency, and lack of economic incentives that permeate the economies of developing nations. (Hunt 1987). What is needed, therefore, is not a reform of the international economic system or a restructuring of a dualistic developing economies or an increase in foreign aid or attempts to control population growth or a more effective central planning system. Rather, it is simply a matter of promoting free markets and laissez-faire economics within the context of permissive governments that allow the “magic of the marketplace” and the “invisible hand” of market prices to guide resource allocation and stimulate economic development. They point both to the success of countries like South Korea, Taiwan, Hong Kong, and Singapore as “free market” examples (although, these “Asian tigers” are far from the laissez-faire prototype ascribed to them by neoconservatives) and to the failures of the public-inventionist economies of Africa and Latin America.
2.2.4 Three Core Values of Development

Is it possible to define or broadly conceptualize what we mean when we talk about development as the sustained elevation of an entire society and social system toward a “better” or “more humane” life? The question, what constitutes the good life? Is as old as philosophy and humankind. It is a timeless and perennial question that needs to be reevaluated and freshly answered with the changing environment of world society. (Meier 1987). The appropriate answer for Third World nations in the last decade of the 20th century is not necessarily the same as it would have been in previous decades. But we believe with professor Goulet and others that at least three basic components or core values should serve as a conceptual basis and practical guideline for understanding the “inner” meaning of development. These core values are life sustenance, self esteem, and freedom, representing common goals sought by all individuals and societies. They relate to fundamental human needs that find their expression in almost all societies and cultures at all times. Allow me to examine each in turn.

Life Sustenance; The Ability to Provide Basic Needs

All people have certain basic needs without which life would be impossible. These “life-sustaining” basic human needs include food, shelter, health, and protection. When any of these is absent or in critically short supply, we may state without reservation that a condition of “absolute underdevelopment” exists. A basic function of all economic activity, therefore, is to provide as many people as possible with the means of overcoming the helplessness and misery arising from a lack of food, shelter, health and protection. To this extent, we may claim that economic development is a necessary condition for the improvement in the “quality of life” that is “development.” Without sustained and continuous economic progress at the individual as well as the societal level, the realization of the human potential would not be possible. One clearly has to “have enough in order to be more.” Rising per capita incomes, the elimination of absolute poverty, greater employment
opportunities, and lessening income inequalities, therefore, constitute the necessary but not the sufficient conditions for development.

**Self Esteem: To Be a Person**

A second universal component of the good life is self esteem - a sense of worth and self respect, of not being used as a tool by others for their own ends. All peoples and societies seek some basic form of self esteem, although they may call it authenticity, identity, dignity, respect, honour, or recognition. The nature and form of this self esteem may vary from society to society and from one culture to another. However, with the proliferation of the "modernizing values" of developed nations, many societies in Third World countries that previously may have possessed a profound sense of their own worth suffer from serious cultural confusion when they came in contact with economically and technologically advanced societies because national prosperity has become an almost universal measure of worth. (Simon 1991). Because of the significance attached to material values in developed nations, worthiness and esteem are nowadays increasingly conferred only on those countries who possess economic wealth and technological power- those that have "developed."

Again, we may quote Professor Goulet:

> The relevant point is that underdevelopment is the lot of the majority of the world’s population. As long as esteem or respect was dispensed on grounds other than material achievement, it was possible to resign oneself to poverty without feeling disdained. Conversely, once the prevailing image of the better life includes material welfare as one of its essential ingredients it becomes difficult for the materially "underdeveloped" to feel respected or esteemed... nowadays the Third World seeks development in order to gain the esteem which is denied to societies living in a state of disgraceful "underdevelopment."... Development is legitimized as a goal because it is an important, perhaps even an indispensable, way of gaining esteem.
Freedom from Servitude: To Be able to Choose

A third and final universal value is the concept of freedom. Freedom here is not to be understood in the political or ideological sense (e.g., the free world), but in the more fundamental sense of freedom or emancipation from alienating material conditions of life and from social servitude to nature, ignorance, other people, misery, institutions, and dogmatic beliefs. Freedom involves the expanded range of choices for societies in the pursuit of some social goal we call development. W. Arthur Lewis stressed the relationship between economic growth and freedom from servitude when he concluded that ‘the advantage of economic growth is not that wealth increases happiness, but that it increases the range of human choice. Wealth can enable a person to gain greater control over nature and his physical environment (e.g., through the production of food, clothing and shelter) than he would have if he remained poor. It also gives him the freedom to choose greater leisure, to have more goods and services, or to deny the importance of these material wants and live a life of spiritual contemplation.

The Three Objectives Development

We may conclude that development is both a physical reality and a state of mind in which society has, through some combination of social, economic, and institutional processes, secured the means for obtaining a better life. Wherever the specific components of this better life, development in all societies must have at least the following three objectives: (Killick 1986).

1. To increase the availability and widen the distribution of basic life-sustaining goods such as food, shelter, health, and protection.

2. To raise levels of living including, in addition to higher incomes, the provision of more jobs, better education, and greater attention to cultural and humanistic values, all of which will serve not only to enhance material well-being but also to generate individual and national self esteem.

3. To expand the range of economic and social choices available to individuals and nations by freeing them from servitude and dependence not only in
relation to other people and nation-states but also to the forces of ignorance and human misery.

2.3 KENYA’S POLITICAL LANDSCAPE (1963-1991)

2.3.1 Introduction

Essentially this Research attempts to articulate the concept of foreign aid in relation to Kenya’s domestic and foreign policies as viewed at the International scene. The direct relationship between good governance and the flow of aid is articulated and an effort is made to show how the conditionalities imposed by the donors were as a direct consequence of the countries leaders inability to meet certain political and economic norms that were critical to transparent and accountable governance.

The analysis concentrates on the two Bretton Woods agencies, namely, the International Monetary Fund (IMF) and the World Bank (WB) together with the other bilateral and multilateral donors; their influence on Kenyan foreign policy from 1991, the period that marked the end of the single party rule in Kenya and the beginning of multi-partism. The paper then attempts to give the twists and turns throughout that period till last year, 2002, when Kenyans voted in the NARC Government, an indication, perhaps, of a positive shift in its foreign policy with the donor countries and agencies.

2.3.2 Cold War Disillusionment

It is often argued that the shift of US policy towards the marginalization of pro-capitalist states like Kenya came about as a result of the end of the cold war. This is not true since the process of realignment and re-evaluation of interests had begun long before the collapse of the Soviet Union. It is reasoned that the shift was as a result of the disappointments that arose out of the failure in Vietnam and the national embarrassment arising from the Watergate scandal.

Initially the anti-communist dictators of the Third World were protected by the 1950 and 1959 “Documents on National Security” which categorically mandated the US government to support and maintain good relationships with third world
authoritarians because they were anti-communist and represented stability in the bipolar international scene.

The disillusionment in the wake of Vietnam war and Watergate scandal (1972) awakened congress to pass several legislatures among them the legislature that inhibited the U.S. Presidents freedom to initiate and conduct undeclared wars; the CIA was forbidden to finance overt operations; congress also passed the foreign assistance Act of 1976 which essentially was intended to promote and encourage increase of respect for human rights and fundamental freedoms throughout the world. (Munene et al 1995 p. 28-29).

Indeed, Africa’s Intellectuals put the West on the spot when they made statements like that of Peter Anyang Nyong’o in his keynote address to the Pan-African conference in Namibia in May 1991 “Those who truly desire to put the people first must condition aid and development assistance to African countries on democracy and the observance of human rights. This is a non-negotiable demand as far as the African people are concerned.” (Nyongo 1992 p.25-49).

Thus the linking of foreign aid to human rights began with the cold war disillusionment. Congress and the public forced cuts in foreign aid and reduced association with international pariahs long before the collapse of communism in Eastern Europe or Soviet Union.6

However in practice this seemed utopian as the Carter administration was to realize. In January 1980 the US News and World Report noted that Carter did not talk of human rights anymore as he concluded a string of military deals with Kenya, Somalia and Oman.7

Carter’s support for Zaire’s Kleptocrat, Mobutu Sese Seko was in contravention of the provisions of the 1976 Foreign Assistance Act. From Zaire, the counselor for political affairs, Robert Remole, repeatedly advised the distancing of the United State from a regime he believed was “incorrigibly corrupt”

2.3.3 Deep Into Nyayoism

By 1984 Moi’s dictatorial tendencies had intensified as he demanded that Kenyans become his sycophants and subordinated institutions to his interest. He said in
September 1984: “I call on all Ministers, assistant Ministers and every other person to sing like parrots, you ought to sing the song I sing. If I put a full stop, you put a full stop.” (Wamwere 1992 p.26).

By 1988 parliament was subordinated to KANU. Political arrests and harassments, tortures and deaths in police custody increased so much that the Catholic bishops in 1986 accused Moi and KANU of assuming a “tolitarian rule” contrary to Kenya’s political system. Amnesty international complained of human rights abuses in Kenya. The judiciary, the US Department noted in its 1987 report on human rights violations, was under the Presidents control while trials for political prisoners were practically a sham.

At this point in time, the economy was deteriorating and the country became more regressive. American attention began to focus on Moi. The Christian Science Monitor reported, US Representative Howard Wolpe’s assessment and continuing reports of torture and human rights abuses had adverse consequences for Moi during his visit to Washington in March 1987 to solicit for money. He was questioned on human rights abuses by the media and government officials who reportedly included President Reagan and Secretary of State Shultz. The demands angered the President and his entourage so much that he left the US unceremoniously and without procured aid.

Kenya had become a pariah by 1985 on account of her deteriorating political and economic record. It was therefore a target for the application of the 1976 Foreign Assistance Act and a Reagan engineered programme to promote democracy in the Third world. This partial-official programme was started in 1982 and was to finance political parties, newspapers and labour unions to fight dictatorship. The then Secretary of State, Alexander Haig, described its aim as promoting American values. “A free press, free trade unions, free political parties, freedom to travel and freedom to create are the ingredients of the domestic resolution of the future, not the status quo of a failed past”.
The most decisive sign of a real change in policy on the part of the United States, Britain and the Democratic West was evident in Kenya. As early as 8 May 1990 the then US Ambassador Smith Hempstone warned that:

“There is a strong tide flowing in our Congress, which controls the purse strings, to concentrate our economic assistance on those of the world’s nations that nourish democratic institutions, defend human rights and practice multiparty politics” (Ake 1991 p.39).

For a time, Western Aid continued to flow to Kenya’s one party regime, but international anger and pressure mounted with the countries deepening descent into brazen corruption, political assassinations and imprisonment, torture, other fragrant abuses of human rights, and a growing culture of sycophancy and fear.11 In 1991 the Scandinavian countries joined the US in warning of an aid cut if human rights conditions were not improved. In September 1991, Denmark froze all new aid for Kenya. Finally, at the November 1991 meeting in Paris of the consultative Group of Kenya, the country’s international aid donors “established explicit political conditions for assistance, making Kenya a precedent for the rest of Africa”12 New aid was suspended for six months pending “the early implementation of political reform”, including “greater pluralism, the importance of the rule of law and respect for human rights, notably basic freedom of expression and assembly and firm action to deal with issues of corruption.13 Private diplomatic messages reinforced this historic pressure for democratic reform. A special conference of the ruling party KANU voted to repeal the ban on opposition parties, which was immediately passed by parliament leading to reappearance of section 2A of the Constitution and allowing for Multi party politics. In January 1992, the President consented bitterly that the change to multiparty politics was a result of Western pressure.14 In his New Year’s message in 1995, Moi announced his intention to invite International experts to help review the Kenyan constitution; a gesture that was well received.
Political castigations from the likes of William Ole Ntimama towards this announcement were deliberate to create friction with donor countries and local opposition groups so as to derail reforms. Ntimama was arousing ethnic animosities at the very time that the government was trying to appear conciliatory to the affected communities. Media crack down e.g. disabling the printers of FINANCE was seen as a means of silencing all voices of dissent, whether it was from the media, civic organizations or the opposition. Formation of SAFINA and the government’s resistance to its registration coupled with the whipping of its Secretary General (Richard Leakey) by KANU Activist in public painted a further negative image of Kenya to the International Community. The Newsweek and the Economist of London reacted with outrage at these attacks. The Economist of London seeing fear creeping into Moi’s racists utterances of depicting Leakey as a Mzungu mused: “Why is his Excellency in such rage? President Moi is pouring abuse on the deeds of his opponents as never before... This surge of phantasmagoria seems to spring from Mr. Moi’s fear of one man: Richard Leakey.”

The image created by the lawlessness of Ntimama and Attorney General Amos Wako’s admission that he dared not question the Minister was that Kenya by the early part of 1996 had become a political jungle. Kenya, wrote former American Ambassador to Kenya Smith Hempstone had become a “tarnished jewel”. Public looting and other forms of lawlessness, so the image emerged, had become a norm.

Blatant interference with the judiciary by the executive became the order of the day – Moi ordered Cockar the then Chief Justice, to tell his officers to stay out of political issues, which was interpreted as executive interference in the judiciary. Mbaya, a retired judge was insistent that the executive interferes with the court process on a regular basis. He asserted: “The menace of the executive’s interference with the judiciary is manifested in consistent pronouncements by the President on matters sub-judice”. Such pronouncements can only be regarded as being intended to influence the decisions of the court.

The Ruling elite, which involved politicians and top individuals closely associated with the President, seemed to have failed to allay public suspicion of the government’s lack of good will and of its inability to protect its citizens. It appeared
to be incapable of protecting students in public universities as police officers appeared to be trigger happy when facing students as was the case in December 1996 when the police killed students at Egerton and Kenyatta Universities.

2.4 **OPPOSITION INITIATIVES**

Political inequalities in terms of skewed voter registration conditionalities, constituency gerrymandering and appointment of election officials who favour the ruling clique were all viewed as pre-rigging tactics so as to pre-determine the outcome of the 1997 election. This led to the civil societies push for reforms as evidenced by bodies like the Law Society of Kenya, the National Christian Council of Kenya (NCCK) and the Catholic Justice and Peace Communism (CJPC), the Citizen’s Coalition for Constitutional Change (4C’s) and Centre for Law Research International (CLARION). CLARION made public its findings on corruption in Kenya and thereby attracted the wrath of Moi’s Government which then banned CLARION. Domestic and international pressure forced the government to rescind the ban. The findings were later published as “The Anatomy of Corruption in Kenya: Legal political, and Socio-Economic perspectives.”

The detention of the Human Rights Lawyer, Gibson Kamau Kuria elicited the ‘demands for his release by American President Ronald Regan and Secretary of State George Schultz.

The initiatives saw to the amalgamation of all opposition political parties and other interested groups into the National Conventional Planning Committee whose mandate was to adopt minimum constitutional, legal and administrative reforms needed before the general election could be held if it was to be free and fair. The convention further reconstituted itself into a National Constituent Assembly in order to force the government to concede to the reforms; the assembly had decided to institute mass action and to hold countrywide rallies explaining the need for reforms at every level. To implement the resolutions, the convention also created the National Convention Executive Council (NCEC). The NCEC rose to the challenge and became effective. In order to force the government to institute minimum reforms, it called for mass
action that captured the imagination of the disillusioned citizens. The confrontations and clashes gave the country poor international images.

Charges of corruption involving Asian business tycoons Kamlesh Pattni and Ketan Somaia just gave more ammunition to reform advocates who were bothered by the fact that Kenya had been ranked as Number 3 behind Nigeria and Pakistan as the most corrupt country in the world.\textsuperscript{18}

The “No reforms, No Budget” demonstrations inside parliament led by James Orengo mirrored Moi as being helpless and vulnerable.\textsuperscript{19}

The July 7, 1997 Saba Saba rally showed a Government under siege. The government reacted with brutality and pictures of a bleeding Rev. Njoya were flashed across the globe. Moi’s forces had beaten him almost to death in the grounds of All Saints Cathedral. The Economic Review described it as a “Reign of Terror” in its coverage of the Saba Saba events which shocked many opinion makers.\textsuperscript{20} The Times of London for instance, appropriately commented: “This was no riot until the government made it one. It was a case of unprovoked and unconscionable brutality, ordered by the state against people assembled to pray for such elementary things as free speech and accountable government” Time magazine of New York was more graphic with a headline “Saba Bloody Saba” which noted that sacrilege had ‘highlighted the government’s ruthless reaction to public protests and has further inflamed the opposition to the autocratic rule of President Daniel Arap Moi.\textsuperscript{21}

Calls and pressure for arrest of police officers involved in killing civilians came from diplomats and churches. The twenty two Diplomatic missions voiced their concern and urged the government to negotiate with reformers. Finally the government relented and conceded to reform talks. It was in the process of agitating for reforms that worldwide media attention was focused on Kenya because of the confrontation between the government and the advocates for political reforms. (Okoth and Ogor 2000).

This saw to the birth of the inter-party group (IPPG) Initiative that saw to minimum reforms before the 1997 elections.
THE CONDITIONALITIES OF AID SUPPORT TO KENYA SINCE 1991

Kenya joined the IMF in 1964, and The World Bank had granted its first loan to Kenya in 1960. In the late 1970’s and early 1980’s, Kenya was among the major aid recipients in Africa, due to the prospects of high returns, and a history of debt repayment. Here Aid is taken to be the sum of all gifts, low interest and soft loans made by governments or official institutions. (McCarthy, 1994:169).

In December 1991, the IMF announced that it had frozen aid to Kenya. The reason for this being their demand for democracy in Kenya, of which President Moi was forced to repeal the one-party system of government.22

The following year, 1992 saw reforms in the constitution, with the change of clauses that transformed Kenya into a multiparty state, and also reduced the Head of state’s term of service from life to a maximum of two five-year terms.23 In 1993, the then finance Minister Musalia Mudavadi, and CBK governor, Micah Cheserem, were forced to deregulate the Kenyan economy to ensure IMF and WB loans were forthcoming. (Gordon 1992). This was done by the scrapping of import licenses, floating of the Kenyan shilling, abolition of price controls, and a sweeping programme of privatization and cut in public expenses.

Donors, having seen the commitment of change in Kenya, pledged $200 million in loans. This was not taken lightly by the human rights bodies namely Amnesty International, Human Rights Watch and African Rights and Lawyers Committee for Human Rights, which accused Moi’s government of lies, by saying that it was harassing political opponents among other vices.

Unfortunately, their cries were not heard, evidently because in 1996, a three-year loan was approved by the IMF to Kenya under the Enhanced Structural Adjustments Facility (ESAF).24 This loan was given to Kenya due to its adhering to IMF and WB conditions, and having reached a major economic transformation with direct control on prices, reduction in the government deficit from 11.4% of GDP in 1992/93 to 2.5% in 1994-95, and restoration of confidence in the banking system.25 However, it still needed other structural reforms enacted like the privatization and structuring of a number of key enterprises like the telecommunications and Kenya Airways, and restructuring of the civil service.
In July 1997, the Bretton Woods again suspended $220 million aid because the Kenyan government had delayed in the privatization of the state-owned telecommunications (KP&T) and Power Company (KPL), which had caused mixed reactions among the Kenyans. Other issues included the establishment of an anti-corruption authority and the prosecution of those involved in the Goldenberg scandal. In December, it was election time again, and again it was Moi as president and KANU in power, leaving a landmark of ethnic violence both on the coast and the Rift Valley, displacing tens of thousands.

In mid 1998, the World Bank made a developmental report; it stated that Kenya had recorded another fall in per capita income and net private capital outflow. There was need for aid in Kenya, but none of the SAP’s had been enacted by the government until in October 6th 1999. President Moi reshuffled the cabinet, and he made a surprising move. He put Richard Leakey, a well-known paleontologist and wildlife conservatist, of whom Moi once described as “arrogant and racist,” was given the post of head of civil service. Another entry was Martin Oduor Otieno, a prominent banker appointed as the permanent secretary of finance. This move, as a matter of foreign policy was to secure the $220 million IMF/World Bank funding had withheld since 1997, in December that year, 1999, IMF gave the go-ahead of negotiations the following year since the government was in need of settling Kshs. 30 billion, which was required to pay off some 60,000 civil servants in its retrenchment programme.

On January 6th, 2000, a Kenyan opposition lobby group known as ‘Stakeholders Support Group (SGS),’ comprised of eight opposition MP’s, lawyers and the civil society, campaigned against IMF’s resumption to Kenya. They were unconvinced that Moi’s government had met all the condition set by the IMF. The pressure group also challenged the Bretton Woods institution to tabulate the achievements that Moi’s government had made on each of the conditions set, if it was truly committed to ensure accountability and transparency in Kenya.

Mrs. Beth Mugo, one of the campaigners, and one of the people who run the Nairobi-based Council for Economic Empowerment of Women in Africa (CEEWA) insisted that the government was not supposed to have the upper hand on the donor money
because the Kenyan people were still poorer, through corrupt deals and tendering procedures.

Two months later, in pursuit of Beth Mugo’s allegations, the World Bank made an unexpected and unusual move and formed an alliance with Africa church leaders. The leaders met with World Bank senior staff in Nairobi from 20 African nations to fight poverty and corruption. The mid-march meeting focused on combining the World Bank’s global prospective on poverty with the churches deep influence among the urban and rural poor.

Callisto Madavo, a Zimbabwean Christian and the World Bank’s highest ranking official for Africa, said that they considered not just the economic and social aspects, but also include the cultural and spiritual aspects of human aspirations, then can there be a valuable instrument for building a new future for Africa. This move of including the church was viable since the government’s were falling, and the church would be the best since they provide care for refugees, have rehabilitation centres for rescued child soldiers, homes for aid orphans, and micro enterprises for the rural and urban poor.

Who else would reach the poor much more efficiently and effectively than the church?

Due to so much controversy and doubt of the efficiency of the IMF and World Bank, they outlined in September their roles to the society. They defined their roles as follows: “The Fund’s core mandate is to promote international financial stability and micro-economic stability and growth of member countries. To that end, the Fund must focus on its core responsibilities: monetary, fiscal, exchange rate policies and their associated institutional structural aspects,” whereas, “The core mandate of the World Bank is to help countries reduce poverty, particularly by focusing on the institutional, structural, and social dimensions of development.”

Though the IMF had stopped giving funds to Kenya, it was rather unusual for it in the subsequent month to grant Kenya $150 million for ‘poverty reduction and growth facility.’ The year too had faced drought in most parts of the country, so the IMF, in the same month granted an additional $40 million to cope with those people faced with drought.
The following year, on 27th March, a report was released in London, which warned Kenya that it was unlikely to qualify for debt relief under the heavily indebted poor countries (HIPC) initiative, unless it began to show a history of commitment to economic reform and good governance. The reasons given to this halt of lending were: the reinstating of the Kenya Anti-Corruption Authority (KACA), the enacting of a Public Service Code of Conduct and the Economic Crimes bill; A Bank Interest Bill that seeks to reduce lending interests had to be shelved; privatization of state corporations like Telkom Kenya, Kenya Power and Lighting Company, and Kenya Railways, and downsizing of the civil service. Unless these issues were acted upon, the report said that Kenya would not get any aid or funding whatsoever.

A month later, President Moi announced after a meeting with US Secretary of State, Colin Powell that Kenya was among the first countries to qualify under the “African Growth and Opportunity Act (AGOA).” This act would help Kenya in the exporting of textile and other products which would spur economic recovery and growth in the country. The President also added that the US government had made an assurance to Kenya that it would continue supporting economic reform programs as long as Kenya was committed to economic, political and constitutional reforms as well as the fight against corruption.

On April 28th, 2001, a two-day economic conference was organized by IMF/World Bank and the government at Mombasa, attended by 140 MPs, senior officials from the IMF and World Bank, the Central Bank, treasury and economic experts from the private sector. The meeting that was convened to broker better understanding between parliament and donors fell flat on the face after MPs rebelled and accused the lenders of imposing policies which hurt ordinary people. Top among the list was the proposal of the immediate withdrawal of the Donde Act. Others were that the Code of Ethics for Civil Servants Bill be made law, anti-corruption courts to be established and the immediate sacking of civil servants or ministers facing corruption charges in court. The meeting ended unresolved and fruitless.

The Bretton Woods had wanted answers given to the following issues:

- The effectiveness of the established corruption courts.
The strength of the Attorney General’s office to cope with cases pertaining to corruption.

The fate of the Donde Act, also known as, the Central Bank of Kenya Amendment Act 2001, (whether it is going to be implemented in the future). This put the Kenyan government in a fix of answering to the questions and adhering to the claims and wants of the IMF.

According to Reuters then, the IMF would grant Kenya an additional $1 billion after the elections because they were anticipating a major change in the next government. This put Kenya in a state of questioning. Who was ruling the country? Who was to blame for all this? What state or form of foreign policy was present between the Kenyan government and IMF?
CHAPTER THREE

3.0 THE ECONOMY OF KENYA FROM INDEPENDENCE TO PRESENT

After independence, Kenya promoted rapid economic growth through public investment, encouragement of small scale holder agricultural production, and incentives for private (often foreign) industrial investment. Gross domestic product (GDP) grew at an annual average of 6.6% from 1963 to 1973. Agricultural production grew by 4.7% annually during the same period, stimulated by redistributing estates, diffusing new crop strains, and opening new areas to cultivation.

Between 1974 and 1990, however, Kenya’s economic performance declined. Inappropriate agricultural policies, inadequate credit, and poor international terms of trade contributed to the decline in agriculture. Kenya’s inward-looking policy of import substitution and rising oil prices made Kenya’s manufacturing sector uncompetitive. The government began a massive intrusion in the private sector. Lack of export incentives, tight import controls, and foreign exchange controls made the domestic environment for investment even less attractive.

From 1991 to 1993, Kenya had its worse economic performance since independence. Growth in GDP stagnated, and agricultural production shrank at an annual rate of 3.9%. Inflation reached a record 100% in August 1993, and the government’s budget deficit was over 10% of GDP. As a result of these combined problems, bilateral and multilateral donors suspended program aid to Kenya in 1991.

In 1993, the Government of Kenya began a major program of economic reform and liberalization. A new minister of finance and a new governor of the central bank undertook a series of economic measures with the assistance of the World Bank and the International Monetary Fund (IMF). As part of this program, the government eliminated price controls and import licensing, removed foreign exchange controls, privatized a range of publicly owned companies, reduced the number of civil
servants, and introduced conservative fiscal and monetary policies. From 1994-96, Kenya's real GDP growth rate averaged just over 4% a year.

In 1997, however, the economy entered a period of slowing or stagnant growth, due in part to adverse weather conditions and reduced economic activity prior to general elections in December 1997. In 2000, GDP growth was negative.

In July 1997, the Government of Kenya refused to meet commitments made earlier to the IMF on governance reforms. As result, the IMF suspended lending for 3 years, and the World Bank also put a $90 million structural adjustment credit on hold. (Hazlewood 1991). Although many economic reforms put in place in 1993-94 remained, Kenya needed further reforms, particularly in governance, in order to increase GDP growth and combat poverty among the majority of its population.

The Government of Kenya took some positive steps on reform, including the 1999 establishment of the Kenyan Anti-Corruption Authority, and measures to improve the transparency of government procurements and reduce the government payroll. In July 2000, the IMF signed a $150 million Poverty Reduction and Growth Facility, and the World Bank followed suit shortly after with a $157 million Economic and Public Sector Reform credit. By early 2001, however, the pace of reform appeared to be slowing again, and the IMF and World Bank programs were in abeyance as the government failed to meet its commitments under the programs.

Aid Flows
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. 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 14% of GDP and to approximately 45% of the government budget. However, this impressive growth in nominal aid inflows merely shows that Kenya has followed the pattern for Sub-Saharan Africa as a whole, since Kenya’s share of total ODA to SSA has remained remarkably stable over this entire period.

Relief are given in Appendix 2, 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.

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 2 Table 5 and mentioned, 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% of gross ODA in the Total cumulative World Bank and IDA lending commitments to Kenya as of 30th June 1998.
were US$4.0 billion, of which US$1.2 billion in IBRD loans and US$2.8 billion in IDA credits.

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, (Johnson and Wasty 1993) 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.
3.1 DEBT ACCUMULATION PROCESS

The Kenyan economy is fundamentally dependent on agriculture. The agricultural sector contributed about 27% of the GDP between 1986 and 1996 whereas the manufacturing sector contributed about 13.3% of GDP- less than half of the contribution of the agricultural sector. However, as is expected, investment in manufacturing is larger than investment in the agricultural sector. Table 1 below gives a more detailed breakdown of the structure of Kenya’s economy for the period 1986-1996.

_Table 1: Structure of the Kenyan Economy_

<table>
<thead>
<tr>
<th>Sector</th>
<th>Sectoral Contribution to GDP Economic Sector %</th>
<th>Of GDP % private Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>27.0</td>
<td>10.1</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>13.3</td>
<td>20.5</td>
</tr>
<tr>
<td>Building and Construction</td>
<td>2.9</td>
<td>8.0</td>
</tr>
<tr>
<td>Trade Restaurants and Hotels</td>
<td>11.2</td>
<td>5.3</td>
</tr>
<tr>
<td>Finance, Insurance etc</td>
<td>8.5</td>
<td>4.3</td>
</tr>
<tr>
<td>Transport, Storage etc</td>
<td>6.1</td>
<td>26.6</td>
</tr>
<tr>
<td>Others</td>
<td>16.4</td>
<td>25.2</td>
</tr>
</tbody>
</table>


From the table above it is clear that shocks to the agricultural sector would represent significant shocks to the economy. This is even clearer when we look at the structure of Kenyan trade. Kenya’s exports are predominantly agricultural though this has been changing of late as increased. Shares of manufactured exports are made to the regional markets-East African Community and the COMESA region. As such it is clear that occurrences in the world commodity markets fundamentally affect the external sector of the economy. Kenya’s economy is shock prone to the extent that
over the last thirty years or so the economy has undergone no less than four external shocks that are due to global commodity price fluctuations. The macroeconomic evolution of the economy since independence in 1963 can roughly be divided to accommodate these shocks, which have coincided with policy regime shifts undertaken by the government. These periods are 1964-1973 when high growth rates were achieved; 1974-1985 when the economy faced significant external shocks and 1986-1996 the period of reforms. The first period was not characterized by any significant commodity price shocks but was a period of high economic growth (about 6.1%) with a low inflation rate (about 2.7%) and prudent economic management.

Characterized by conservative fiscal policy and a conducive policy framework that sought to spur both foreign and domestic investment resulted in a sharp increase in agricultural and manufacturing production with a relatively healthy external position. The second period 1974-1985 is characterized by two negative external shocks – the oil shocks of 1973/1974 and 1979/1980 and a positive external shock – the so-called coffee boom of the 1976/77 periods. (Mosley 1986)

1. The negative shocks, as would be expected, precipitated a BOP crisis while the impact of the positive shocks has been the subject of much debate (Bcevan, Collier and Gunning (1992). The government response to the negative shocks was to increase controls so as to stem the loss of foreign exchange reserves and its inflationary consequences. The response of the government to the positive shock was indigenous trade liberalization (Reinnika 1997) – that precipitated a balance of payments crisis. The "Coffee boom" led to a temporary relaxation of the control regime that had been put in place since the first oil shock. It also led to an expansion of government expenditures that proved unsustainable once the windfall revenues disappeared in 1978. The macroeconomic imbalance that resulted from the deficit worsened the crisis resulting from the second oil shock in 1979. An essential part of the story hinges on the effect of the unsustainable increase in government expenditure following the coffee boom. However, it is not clear whether this expenditure
boom would have been as problematic if there had not been a second negative shock precipitated by a sharp rise in coffee prices.

2. The ensuing **policy** reforms were fundamentally aimed at correcting the imbalances created by these shocks. For example there was need to address the unsustainable worsening of the current account deficit that had:

i) While a quadrupling of oil prices, which impacted on the entire world economy, precipitated the negative shocks the positive shocks were precipitated by a sharp rise in the coffee and tea prices due to coffee production failures in Brazil what reduced the amount of coffee in the world market.

ii) However, the **Kenyan** experience with two coffee booms – one in 1976-79 and the more short lived one in 1986 provides some form of natural experiment by which we can answer this question. While the first coffee boom was immediately succeeded by the second oil price shock the second coffee boom was not. As such by observing the impact of increases on government expenditure in both booms one can make some evaluation on how export booms lead to debt accumulation.

According to Swamy (1994) it was initially necessary to borrow on commercial terms to finance this deficit. The period between 1986 and 1996 is characterized by a commitment – at least in paper – to extensive structural reform of the economy. Through its flagship **policy** reform document released in 1986 – “Sessional paper number 1 on Economic Management for Renewed Growth” – the government undertook to reform the economy through a gradual, albeit slow, dismantling of the control regime put in place in earlier years. These policies included interalia: a reduction of the budget deficit through public expenditure cuts; a reduction of domestic credit expansion; liberalization of domestic interest rates and other monetary reform measures; further devaluation of the exchange rate; trade liberalization measures such as the removal of the quantitative restrictions on imports and the reduction of tariffs; promotion of non traditional exports through specific
incentives; decontrol of domestic prices and trade; financial sector reform through improved regulation and supervision as well as restructuring of weak banks; Divestiture from public enterprises; civil service reform and various social sector reforms such as the reorientation of the expenditures in the health and education sectors to increase efficiency (Swamy, 1994). However, in the same year the document was released, the country experienced another – albeit milder – external shock precipitated by another sharp increase in coffee prices. This shock may have delayed the implementation of the reform as it gave the government more time. In subsequent years the proposed reform process was not smoothly undertaken and there were several reversals. However the period from the 1993, after the World Bank and IMF suspension of aid, the government has pursued these reforms in a more vigorous and transparent manner. The outcome of these policy regime shifts can be gauged in terms of macroeconomic performance and the trends in investment. The latter is especially important because the success of these reforms depend on an adequate private investment and supply response. Indeed according to O’Brien and Ryan (1999) some of the foreign debt accumulated in the late 1970s following the second oil price shock were borrowed on commercial terms. However the bulk of the country’s foreign debt has remained that from bilateral and multilateral sources. Although the country is subject to shocks from other sources such as the aid moratorium the focus here is on those shocks that the government had no influence over.

Failure on these counts would negate the further implementation on the reforms. This assessment is made below.
Table 2: Evolution of Kenya’s Macroeconomic Performance

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Inflation</td>
<td>-4.9</td>
<td>-7.6</td>
<td>-4.2</td>
</tr>
<tr>
<td>Foreign Debt/GDP</td>
<td>-2.6</td>
<td>-5.47</td>
<td>0.7</td>
</tr>
<tr>
<td>GDP Growth</td>
<td>6.1</td>
<td>4.2</td>
<td>3.5</td>
</tr>
<tr>
<td>Current deficit/GDP</td>
<td>2.7</td>
<td>14</td>
<td>16.8</td>
</tr>
<tr>
<td>Terms of Trade Changes</td>
<td>-3.7</td>
<td>-5.8</td>
<td>-3.4</td>
</tr>
<tr>
<td>GDP Growth</td>
<td>6.1</td>
<td>4.2</td>
<td>3.5</td>
</tr>
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The macroeconomic conditions deteriorated in the second period and the budget deficit worsened compared to the previous periods. From an average of −4.9% of GDP, the budget deficit worsened to −7.6% in the second period before dropping to −4.2% in the third. This indicates that the reforms of the latter period succeeded in reducing the deficit. The budget deficit in the second period may also have resulted in the deterioration of the current account deficit as a proportion of GDP in that period from −3.7% in the first to −5.8% in the second. However this was also the result of terms of trade deterioration. Terms of trade changes worsened in the second period. However, they improved in the third and therefore could explain the improvement may, also be the result of the improvement of the budget deficit in the same period. The deterioration of the current account deficit was worsened by the foreign debt position as reflected by the worsening Debt/GDP ratio. It increased by almost 20% from the first period to the second and another 20% from the second to the third period. In line with these indicators, GDP growth has shown a declining trend from 6.1% in the first period to 4.2% in the second to 3.5% in the third. Although it was to have increased following these reforms, GDP growth declined. This indicates that the negative external shocks over this period probably dominated the positive external shock and it may thus be difficult to precisely disentangle the effects of the positive external shocks on the debt situation of the country.
The foregoing discussion outlines the policy environment of the economy. Further it shows that there has been a commitment by the government to increase and diversify exports from the mid eighties. This is perhaps a policy, which reflected a need to reduce the vulnerability of the economy to external shocks. However, although policy concern was centered on reducing the countries exposure to external shocks – both negative and positive – of present concern is the analysis of the impact of the positive external shocks to show their contribution to the debt accumulation process in the country. The next section considers the conceptual and theoretical process by which positive terms of trade shock lead to debt accumulation.

External debt in Kenya has witnessed large increases especially since the first coffee boom of 1976-1979 when the economy' performance improved significantly. (Mosley 1991). This boom was followed by expansionary fiscal policies since expenditures achieved during the boom period had to be maintained. From table 1 in the appendix, it is evident that the first coffee boom period of 1976-1979, was accompanied by increased public expenditures. This is because the external debt to GNP ratio increased to 41.3% and 42.9% in 1979 and 1980 respectively – indicating increased external borrowing. The total external debt to GDP ratio also increased in the same period from 28 percent in 1971 to 43.6% in 1978. In the second boom period of 1986 the ratio increased further to 68.14%, 63.37% and 72% in 1985, 1986 and 1987 respectively then witnessed a decline in the preceding years. In 1994, however the external to GDP ratio increased to 143%. This could be attributed to the liberalization policies, which led to increased domestic interest rates, and the resulting increased cost of borrowing and debt servicing costs. The debt indicators show that the external debt to export ratio increased to 104% in 1977 from 94.13% in 1971. The total debt to export ratio also increased to 20.4% in 1977. The total long-term debt service cost increased from US$52 million in 1971 to US$282 million in 1977. This is a large increase, which is an increasing debt burden. In the second boom period the external debt to export ratio increased to 241.7% and 336.4% in 1986 and
1987 respectively. The debt service costs also rocketed to 34.8% in 1986 from 12.5% in 1978.

3.1.1 Debt and Debt Relief

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.

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.

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 payments were resumed. In January 1994 Kenya was able to negotiate with the Paris club a highly favourable refinancing (of arrears only) over an eight-year repayment period. A
similarly favourable refinancing of arrears was subsequently negotiated with the London Club. (Dam 1996).

3.2 KENYAN CRISIS

Transparency International released its annual Corruption Perceptions Index (CPI) that ranks 90 countries around the world with regard to how corrupt they are perceived to be. In 1996, Kenya was ranked third from the bottom of all the countries surveyed, with only Pakistan and Nigeria below it on the list. In the expanded 1998 index Kenya ranked 73rd out of the 85 countries surveyed and 90th out of 99 in the 1999 index. The lack of transparency in both public and private affairs helped fuel corruption now widely acknowledged as one of the greatest challenges facing Kenya today. It undermines the development and rational stability. The interesting thing was to find out when the Index was released was whether there had been a significant change in international perceptions as to how corrupt Kenya is. When the Index was released late last year (2002) it was felt that the work of the Kenya Anti-Corruption Authority (KACA) and the civil service reforms that had started had not factored into perceptions sufficiently. Roughly one year later it will be interesting to see what the case will be.

3.2.1 Poverty and Unemployment

Over half the Kenyan population is now considered absolutely poor which means they cannot meet their food and other basic needs. Poverty grew by 63% in urban areas between 1992 and 1997, from 30% to 49%. However, the poor in Kenya are concentrated among subsistence farmers, pastoralists, people without any education and among unskilled workers. Corruption is considered an important cause of poverty because it promotes unfair distribution of income and inefficient use of resources. It can be argued that while poverty is a real national problem, economic inequality is what has the more insidious effect on the national psyche. A World Bank report in 1996 indicated that the top 10% of Kenya’s population earned 47% of the national income. According to the same report, these inequalities were second only to those reported for Brazil. The political implications of sharp economic
inequalities are sometimes even more potent than those of poverty when considered alone as an issue. Tackling poverty and unemployment are therefore key priorities in Kenya, especially poverty among the urban poor, and in the marginal and arid and semi-arid areas.

3.2.2 Bad Politics

Political uncertainty remained the major problem facing Kenya. Indeed, Kenya’s major crisis was the fact that our politics seemed all wrong; it was cynical, ethnic, corrupt and totally disconnected from the needs and aspirations of wananchi. Following on from this, our current economic crisis is largely as a result of the previous government’s low credibility with investors both local and foreign and the international community generally. Ironicaly, the most significant shots in the arm vis-à-vis our government’s political credibility over the last 12 months in 1999 had been the work of what was described as the Dream team of Dr. Richard Leakey and also expectations with regard to the then apparently energized Kenya anti-Corruption Authority (KACA).

Partly as a result of this, Kenya’s foreign donors led by the IMF and World Bank renewed aid programmes to the country. However, the interesting thing about the IMF coming back on board was that even that positive development seemed to have been driven less by confidence in the government than in actual fact of the lack of it on the part of donors. Quietly, when you met them away from the public limelight donors were saying that Kenya needed a renewed aid package because without it the combined effect of drought, political uncertainty and an economy that is grinding to a halt could have brought Kenya tumbling down. Visions of major civil unrest in Kenya unsettled all and there was a feeling among donors that things were so difficult that if aid was not renewed things would go terribly wrong. So aid was not renewed because of overwhelming confidence that the leopard of the Kenya government had fundamentally changes in spots. This accounts for the conditionalities imposed by the IMF which some are describing as the most comprehensive in the history of the organization. These conditionalities did not demonstrate confidence but rather the
lack of it. Whatever confidence that had been inspired by the Dream Team has
hampered by difficult political circumstance. It must be kept in mind that the most
important member of the Dream Team was not Dr. Leakey, it was the President for it
is he who ultimately determined the teams success or failure.

3.2.3 Dilemma of Donor Aid Coordination
Given the multiplicity of multilateral and bilateral donor agencies active in Kenya,
donor coordination has been an on-going 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 of 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. (Gurushe 1994). This group met regularly
throughout the 1970s and 1980s, normally once every two years. In the early 1990s
as donor concerns grew over economic mismanagement, 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. 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.
3.3 WAY FORWARD OUT OF CRISIS

Though foreign policy relations may be strained between the Donors and Kenya, there is a solution to ending the annoyance of the people towards the lenders and improving the image of Donors so as to benefit if not just the nation but also the average Kenyan. Possible ways of approach could include:

- Solving the conditionality quandary.
- Injecting the catalytic effect into the economy.
- Provisions of access to fund resources.
- Disbursement of funds to other organizations.

IMF and WB conditions have no doubt been of limited success to the less-developed countries. This limited success of the conditionalities could elicit two extreme responses: (Bird 1995). First, it would broaden its range and deepen its severity, on the basis that conditionality has not gone far enough to have a discernible impact. Secondly, is to remove or reduce conditionality on the grounds that it has already gone too far and that removing or reducing it will at least allow countries to design their own adjustment programs to which they will be more strongly committed to. By adhering to this, either doing away or reducing the conditionalities, countries like Kenya can in return improve the welfare of its people and concentrate fully on reviving the economy rather than making sure they are at par with IMF conditions.

3.3.1 The Genesis of Structural Adjustment Programmes

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. (Mosley 1996). 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.

Kenya first received loans for balance of payments support in 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).

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 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.31

In 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 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.

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. (Dam 1996).

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 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.
CHAPTER FOUR

4.0 KENYA IN THE CONTEXT OF THIRD WORLD ECONOMIES

4.1 Direct Foreign Investment and Foreign Aid: Controversies and Opportunities

Few developments played a critical role in the extraordinary growth of international trade and capital flows during the 1960s and 1970s as the rise of the multinational corporation (MNC). An MNC is most simply defined as a corporation or enterprise that owns and controls productive activities in more than one country. These huge business firms, mostly from North America, Europe, and Japan, present a unique opportunity and a host of serious problems for the many developing countries in which they conduct their business.

The growth of private direct foreign investment in the Third World has been extremely rapid. It had risen from an annual rate of $2.4 billion in 1962 to over $20 billion by 1995. Multinationals based in the United States provided almost half of the total flow during the 1990s, with the United Kingdom, Japan and West Germany making up most of the balance. Major recipients were concentrated among the higher income LDCs such as Brazil, Mexico, Argentina, Indonesia, and Hong Kong, although the country spread of MNC investments widened considerably so that they are now found in almost every developing country. But direct foreign investment involves much more than the simple transfer of capital or the establishment of a local factory in a developing nations. Multinationals carry with them technologies of production, tastes and styles of living, managerial services, and diverse business practices including cooperative arrangements, marketing restrictions, and advertising. They engage in a range of activities, many of which have little to do with the development aspirations of the countries in which they operate. But before analyzing some of the arguments for and against private foreign investment in general and multinational corporations in particular, let us examine the character of these enterprises.
Multinational Corporations: Size, Patterns, And Trends

Two central characteristics of multinational corporations are their large size and the fact that their worldwide operations and activities tend to be centrally controlled by parent companies. \(^{33}\) (Moran 1985 p.3-24). Many MNCs have annual sales volumes in excess of the entire GNPs of the developing nations in which they operate. In 1985 the two largest multinationals (General Motors and Exxon) each had a gross sales value greater than the GNPs of all but five developing nations (China, Brazil, India, Mexico, and Iran). The combined sales of the six largest MNCs alone exceeded the GNPs of many developed nations including Australia, Canada, Belgium, Sweden, Italy, and Switzerland. In fact the largest multinational, General Motors, had total revenues in 1985 in excess of $95 billion, thus by itself surpassing the entire gross national products of countries like Norway, Belgium and Switzerland! Looking further, we see that 86 of the largest 150 economic units surveyed were companies; only 64 were countries. At the top, the industrialized countries and largest developing countries hold 41 of 50 spots. The position reverse in the next 50, with only 19 countries and 31 companies. In the final 50 positions, only 4 countries, but 46 companies appear. Thus, as we move down the list, the number of very large companies increases much more rapidly than does the number of countries. This is especially significant, for when we reach the point of the 150th largest economic unit (Union Carbide Corporation) we are still 21 countries shy of the median GDP for UN member states!

Table 3 attempts to summarize the debate about multinationals in terms of seven key issues and a range of questions that surrounds each of them:

1. International capital movements (including income flows and balance of payments effects)
2. Displacements of indigenous production
3. Extent of technology transfer
4. Appropriateness of technology transfer
5. Patterns of consumption
6. Social structure and stratification
7. Income distribution and dualistic development

Table 3: Seven Key Disputed Issues about the Role and Impact of MNCs in Developing Countries;

<table>
<thead>
<tr>
<th>Key Issue</th>
<th>Sources of dispute</th>
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<tr>
<td>1. International capital movements</td>
<td>a) Do they bring in much capital (Savings)?</td>
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<td>(income flows and balance of payments)</td>
<td>b) Do they improve in the balance of payments?</td>
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<td></td>
<td>c) Do they remit “excessive” profits?</td>
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<td></td>
<td>d) Do they employ “transfer pricing” and disguise capital outflows?</td>
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<td></td>
<td>e) Do they establish few linkages to the local economy?</td>
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<td></td>
<td>f) Do they generate significant tax revenue?</td>
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<tr>
<td>2. Displacement of indigenous production</td>
<td>a) Do they buy out existing import competing industries?</td>
</tr>
<tr>
<td></td>
<td>b) Do they use their competitive advantages to drive local competitors out of business?</td>
</tr>
<tr>
<td>3. Extent of technology transfer</td>
<td>a) Do they keep all R &amp; D in home countries?</td>
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<tr>
<td></td>
<td>b) Do they retain monopoly power over their technology?</td>
</tr>
<tr>
<td>4. Appropriateness of technology transfer</td>
<td>a) Do they only utilize capital-intensive technologies?</td>
</tr>
<tr>
<td></td>
<td>b) Do they adapt technology to local factor endowments or leave it unchanged?</td>
</tr>
<tr>
<td>5. Patterns of consumption</td>
<td>a) Do they encourage inappropriate patterns of</td>
</tr>
</tbody>
</table>
6. Social structure and stratification
   a) Do they develop allied local groups through higher wage payments, hiring (displacing) the best of the local entrepreneurs, and fostering elite loyalty and socialization through pressures for conformity?
   b) Do they foster alien values, images, and lifestyles incompatible with local customs and beliefs?

7. Income, distribution and dualistic development
   a) Do they contribute to the widening gap between rich and poor?
   b) Do they further promote "urban bias" and widen urban-rural differentials?


4.1.2 Why Donors Give Aid
Donor countries give aid primarily because it is in their political, strategic, and/or economic self-interest to do so. While some development assistance may be motivated by moral and humanitarian desires to assist the less fortunate (e.g.,
emergency food relief programs), there is no historical evidence to suggest that over longer periods of time donor nations assist others without expecting some corresponding benefits (political, economic, military, etc) in return. We can therefore characterize the foreign aid motivations of donor nations into two broad, but often interrelated, categories: political and economic.

4.1.3 Why LDC Recipients Accept Aid
The reasons why Third World nations, at least until recently have been very eager to accept aid, even in its most stringent and restrictive forms, have been given much less attention than the reasons why donors provide aid. This omission is puzzling in view of the many instances where both parties may have conflicting rather than congruent motives and interests. Basically, one can identify three reasons — one major and two minor — why LDCs have sought foreign aid. (Bhagirati 1972).

The major reasons is clearly economic in concept and practice. Third World countries have often tended to accept uncritically the proposition, typically advanced by developed country economists, taught in all university development courses, and supported by reference to “success” cases like Taiwan, Israel, and South Korea to the exclusion of many more “failures” that aid is a crucial and essential ingredient in the development process. It supplements scarce domestic resources; it helps to transform the economy structurally; and it contributes to the achievement of LDC takeoffs into self-sustaining economic growth. Thus, the economic rationale for aid in LDCs is based largely on their acceptance of the donor’s perceptions of what they, the poor countries, require to promote their economic development.

Conflicts generally arise, therefore, not out of any disagreement about the role of aid but over its amount and conditions. Naturally, LDCs would like to have more aid in the form of outright grants or long-term low-cost loans with a minimum of strings attached. This means the abolition of tying aid to donor exports and the granting of greater latitude to recipient countries to decide for themselves what is in their best long-run development interests. (Bhagirati 1972).
The two minor though still important motivations for LDCs to seek aid are political and moral. In some countries aid is seen by both donor and recipient as providing greater political leverage to the existing leadership to suppress opposition and maintain itself in power. In such instances, assistance takes the form not only of financial resource transfers but military and internal security reinforcement as well. While South Viet Nam represents the most dramatic illustration of this “aid” phenomenon in the 1960s, as do perhaps Iran in the 1970s and Central America in the 1980s, many other Third World nations also have this political motivation. The problem is that once aid is accepted, the ability of recipient governments to extricate themselves from implied political and/or economic obligations to donors and prevent donor governments from interfering in their internal affairs can be greatly diminished.

Finally, we come to the moral motivation. Whether on grounds of basic humanitarian responsibilities of the rich toward the welfare of the poor or because of a belief that the rich nations owe the poor “conscience money” for past exploitation, many proponents of foreign aid in both developed and developing countries believe that rich nations have an obligation to support the economic and social development of the Third World. They then go on to link this moral obligation with the need for greater LDC autonomy with respect to the allocation and use of aid funds.

4.1.4 The Effects of Aid

The issue of the economic effects of aid, like that of the effects of private foreign investment, is fraught with disagreements. On one side are the “economic traditionalists,” who argue that aid has indeed helped to promote growth and structural transformation in many LDCs. On the other side are those who argue that aid does not promote faster growth but may in fact retard it by substituting for, rather than supplementing domestic savings and investment and by exacerbating LDC balance of payments deficits as a result of rising debt repayment obligations and the linking of aid to donor country exports. (Chenery and Strout 1996).
Aid is further criticized for focusing on and stimulating the growth of the modern sector, thereby increasing the gap in living standards between the rich and the poor in Third World countries. Some would even assert that foreign aid has been a positive force for antidevelopment in the sense that it both retards growth through reduced savings and worsens income inequalities. Rather than relieving economic bottlenecks and filling gaps, aid, and for that matter private foreign investment, not only widens existing savings and foreign exchange resource gaps but may even create new ones (e.g. urban-rural or modern-sector-traditional-sector gaps).

Quite a part from these criticisms, the 1970s and 1980s witnessed, on the donor side, a growing disenchantment with foreign aid, as domestic issues like inflation, unemployment, governments deficits, and balance of payments problems gained increasing priority over international cold war politics. During this period, one often heard the expression “aid weariness” used to describe the attitudes of developed countries toward foreign assistance. Taxpayers became more concerned with domestic economic problems especially as they increasingly realized that their tax dollars allocated to foreign aid often were benefiting the small elite groups in LDCs who in many cases were richer than the taxpayers. Given the declining real value of Western aid programs, hope arose among the LDCs that the vast new oil wealth generated by the OPEC trade surpluses in the 1970s might help to compensate for lost revenues.

4.1.5 Conclusions: Toward A New View of Foreign Aid
The combination of “aid disillusionment” on the part of many Third World recipients and “aid weariness” among some traditional developed country donors does not augur well for the continuation of past relationships. But it can be argued that this is desirable rather than disheartening. (Cassen 1986). Dissatisfaction on both sides creates the possibility for new arrangements characterized by greater congruence of interest and motivation on the part of donor and recipient. A lower total volume of aid from the developed nations that is, however, geared more to the real development needs of recipients and permits them greater flexibility and autonomy in meeting their
development priorities would on balance represent a positive step. The rising proportion of development assistance funds now being channeled through multilateral assistance agencies like the World Bank, whose political motives are presumably less narrowly defined compared with those of individual donor countries, is also a welcome development. It tends to minimize one of the major criticisms of past foreign aid practices, that is, the linking of economic aid political conditions.

More aid is better than less aid for some of the reasons outlined earlier. But from the viewpoint of LDC recipients, whatever the source and volume of aid, the more it takes the form of outright grants and concessional loans, the less it is tied to the donor exports, the more autonomy is permitted in its allocation and the more it is supplemented by the reduction of donor country tariff and non tariff trade barriers against Third World exports, the greater will be the development impact of this foreign assistance. In fact, many argue that better opportunities of profitable trade with the industrial nations are much more vital to Third World economic growth than quantitative increases in development assistance. Although it may seem wishful thinking to imagine that rich countries (both capitalist and socialist) will move in the direction of such real development-oriented trade and aid policies that at first glance appear to be against their economic self-interests, or closer examination this viewpoint may not be so farfetched after all.

As the realities of global interdependence slowly penetrate the political perceptions of developed nation governments, and perhaps eventually their populaces as well, it may begin to dawn on them that their real long-run economic and political interests in fact lie with the achievement of broad-based development in the Third World nations. Eliminating poverty, minimizing inequality, and in general raising levels of living for the masses of LDC people may just turn out to be in the most fundamental “Self Interest” of developed nations, not just of any humanitarian ideals (though one would hope that these are present) but simply because in the long run there can be no two futures for mankind, one of the very rich, the other for the very poor, without the proliferation of global conflict. Enlightened self-interest, therefore, may be the only
peg on which to build the hope for a “new international economic order” one in which both foreign assistance and private investment can begin to make a real and lasting contribution to Third World development.

4.2 The Emergence of Development Banking

Development Banks are specialized public and private financial institutions that supply medium and long-term funds for the creation and/or expansion of industrial enterprises. They have arisen in many Third World nations because the existing bank usually focus on either relatively short-term lending for commercial purposes (commercial and savings banks) or, in the case of Central Banks, the control and regulation of the aggregate supply of money. (Collyns 1983). Moreover, existing commercial banks set loans conditions that often are inappropriate for establishing new enterprises or for financing large-scale projects. There funds more often are allocated to “safe” borrowers (i.e. established industries, many of which are foreign owned or run by well known local families). True “venture capital” for new industries rarely finds approval.

In order to facilitate industrial growth in economies characterized by a scarcity of financial capital, Development Banks have sought to raise capital, initially focusing on two major sources:

1. bilateral and multilateral loans from national aid agencies like the U.S. Agency for International Development (USAID) and from international donor agencies like the World Bank, and
2. loans from their own governments.

However, in addition to raising capital, Development Banks have had to develop specialized skills in the field of industrial project appraisal. In many cases their activities go far beyond the traditional banker’s role of lending money to credit-worthy customers. The activities of Development Banks often encompass direct entrepreneurial, managerial, and promotional involvement in the enterprises they finance – including government-owned and operated industrial corporations.
Development Banks are thus playing an increasingly important role in the industrialization process of many LDCs. (Griffin and Enos, 1970).

Although Development Banks are a relatively new phenomenon in the Third World, there growth and spread has been substantial. In the mid 1940s there were no more than 10 to 12 such institutions; by the end of the 1980s, their numbers had increased into the hundreds, and their financial resources had ballooned into billions of dollars. Moreover, although the initial sources of capital were agencies like the World Bank, bilateral aid agencies, and local governments (e.g., the Industrial Credit and Investment Corporation of India was established in 1954 with a 30-year interest free advance of 75 million rupees from the Indian government), the growth of Development Bank finance has increasingly been facilitated by capital from private investors, both institutional and individual, foreign and local. Almost 20% of the share capital of these banks was foreign owned in 1980 with the remaining 80% derived from local investors.

Inspite of there impressive growth and their increasing importance for Third World industrial expansion, Development Banks have come under mounting criticism for their excessive concentration on large-scale loans. Some privately owned finance companies (also categorized as Development Banks) refuse to consider loans of less that $20,000 to $50,000. They argue that smaller loans do not justify the time and effort involved in their appraisal. As a result, these finance companies almost totally remove themselves from the area of aid to small enterprises, even though such aid is of major importance to the achievement of broadly based economic development in most countries and often may constitute the bulk of assistance needed in the private sector. Small-scale entrepreneurs, often lacking technical, purchasing, marketing, organizational, and accounting skills, as well as access to bank credit, are thus focused to seek funds in the exploitive unorganized money markets. Unless these small enterprise financial and technical needs can begin to be served, the long-run impact of Development Banks, public as well as private, will be confined mainly to
assisting relatively few private corporations and parastatals enterprises to consolidate their combined economic power even further.

It can be concluded, therefore, that in spite of the growth of Development Banks in almost every Third World nation, there remains a need for the establishment of new types of savings institutions and financial intermediaries. Such institution not only should mobilize domestic savings from small as well as large savers but, more important, should begin to channel these financial resources to those small entrepreneurs, both on the farm and in the marginal or “informal” sector of urban areas, who have until now been almost totally excluded from access to needed credit at reasonable rates of interest.

4.3 Financial Liberalization, Real Interest Rates, Savings and Investments

The concentration of Development Bank loans to a few large borrowers, together with the widespread existence of high inflation, growing budget deficits, and negative real interest rates, led to a serious LDC “credit crunch” during the 1980s. The global recession of 1981-1982 exposed the frailty of many Development Bank loans so that by 1983 almost half of them were reporting at least 25% of their loans were in arrears while a quarter had delinquency rates in excess of 50%. (Arrieta 1988). With real interest rates on savings deposits in negative territory and expectations of continued inflation and exchange-rate devaluation contributing to substantial capital flight, it is not surprising that few individuals were willing to save.

Being subject to numerous lending restrictions and facing mandatory interest rate ceilings on loanable funds at levels well below market-clearing rates, commercial banks naturally tended to ration the available credit. Figure 1 on page 71 shows the impact of binding nominal interest rate ceilings at below market-clearing levels. With the interest rate ceiling at \( r^c \), which is below the market-clearing equilibrium rate \( r_e \), the demand for loanable funds \( OL_2 \) greatly exceed the available supply \( OL_1 \). This excess demand leads to a need to ration the limited supply – a phenomenon known as “financial repression” since investment is limited or “repressed” by a shortage of
savings, which in turn, results from administered real interest rates at below market-clearing levels. In the absence of outright corruption in the allocation of OL1 loanable funds, most commercial banks choose to allocate the available credit to a few large borrowers so as to minimize the administrative overhead cost as a proportion of the total cost of lending. Thus, the net effect of government controls over lending rates means that even fewer loans will be allocated to small investors. Banks can only cover the additional administrative costs as well as the added risks of smaller loans by charging higher interest rates. Hence, small farmers and urban entrepreneurs have recourse but to seek finance from the unorganized money market, where as we see from the figure, they are willing to pay above market-clearing rates of r_u.

One suggested solution to the problem is to liberalize the financial sector by allowing nominal interest rates to rise to market-clearing levels. This would cause real interest rates to rise to positive levels and thus remove the explicit interest-rate subsidy accorded to preferred borrowers who are powerful enough to gain access to the rationed credit. Higher real rates should also generate more domestic savings and investment, and permit some borrowers to shift from the unorganized to the organized credit market. The World Bank cites evidence from a number of countries such as Thailand, Turkey, and Kenya where the liberalization of interest rates generated more savings and investment. On the other hand, evidence of the effects of financial reform in Chile during the 1970s revealed many shortcomings of the process. These included the acquisition of numerous banks by large conglomerates or groups who used their new financial resources to buy recently privatized firms or to expand their own companies. When many of their firms faced financial losses, these groups had to resort to additional funding to avoid bankruptcy. Thus, the Chilean financial system was very vulnerable when the debt crisis struck in 1982.

Reform and liberalization of the organized money sector, is, therefore, no panacea for the financial systems of developing nations. While removing artificial interest rate distortions and thus possibly promoting more saving and more efficient investments
allocation, financial reform always needs to be accompanied by other more direct measures to give small farmers and investors access to needed credit and by careful governmental supervision of the banking and financial sectors to prevent undue concentration by local elites. As pointed out throughout (e.g., with regard to land reform, access to higher education, employment creation and multinational corporate investment), "getting prices right" is only one step, albeit an important one, in making development better serve the needs of the forgotten majority.

Fig. 1

The Effects of Interest Rate Ceilings on Credit Allocation

4.4 Public Administration: The Scarcest Resource
Throughout this narration the approach has tended to gloss over one of the most critical shortages in the development process. This is the very real and often binding constraint on economic progress that arises out of the shortage of public (and private) administrative capability. Many observers would argue that the lack of such managerial and administrative capability is the single scarcest public resource in the developing world. The problem is not only a lack of training or experience, it also arises out of the political instability of numerous Third World nations. (Killick 1993). When power is constantly changing hands, considerations of efficiency and public welfare are likely to be subordinated to political loyalty. Moreover, the larger the group of officials affected by a change of power, the more difficult it will be to maintain any continuity of the formulation and execution of policy.
Public administration is unlikely to function efficiently when the rule of law is in question, when there is public disorder, or when there is little consensus of fundamental issues. Acute condition of class, tribal, or religious conflict within a society will usually be reflected in the management and operation of government departments and public agencies. In a highly traditional society, where kinship ties are strong and such concepts as statehood and public service have not yet taken firm root, there is little space for a merit system. Similarly, where the dominant values are religious or transcendental, traditional incentives to perform in the wider public interest may not have much appeal.

Many LDC governments may also have civil service goals other than performance: to break up traditional elites, to "nationalize" the civil service, to conform to ideological correctness, to reflect or favour an ethnic ratio, to include or exclude minorities. Most governments also are organized in the traditional hierarchical form. But some have experimented with negative hierarchy (from bottom to top), ad hococracy (temporary arrangements), and polyarchy (cooperation with outside organizations) — this last being attempted particularly when some special form of expertise is involved.

Virtually all LDC bureaucracies are hopelessly overstaffed at the bottom and hopelessly understaffed at the top. There is a chronic and desperate shortage of skilled competent managers capable of independent decision-making. The greater the number of parastatals organizations set up — the more state-owned enterprises and nationalized industries, quasi-governmental bodies, development corporations, training institutions — the thinner this layer of managers is spread.

In the case of nationalized industries most experiments have been economically disastrous and have resulted in all kinds of strains within the central civil service. Personnel systems within the public service are usually not adequate for the increased management complexities of an industrial enterprise. So parallel personnel systems have been set up, multiplying the public service systems, draining skills, leading to
disparities in terms of conditions and service, and resulting in manpower shortages and morale problems. Political considerations often affect the ability to recruit competent managers with special technical skills. In short, nationalization in many incidents has often added to the financial burden of the government budget.

But whatever the organizational and political problems of public administration, the sheer difficulty of efficiently managing complex modern economic system is often cited when referring to critical public policy issues in the Third World. A striking example of the administration problem is provided by the case of the Tazara railroad through Tanzania and Zambia.

The Tazara railway, giving Zambia access to the sea at Dar es Salaam, the capital of Tanzania, was built in less than five years by the Chinese and was formally opened in July 1976. In October 1978, President Kaunda of Zambia announced that, effective immediately, and inspite of UN sanctions, OAU pressures, and the civil war in Zimbabwe-Rhodesia, he was reopening Zambia’s border with Rhodesia and resuming the interrupted rail link with the South. The reason: Massive administrative breakdown had so impaired the function of the railway that it was threatening to strangle the entire Zambian economy.

In early 1978 the EEC had granted Zambia $8 million for fertilizer desperately needed by its ailing agricultural sector. The first consignments from the United States were unloaded at Dar es Salaam, where the railway was unable to handle them and they were left in the open to rot. As the pileup increased, Tanzania was reported to have increased storage and demurrage charges by 100%. Zambia then ordered the fertilizer rerouted through Beira, Mozambique, whence it went by rail to the town of Moatize, and then by road through Malawi and Zambia. After 60,000 tons had been transported, it became clear that Mozambique railway and Zambia transporters, already short of fuel and spare parts could not cope. Shippers refused to take the remaining 90,000 tons to Dar es Salaam because of the congestion there. Zambia then suggested it go to Maputo, Mozambique, from which it could be carried by
South Africa Railways through South Africa via Pretoria and Marketing to Francistown, where an armada of small Zambia truckers would carry it across the Kazungulu ferry. But the Dunkirk did not materialize. By the end of September, Zambia had spent an extra $25,000 in transport costs, Maputo and Francistown were drowning in fertilizer, only some 2,000 tons had arrived in Zambia, and the ploughing season had begun.

In addition, some 100,000 tons of Zambia copper was either awaiting transportation or trapped somewhere on the line. Further stockpiles at the mines reached 70,000 tons by early October, causing cash shortages to the copper companies, which do not get paid until the copper is on the high seas. Production was hampered by shortages of spare parts and lubricating oil, which were held up elsewhere.

In four years' time, Tanzania and Zambia would have to start repaying their $400 million debt to China. About a hundred Chinese specialists were brought back to try and restore the line to working order; they saw little chance of its paving its way unless its administration was completely overhauled. More than half the locomotives were under repair. A quarter of the 2,100 freight cars were off the line at any one time. The account department wasn't getting the bills out, and the railways was owed millions of dollars. Without huge spending on new equipments and training programs there was little possibility of Tazara handling even a fraction of its capacity; even the massive spending would not necessarily guarantee results.

This is a dramatic example of a dramatic shortfall in one sector—unanticipated in any feasibility study or economic blueprint — whose effects were felt not only at other sectors of the Zambian economy but also in neighbouring states. It serves to illustrate the crucial importance of the administrative component in economic development planning — not only in relation to the particular project under consideration but also in relation to the functioning of the entire public and private economic system.
4.5 Development Policy and The Role and Limitations of The State

Keeping the public administration and state-owned enterprise issues in mind, it is reasonable to further generalize on the actual formulation of economic policy in the Third World and speculate about the future role and limitation of the state in the mixed market economies characteristics of most countries of Asia, Africa, and Latin America.

In view of the record of the past three decades, most development economists would now probably agree that their early and almost mystical belief in the efficacy and benefits of central planning and extensive public intervention has not been validated by Third World experience. (Healey, 1992). Moreover, as mentioned earlier, economic policies have more often than not tended to be ad hoc responses to recurring and often unexpected crisis rather than the playing out of a grand economic design for development. We should never forget that political leaders and decision-makers are human beings like the rest of us with all the usual human idiosyncrasies, foibles, and weakness. Except in very unusual cases, they will tend to take a parochial (class, caste, tribal, religious, ethnic, regional etc) rather than national point of view. In democracies, politicians will respond first to their political constituencies and the vested interest groups within their home areas. In more autocratic forms of government, dictatorship, or strict one-party rule, political leaders will still have a natural tendencies to respond to those groups to whom they owe their power or on whom their continued power depends. We must always bear in mind that economic policies are ultimately made not by economist or planners but by politicians, who may well be more interested in “muddling through” each emerging crisis and staying in power than in instituting major social and economic reforms. But the situation may change, if only because, as many now believe, the coming year will see a development crisis that simply may not be resolvable without widespread economic and social reform.

We therefore need to be pragmatic about the role and limitations of economic policies in developing nations. On the one hand, we should avoid the tendency to assume that
political leaders and decision makers place the “national interest” above their own private interests, or base their policies on some notion of social welfare as opposed to the private welfare to those groups to whom they are primarily indebted. On the other hand, we should equally avoid the cynical view that the social interest, and especially the interest of the poor, the weak, and the inarticulate, will never be considered short of revolution. Social and political revolution are notorious vehicles by which one elite replaces another while the welfare of the poor remain largely unaffected (China and possible Cuba being the most notable exceptions). It appears more reasonable, therefore, to base our discussion of the role and limitation of the state on the proposition that most Third World government are beset by conflicting forces, some elitist, others egalitarian, and that their economic policies will be largely a reflection of the relative strength of these competing forces. Although narrow elitist interest have tended to prevail in the past, the groundswell for a more egalitarian development process has now reached the point where politicians and planners can no longer ignore it or camouflage it behind noble but empty rhetoric.

Whatever one’s ideological preconceptions about the proper role of government versus the private sector there can be no denying that over the past few decades governments in developing countries have claimed a major responsibility for the management and direction of their economies. It has been said that in many countries, especially in Africa, if the government does not include development, then it probably will not happen at all. If nothing else, governments in these countries are the most important users of trained manpower. How they deploy these limited human resources thus becomes a crucial issue for the success of failure of the development effort. In short, how governments are structured and how they manage development has been vitally important and will become even more so in the future.

In classical economies the role of government was conceived simply in terms of maintaining law and order, collecting taxes, and generally providing a minimum social services. With the Keynesian revolution, the economic role of government was greatly expanded. Governments were assigned prime responsibilities within a market
economy for stabilizing overall economic activities by means of countercyclical monetary and fiscal policies with the objective of obtaining full employment without inflation. At the same time that the Keynesian revolution in Western economic thought was occurring, the Soviet Union was demonstrating to the world the power of central planning to mobilize resources and accelerate industrial growth.

As indigenous leadership replaced colonial leadership in Third World nations, these two models of the role of the state were at hand. Impressed by the Soviet planning performance yet inheriting a free enterprise structure and philosophy from colonial days, most LDCs adopted the system of a mixed market combined with planning, with, as we have seen, a relatively heavy emphasis on central coordination and public sector participation of all aspects of economic activity. Given the rising concern with questions of poverty and inequality, however, the role of the state today has increased to an even greater extent despite the consensus that planning has not worked the magic that some believed it would and that many public corporations are inefficient users of valuable financial and human resources.

Thus there seems to be general agreement today among economists that LDC government should not necessarily do less, but that they should do what they are now doing better than in the past. Most would agree that the machinery of many Third World governments has become too cumbersome. There are too many ministries often with competing interests, too many public corporations, and too many boards of one kind or another. Governments are criticized for being too centralized and too urban-oriented in both staff and outlook. Civil servants and other trained personnel are often poorly utilized, badly motivated, and in most respect less productive than they should be. There is too much corruption and too little inventiveness and innovation. Bureaucratic red tape and ossified procedures and processes sap originality and flexibility. In short, contemporary LDC governments are criticized for being not too different from almost any other government or international agency around the world!
But, whether one likes it or not, Third World government must inevitably assume a more active responsibility for the future well being of their countries than the government of the more developed nations. As their primary task of nation building (in the newly independent countries) and generating rapid economic growth (in all LDCs) are gradually supplemented by preoccupations with problems of debts and deficits as well as poverty, unemployment, and inequality, Third World governments are forging a new role, one that will require innovation and change on a scale that has rarely occurred in the past. Central to this new role will be institutional and structural reforms in the field of land tenure, taxation, asset ownership and distribution, education and health delivery systems, credit allocation, labour market relations, pricing policies, the organization and orientation of technological research and experimentation, the operation or privatization of state trading corporations and public sector enterprises, and the very machinery of government and planning itself.

Whether or not such a transition from a purely growth oriented development strategy to one also emphasizing the elimination of poverty and the reduction of inequality will require major political transformations, as some have suggested, or whether the existing leadership can respond to the new environment of development by initiating and carrying out fundamental institutional reforms remains open to debate. But whatever the nature of the response, one can suddenly predict that the public sector, whether centralized or decentralized, whether jointly with private enterprise or on its own will in the coming decades continue to claim major responsibility for the “commanding heights” of most Third World economies. It is hoped, therefore, that LDC governments have learned much from their experiences of the past three decades and that future successes will more than compensate for any past inadequacies.

4.6 Global Interdependence

We live in an increasingly interdependent world, and sometimes some day we will live in a “world without borders” to borrow from the title of a provocative book of the 1970s. For Third World countries, dependence on rich nations is and has always been
a stark fact of their economic lives. It is the principal reason for their heightened interest in promoting individual and collective self-reliance. At the same time, the developed world, which once prided itself on its apparent economic self-sufficiency, has come to realize that in an age of increasingly scarce natural and mineral resources and burgeoning Third World debts, it is becoming ever more economically dependent on the developing world. In the case of the United States for example, Third World nations supply 80% of its fuel imports, as well as 26% of its imports of industrial supplies, 25% of its imports of capital goods, and 53% of its imports of consumer goods. (Jennifer 1994).

However, rich nation dependent does not center solely on the need for energy and raw materials supplies, or on the ability of key nations like Brazil, Mexico, and Argentina to repay earlier loans. It is also manifested in the importance of Third World nations as markets for export products. In the case of U.S. trade, exports to developing countries increased at a 15% annual rate between 1975 and 1981 and grew faster than U.S. exports to any other group of countries. By the early 1980s over 41% of all U.S. exports went to developing nations. One out of every 6 jobs in the U.S. manufacturing sector was directly dependent to exports on Third World markets. Of the 20 largest U.S. trading partners, 11 were developing nations, and together these 11 nations accounted for more than 26% of all U.S. trade and 22% of all U.S. exports. However, because of the accounting Third World debt crisis, which has caused LDCs to drastically curtail their imports, by 1986 only 9 of the 20 largest U.S. trading partners were developing nations, while total U.S. exports to LDCs fell to under 35%. When Third World economies stagnate, industrial economies feel the effects in terms of diminished exports and lost jobs. For example, during the 1981-1982 recession, sales to non-oil developing nations fell by over $24 billion. In the United States, the Commerce Department has estimated that each $1 billion in exports sustains approximately 25,200 American jobs. By that yardstick, declining U.S. exports to Latin America alone accounted a loss of nearly 400,000 American jobs in 1982 and 1983, with an additional loss of almost 500,000 jobs by the late 1980s. For the first time in recent history, therefore, the economic progress of developing countries has
both a direct and indirect impact on the economic performance of industrialized nations, and this "reverse economic dependence" continues to be evident in this 21st century.

4.6.1 An Uneven Process: Incorporation and Marginalization

Jeffrey James says that globalization is an undeniable real phenomenon defined in terms of increased flows of trade and investment between countries. According to James, over the ten-year period, from 1985 to 1994, the ratio of world trade to GDP rose more than three times more rapidly than during the ten previous years, while the ratio of foreign investment to GDP doubled. This undeniably real phenomenon of globalization is certainly causing serious changes in every part of the world through enhanced network of interconnectedness and interdependence. So Paul Streeten says globalization is transforming trade, finance, employment, migration, technology, communications, the environment, social systems, ways of living, cultures and patterns of governance.

However, as stated in this narration, this process of globalization is not occurring evenly throughout the whole world. It has been developed in some parts of the world fast, while the other parts have been relatively marginalized from the trend. We might recognize this fact rather easily by referring to some indicators that can be interpreted as showing the trend of globalization.

During the past few decades, the economic development gap has widened between the industrial countries and developing countries as a group, and again between different regions among developing countries. According to a UNDP statistic cited by Paul Streeten, the share of industrial nations in the global distribution of wealth has increased from 67.3% in 1960 to 78.7% in 1994. The share of developing counties has shrunk from 19.8% to 18.0% during the same period. The former USSR and Eastern Europe have taken up the remaining portion, which has also shrunk dramatically.
Indicators related to world trade and financial flows, which are frequently used by many authors as indicators of globalization, also show that discrepancies have been increased between as well as regions. World trade of commodities has been highly concentrated on the tripolar industrial nations of US, Europe and Japan and this trend has not changed much. On the while, world financial flows have been more and more concentrated on the industrial nations especially since the early 1980s. The share of industrial nations in the net inflows of foreign capital has grown from 57.2% in 1980-82 to 82.8% in 1991-92.

Besides the facts stated above, a lot of other indicators such as technology and human development-related statistics also show big discrepancies between different parts of the world. So, seeing from the trend, we might even say that the process of globalization has been moving in a direction, which is not so truly global. It has been a process largely contained and developed within industrial nations.

However, a much more important aspect of globalization lies in the fact that it has been developed quite differently even among the developing countries. Briefly summarizing, some East Asian countries have been most dynamically incorporated in this process, while Africa and the Middle East have been seriously marginalized. A.S. Bhalla and Albert Berry seem to have summarized the uneven process of globalization well in the following phrases:

"Over the last couple of decades, during which the effects of globalization and the new wave of technological change have been felt, income disparities have widened in two areas of particular concern. First, certain regions or countries have tended to slip back in the global income parade. Sub-Saharan Africa has lost ground in both relative and absolute terms, with per capita GDP falling by about 24% over 25 years. Despite the increasing participation of the developing countries in world trade, growth is not evenly distributed among them. Three quarters of the aggregate increase in the ratio of trade to GDP has occurred in just 10 developing countries – the ratio has fallen in 44 of 93 developing countries over the last decade (World
The ILO (1995a) points out that the overall developing country share of world trade scarcely changed between 1970 and 1991: the remarkable increase in the share of the Asian countries from 4.6% to 12.5% was offset by a corresponding decline for other developing countries. The 1990s have witnessed a surge of private capital flows to developing countries – both FDI and other types of capital – but official flows have dwindled. However these flows, like the growth of trade over a longer period, have been highly concentrated among a few countries: half of the developing countries receive little or no FDI, and in a third of them the ratio of FDI to CJD has fallen over the last decade. Africa’s share of net private capital inflows from 1989-95 was just 4.2%.”

Let us now examine some of the major manifestations of global interdependence by focusing on four key issues that are likely to dominate international economic prospects in this century. These are:

### 4.6.2 Energy and Resource Balances

If anyone ever doubted that energy and energy supplies (e.g., oil, coal, natural gas, and hydroelectric power) were the foundations of modern industrial economies, the “energy shocks” of the 1970s dramatically proved the point. The developed nations, which make up less than one-quarter of the world’s population, consume annually almost 85% of world energy production. But the non-oil producing Third World countries also rely heavily on oil to fuel their growing industrial and agricultural economies. The massive and unprecedented 400% price increase announced by members of the Organization of Petroleum Exporting Countries in 1974 resulted in enormous additions to their total export revenues, which rose from some $14.5 billion in 1972 to over $110 billion in 1974.

Admittedly, a vast proportion of these revenues was derived from the principal oil-importing developed nations like West Germany, France, Italy, Japan, and the United States. But the oil-import bill on non OPEC developing countries – about 90 of them – rose from $4 billion in 1973 to over $15 billion in 1974, an increase of more than
$10 billion, or 250%. That increase in the cost of imports alone amounted to more than the total value of all official foreign aid provided of these countries by the developed world. The continued upward spiral in petroleum prices in 1979 further aggravated the balance of payments and inflationary problems of developed and developing nations, with the latter again feeling the impact more severely than the former. For example, the 1979 price increases added $10 billion to the import bills of the oil-importing developing nations and lowered their aggregate growth rates by over 20%.

No nation or continent is endowed with all the raw materials essentially for the functioning of a modern industrial economy. As these materials become increasingly scarce, their very uneven distribution throughout the world could thrust previously weak nations into positions of considerable economic power, much as occurred with the oil-producing states. World mineral interdependence and, especially, the growing raw material dependence of rich nations on poor ones, is a new and vital component of the growing economic interdependence of all nations. Raw material interdependence in particular has two main aspects.

1. The consumption of nearly all-essential minerals, both metallic and non-metallic is rapidly rising. Thos countries of North America and especially Western Europe that industrialized earliest have almost depleted many of their indigenous supplies of basic raw materials. According to Lester Brown, the rich countries, particularly the United States, Japan and those of Western Europe, with their steadily rising consumption of minerals required to support their affluence, are becoming increasingly dependent on the poor countries with their largely unexploited mineral reserves. In Western Europe, consumption of eleven basic industrial raw materials – bauxite, copper, lead, phosphate, zinc, chrome ore, manganese ore, magnesium, nickel, tungsten and tin – exceeds production. In the case of copper, phosphates tin, nickel, manganese re and chrome ore, nearly all needs must now be met from imports.
United States for example, has to import over 80% of its aluminium, chromium, cobalt, manganese, rubber, and tin. By 1990, iron, lead, and tungsten were added to the list, bringing it to a total of nine of the thirteen basic industrial raw materials. Today, the United States is more than likely be dependent primarily on foreign sources of supply for all its basic industrial raw materials with the probable exception of phosphate. Its total import of energy fuels and minerals, which cost $8 billion in 1970, is projected to increase to almost $64 billion by the turn of the century. As competition for dwindling reserves of high-grade minerals becomes more intense in the coming decades, the United States and other industrialized countries may feel increasingly vulnerable to external forces beyond their control. Conversely, supplier nations, mostly in the Third World, will experience a rise in their international bargaining power, especially if organizations like OPEC are able to be formed for other scarce minerals.

2. The other aspect of raw material interdependence, therefore, is the fact that known reserves of a number of minerals are highly concentrated in a few, mostly Third World, locations around the globe. For example, four less developed countries (Chile, Peru, Zambia, and Zaire) supply much of the world’s exports of copper. Three others (Bolivia, Malaysia and Thailand) supply over 70% of all tin traded in international markets. Mexico, Brazil, and China account for almost 80% of the world’s traded supply of graphite, Jamaica and Guinea supply almost 60% of the bauxite while Mexico and Brazil supply almost all of U.S. imports of strontium and columbium, respectively. The importance of LDCs as suppliers of these and other essential minerals to the United States is indicated.

Growing resource scarcities therefore could modify current international economic and political relationships with the potential elevation of the relative influence and power of a few Third World countries. Whatever the ultimate outcome, however, it can no longer be said that international dependence runs only from poor countries to rich countries.
4.6.3 The Economic Crisis in Sub-Saharan Africa

Although the Third World debt problem is widely perceived as a Latin American problem, in fact the burden of debt service is in many cases more onerous for countries in Sub-Saharan Africa, having grown from 15% of export earnings in 1980 to 31% in 1986. (Fields 1990). But foreign debt is only one of their major problems in the 1990s. It is the inexorable economic decline, the drop in per capita incomes, the rapid increases in population, the loss of export revenues, the curtailment of foreign investment, the destruction of fragile ecosystems, and the inability of many countries to even feed their people and provide basic human needs that lies at the heart of the African dilemma. As a recent joint report by the international Institute for Environment and Development and the World Resources Institute noted:

Sub-Saharan Africa poses the greatest challenge to world development efforts to the end of the century and beyond. Recurrent famine there is only the symptom of much deeper ills. Africa is the only major region where per capita income, food production, and industrial production have declined over an extended period: the only developing region where development appears to be moving in reverse.... In recent years, Africa’s farmers and herders, its soils and forests, have been chasing each other down a vicious spiral of environmental degradation and deepening poverty. Conventional development efforts by donors and governments have largely failed to halt the spiral, indeed in some cases have aggravated it.

The specific quantitative dimensions of the economic predicament in Sub-Saharan Africa are vividly portrayed. Twenty-two economically distressed countries suffered a 17% per capita GDP decline between 1980 and 1986. Falling commodity prices along with limited growth in world demand and natural cum policy induced domestic production shortfalls combined to cause nominal export earnings to decline by 30% and real earnings to fall by 50% during the same period. Finally, domestic investment fell by about 16% while per capita consumption – the most important development measure of all – fell by more than 12%. What is even more important is that the economic disasters recorded for the 1980s follow more than a decade of
similar declines. Thus, Sub-Saharan Africa has become more underdeveloped during the past 20 years, and prospects for the 21st century continue to be grim.

The causes of the African dilemma are many and varied. Some were beyond its control (drought, depressed commodity prices, foreign capital withdrawal, and diminished foreign aid), while others can be ascribed to poor government policies (neglect of agriculture, inefficient SOEs, lack of concern with population growth etc). The population of Sub-Saharan Africa is growing faster than ever before, and far faster than any other Third World region. In fact, at its current growth rate 3.3%, the population of 17 eastern African nations is growing faster than any other region in history! Food production has grown a bit, but certainly not at a pace to keep up with population. As a result, per capita food production was 16% lower in 1984 than it was in 1969. While some of these declines can be attributed to the Sahelian drought in 1983-1984, even before the drought, per capita food production was 11% lower than in 1969. Absolute poverty in Africa rose from 205 million in 1974 to an estimated 258 million in 1982, while the estimated number of acutely malnourished people rose steadily from 81 million in 1969-1971 to 9 million in 1981, three years before the drought and famine of 1983-1984. As Africa's own debt crisis worsened (total debt rose 680% from $14.9 billion in 1975 to $102 billion in 1986 and the need for foreign assistance became crucial, the net flow of resources to Africa plummeted from $8.2 billion in 1982 to $2.7 billion in 1984. Foreign aid stagnated at $7 billion (so that "real" aid fell) while net private foreign investors, who had brought in $4.2 billion in 1982, withdrew $480 million in 1984. Finally, as a result, of the financial crunch of the 1980s, the "stabilization" policies of the IMF, and the "structural adjustment" policies of the World Bank, African governments were forced to cut their budgets for numerous social and economic services aimed at the urban poor and the peasant farmer, including payments for health, education, and agricultural development. Thus, the real burden of the crisis was and is still being borne by those most vulnerable.
If the disaster of the past two decades are not to be repeated in the 21st century coordinated efforts by African governments and international assistance agencies will be required to reverse the decline. More emphasis needs to be placed on agricultural and rural development with enhanced price and investment incentives for small farmers being accompanied by institutional and structural reforms designed to improve the marketing and distribution of agricultural produce. Concern with preventing further environmental deterioration desertification must be increased. Inefficient state-owned enterprises and ossified public sector bureaucratic procedures need to be addressed, and managers must be made more accountable for resource allocation and investment decisions. Privatization possibilities should be pursued where financially feasible and socially acceptable (e.g., with due regard to issues of income distribution and dualistic development). Finally, major debt relief and population stabilization programs need to be put in place, with the former taking the form of significant debt cancellation (since most is publicly owned) and the latter focusing on a combination of demand reduction through poverty alleviation and the promotion of women’s economic progress along with supply improvements through more accessible and effective family planning programs.

A difficult period lies ahead for Sub-Saharan Africa. If development is going to succeed, Africa will be its severest test case. If it doesn’t succeed, then not only will the 510 million Africans South of the Sahara be its victims, but directly and indirectly, the wealthy nations of the industrialized world will have to bear a major responsibility for this failure.

4.6.4 The Future of the Third World Debt Crisis

Any viable long-run solution to the debt crisis will require at a minimum the following “adjustments” on the part of both lenders and borrowers, the developed and the less developed world:

1. A willingness on the part of lenders to put a “cap” or ceiling on the interest rate paid on existing loans. Whatever excess would remain would then be capitalized (i.e., added to the principal outstanding) so that the real value of
the debt remains fixed. Alternatively, there could be a temporary suspension of interest payments in dollars, which exact a heavy toll on debtor nations by slowing investment growth while promoting inflation. According to this, debtors would pay interest only in local currency, which creditors would be required to invest in the local economy. Such interest rate proposals represent the most realistic and acceptable form of debt relief to the LDCs short of an official moratorium or outright repudiation.

2. A substantial expansion of official lending from both developed country governments and the multilateral lending agencies to permit debtor nations to undertake the long-term structural changes necessary to rebuild their economies and pay their debts.

3. A major reduction or elimination of all kinds of tariff and nontariff trade barriers by developed countries against the exports of developing nations. Unless LDCs can find growing markets for their primary and secondary exports, there is little chance that they will be able to grow their way out of the current debt trap.

4. Finally, a willingness on the part of debtor nations to reconstruct and reform their economies. In order to do this they need to muster the political will and formulate the appropriate policies aimed at mobilizing domestic resources, improving the efficiency of the economic system while preserving equity considerations, raising agricultural productivity, identifying and pursuing real opportunities for new export promotion and in general meeting the challenges of the new development environment of the 21st century.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 The New International Economic Order (NIEO)

5.1.1 Evidence of Persistent Inequities

The 1990s were marked by a major challenge by Third World nations against an international economic order that they believed to be strongly stacked against their economic interest. Although fundamental areas of contention have been identified and analyzed earlier on international trade, private investment, and foreign assistance, it is useful to reiterate the impressive and growing evidence that demonstrate how poor nations are being disadvantaged by existing global market structures.

First, there is the substantial imbalance in the distribution of international monetary reserves. Although Third World nations contained over 70% of the world’s population, they received less than 4% of the international reserves of $131 billion during the first half of the 1990s. Because rich nations control the creation and distribution of these reserves (e.g., through their own monetary expansion and through their effective control over actions of the IMF), they have the power to manipulate these international assets to their own benefit.

Second, rich nations benefit disproportionately in the distribution of the value added to the products traded between themselves and the poor nations. Unlike the developed countries, Third World nations receive back only a small function of the final price obtained from international purchases of their products. The reason is simple: LDCs are often too weak and powerless to exercise any substantial control over the processing, shipping, and marketing of their primary products. Often they themselves must purchase back at substantially marked-up prices the final products processed from their own raw materials.
Third, in order to protect and perpetuate profits and jobs in uncompetitive and declining sectors of their economies, rich nations typically resort to tariff and nontariff protection of inefficient domestic industries while restricting immigration to maintain high wages. Thus, their rhetoric in support of the "free" working of the international market mechanism bellies the reality of their market management and control. Third World countries contend, therefore, that any genuine competitive success they may realize from international trade become nullified by the restrictive commercial policies of increasingly protectionist industrial nations.

Fourth, most of the contracts, leases, and concessions that the multi-national corporations have negotiated in the past with the developing countries have unfairly benefited the MNC at the expense of the host country. Thus, LDC host governments contend that because of royalty payments, tax concessions, transfer pricing, capital allowances, and so fourth, they receive only a small fraction of the benefits derived from the exploitation of their own natural resources by the MNCs.

Fifth, and finally, when it comes to critical economic decisions affecting the workings of the world economy, Third World nations have only a pro forma participation in the decision-making process. Their advice is rarely solicited by the industrial powers in key decisions relating to the future of the world economy. More importantly, although they represent a large majority of the world’s population, developing countries have less than one-third of the total votes in such key international economic institutions as the World Bank and the IMF. Their numerical majority in the UN General Assembly carries no influence on international economic decisions.

Given this background of international inequities in economic power and influence, Third World nations launched a major drive in the 1970s to try to reshape the world economic order to better serve their own interests. (Low and Howe 1974). As is not uncommon in social and political movements, the rhetoric used was often unnecessarily inflammatory, and many charges and allegations were patently unfounded. Nonetheless, many propositions were based on the facts already
discussed, and it is informative to trace the new international economic order (NIEO) movement and to highlight some of its key provisions and shortcomings.

Four main points of the Program for Action deserve special attention. These are:-
1. Renegotiating the debts of developing countries.
2. Redefining the terms of trade and assuring greater access to developed country markets.
3. Reforming the IMF and its decision-making process.
4. Attaining UN official development assistance targets.

5.1.2 Renegotiating the Debts of Developing Countries.
At the heart of most developing countries' plans for rapid economic progress is the need for a continuous flow and stable stock of foreign currency. By far the most serious drain on these stocks is the ever-increasing debt burden. The Program for Action calls for urgent action to "mitigate adverse consequences for the current and future development of developing countries arising from the external burden of debt contracted on hard terms." It further demands "debt renegotiation... with a view of concluding agreements on debt cancellation, moratorium, rescheduling or interest subsidization." (Brown 1999).

The major concern is to halt the drain on foreign currency that debt repayment aggravates, often to the point where, as we saw earlier, a larger percentage of foreign-exchange earnings goes solely to the repayment of past debt, thereby crippling current development projects. It was hoped that debt renegotiation would enable a developing country to continue debiting payments and so restore its position in international financial markets. On becoming a "better risk." A developing country would then be better able to attract needed foreign private capital. One suggested method of reserving was for the IMF to act as an international facility to 'finance part of the financial requirements of the countries' deficits.'
5.1.3 Redefining the Terms of Trade and Access to Markets.

The main purpose of reforms related to trade and market access would be to secure a stable if not increasing amount of foreign currency. Faced with deteriorating terms of trade, the non-oil-exporting developing nations sought to stabilize their financial situation in several ways:

1. Through indexation, the tying of primary commodity prices to those of manufactured goods. This policy would arrest the tendency of primary commodities to lose ground to imported manufactured goods, thus stabilizing the real price of LDC exports.

2. Through the creation of Common Fund to help stabilize commodity price fluctuations of such products as tin, rubber, sugar, and cocoa, partly by establishing buffer stockpiles. In June 1980 agreement was reached with industrialized countries to establish a Common Fund Under the Integrated Program for Commodities, as it is formally known. The accord, reached under the auspices of UNCTAD, provide $750 million (Third World countries had initially demanded $6 billion) to aid individual groupings of commodity-producing and consuming nations in their efforts to stabilize markets and promote trade in primary products.

3. Through preferential treatment of LDC exports by a nonreciprocal lowering of tariff barriers by the developed West and Soviet bloc nations, as well as reforms concerning nontariff programs, duties, and restrictive import regulations, particularly those concerning processed goods.

With these reforms, the developing nations argued, they would be better able to compete with the developed countries and to expand and diversify their export capacities. Expansion and diversification would in turn allow for more rapid and continuous growth.

5.1.4 Reform of the IMF.

Developing nations, like the end of a whip, are affected in the extreme by fluctuations in the developed economies on which their development programs ultimately depend. (Ishrat and Faruque 1994). The NIEO sought a way to assure the stable and
continuous flow of development assistance from the IMF, whose major contributors are the OECD nations, and hence a source of protection from the deteriorating effects of inflation and recession in the West.

In addition, the NIEO proposed a restructuring of the decision-making process within the IMF to give a greater voice to the developing world when critical decisions are to be made.

5.1.5 Attaining UN Official Development Aid Targets.
Set out in the objectives of the NIEO was the goal that each economically advanced nation should progressively increase its development assistance to 0.7% of its GNP. In principle, this aid was to be untied and provided on a long-term and continuous basis. Several mechanisms were put forward, including the sale of gold held by the IMF and a development tax on developed countries. Major emphasis was on stable, concessional (i.e., grant or very soft) untied flows.

By 1996, only the Netherlands, Sweden, Norway, Denmark, and France met the 0.7% GNP target. The United States, Japan, Switzerland, Finland, and Italy each contributed less than 0.3% of the GNP, with the United States (at 0.20) ranked 16th among the 17 major aid-giving nations in terms of the proportion of GNP allocated to development assistance. The average of all DAC countries was only 0.35% of total GNP.

5.2 Aid Conditionalities in Retrospect
Motivation for aid: In terms of appropriateness, quality and relevance, does aid really address itself to development and poverty reduction or does it serve other hidden agendas? Aid and Debt: What are the real underlying reasons for the co-existence of aid and debt? Is aid conditionality a means of imposing an inferior but monopoly product? Management of aid: Does institutional capacity to manage aid exist both among the creditors and debtors? If so why has aid been ineffective; and if not why is its building not part of the aid regime? Poverty Reduction Strategies and the link to
debt relief. Is this a fundamental change, applicable in all countries receiving IDA or is it applicable in only a few 'strategically important' HIPC's? (Gwin and Nelson 1997). Governance and aid: Does aid facilitate or undermine genuine participation and equity, especially in terms of gender? The motivation of aid: Aid and development cooperation can be said to fulfill ideological, foreign policy, business and military interests and objectives of the donors. There are differences between its stated objectives and the hidden motives; real intention and presumption and development cooperation objectives and recipients countries national interest. The origin of foreign aid are consistent with the question of motivation. The marshall plan was for humanitarian as well as political considerations. It is essential that Africa examine aid’s real motivation. Although development should be “the war against global poverty, starting from the recognition that this is an investment not only in the development of poor nations but also in the security of rich nations”, Aid has gone to Africa for many purposes – only one of which is development. “Donors use aid to advance their values, their commercial interests, their cultural aspirations and their diplomatic and political objectives.”

How did conditionality creep into the aid business? For example, Uganda applied for its first external loan at independence in 1962 to pay the retirement benefits of colonial civil servants. Repayment was pegged to future earnings from cotton and coffee. Soon there were no more cash crop earnings to mortgage ushering in the era of unsecured loans. The country then took bilateral, commercial and multilateral loans. Other than commercial loans, terms were ‘soft’, but conditional, binding the borrower to contracts, purchases and prices from the creditor country. Later, as new conditions in influence policy were added and loans were given for balance of payments support and servicing loans, the borrower was failed. Since the early eighties, conditions associated with aid have proliferated, typically coming through Structural Adjustments Programs. More recently, conditions have come in form of good governance.
Conditionality is most powerful when collectively imposed. In recent years, individual bilateral donors have ceded much of their decision-making power to the IMF, which certifies that the macroeconomic management of a country is sound and deserving of support. In addition, donors have increased coordination among themselves and increasingly present a united position to the recipient countries.

Why Conditionality Succeeds

Conditionality has succeeded because: (Burnside and Doppel 1998)

1. The recipients have been denied other alternatives sources of development finance. Donors killed off all alternative channels for poor countries to obtain development finance, starting with independent thinking. When Africa has come up with an original or alternative idea, as in the Lagos Plan of Action and Africa Alternative Framework to Structural Adjustment Programmes for Socio-Economic Recovery and Transformation (AAF-SAP), these have been quickly countered.

2. Comparative advantage has been applied to block potential to generate own resources, condemning Africa to exporting a narrow range of primary commodities whose exchange value never appreciates.

3. There is no ideological alternative, the one that gave so much hope to poor people and without which much of Africa would perhaps not have been liberated, having been finally dismantled.

4. Vulnerability has increased as developed countries caused exogenous shocks to already weak and vulnerable economies.

5. South-South cooperation joint initiatives have been thwarted, making it hard for disaffected economies to extricate themselves from destructive conditions. The global economy is designed to work against them.

6. They have failed to learn alternative survival skills, poor countries are unable to create internal conditions gains, which undermine their long-term development prospects.
Undoubtedly, at the right levels and properly targeted, aid can be a catalyst for long-term development to help people who are not reached by other capital flows and yet despite apparent high aid floss, Africa’s average output per capita in constant prices was lower at the end of the 1990s than 30 years before and it’s debt greater than it’s GNP. For rich industrialized countries, aid has helped to stabilize their economies and strengthen their influence over developing poor nations. Aid and conditionality have helped to ensure that donors advance their values, commercial interests, their cultural aspirations and their political objectives. But for Africa, aid has had a destabilizing effect. During the colonial era, it underdeveloped industrialization and later de-industrialized what has been built by post-independence governments. The parastatals have all been replaced with a new industrialization dominated by subsidized foreign companies without seriously considering alternative options of making them productive.

5.3 Aid and Policy Reforms
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.34

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 35 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 3: Foreign Direct Investment in Kenya 1980-1996

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<tr>
<th>YEAR</th>
<th>AMOUNT (US$) MILLIONS</th>
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<tr>
<td>1980</td>
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<td>1981</td>
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<td>1995</td>
<td>32</td>
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<td>1996</td>
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Source: World Bank, Global Development Finance (formerly World Debt Tables,) various years.

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 the 1990s must also be attributed to deficiencies in these other essential prerequisites for higher investment and growth.

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 36 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. (Gordon 1992).

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 in the government. Admittedly, advanced consultations with either stakeholders or implementers 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.

Donor conditionality. Kenya’s economic reform efforts, ongoing but with slowdowns 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 adjustments which 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.

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 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 studied or on developing “action plans”. This approach often delays getting to any concrete action.

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 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. (Cassen 1994). The expectation now is for full compliance with agreed concessions, 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.

Aid and reforms: (Collier, Guillaumont and Gunning 1997). 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”. If aid flows into the country outside the government budget, of 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.

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 concessions; however, the final document prepared in Washington was, in the eyes of the Kenyan officials, another “Christmas Tree.” Certainly Kenya received massive amounts of aid in return for policy reform agreements – almost US$15 billion over the entire 1970-96 period. How effective was this aid in “buying” reforms? One can argue that at times of
severe economic crisis, as in 1980-82 and 1993, the governments 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 therefore a rational view, 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.

If aid has had only limited impact on the implementation of reforms, it is 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 of 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 step 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, one can conclude that government ownership and political
5.4 Way Forward (Recommendations)

At the beginning of 1988 the ECA embarked on a search for an African alternative framework to SAPs. The search was conceived as a process of extensive consultations, both within and outside Africa, with a view to reaching a consensus among African countries and between African and its development partners, attempting to remove the dichotomy between structural adjustment and long-term development. It is people centered and ensures equitable distribution of income. Policy directions included the shifting of resources to minimize non-productive and excessive military expenditures. Debt management and servicing capacity was to be continuously assessed in the short and long term. The framework was not to be applied indiscriminately in all countries but was taken into consideration the peculiar characteristics of each country. It implied full democratization of all aspects of economic and social activities from decision-making to implementation, calling for intensified inter-country co-operation. The AAF-SAP contains almost all the critical elements to bring about fundamental socio-economic structural change, which have been intentionally frustrated or ignored by those pretending to help. As a medicine man puts it, “we have no dream anymore...” because those who know everything have completely taken over the show. Real solutions require thinking backwards to people’s dreams and aspirations. (Collier 1997). The realities portrayed above calls of the following action from the different players: Civil Society Actors (CSAs) have to “restructure, re-skill and renew”, to enhance their capacity to influence policy through a three-track approach:- Maintain pressure on the development partners to change their approach to aid and the basic structure of the development model now in dominance – Work with their local and Central Governments to lay internal strategies of strengthening their individual and collective bargaining capabilities. Build linkages between their local operations and policy enclaves. Donors, Governments and civil society must address the question of the quantity and quality of aid. There should be an assessment of net aid needed by HIPC’s to get out of debt. A
comprehensive framework should address the unattainable debt question, the aid that does not reach recipients, and unproductive aid in order to establish required amount. Once established, partners must ring-fence it so that, in case of any shocks, pending on minimum poverty reduction targets (estimated at US$28 per capita) should be given a higher priority than debt servicing. A more rational and objective way of giving aid should be established in a participatory manner. It is proposed that loans should be secured, character loans or group/collective loans. Countries unable to secure their loans must demonstrate character, elements of, which will have been predetermined in a transparent manner. Governments that cannot live within their means (defined as domestic and export revenue plus net/essential aid, with low or no debt servicing) should be assisted to objectively assess their political and economic viability and to form politico-economic alliances. Countries need to recognize alliances or even integration as an imperative necessity of which future survivals depends. HIPC’s should be supported to build capacity to create their own strong terms and ‘conditions’ on which they will take aid, the ability to access themselves and say “no” to policies and aid packages that not in their long-term interests. In conclusion, for aid to facilitate sustainable development in Africa, the issues of motive, quality, aid management capacity and governance on the part of both the donor and the recipient must be addressed. Ongoing efforts to review aid efficiently and effectiveness must be intensified. But if the arguments of this paper, that aid to Africa is not effective, are validated, then, without the possibility of achieving the alternative agendas or dealing with the weaknesses of the aid regime, there is no chance of implementing the unfinished agenda.

The Government will be required to embrace the Poverty Reduction Strategy (PRSP) Initiatives with the assistance of the IMF, the World Bank and other partners, (Husain and Faruqee 1994), PRSPs have the following characteristics:-

1. They identify poor communities and seek their views on the causes of poverty.


3. Participatory poverty assessments
4. Assessments of the distributional impact of adjustment reforms.

5. Shifts of the pattern of public expenditure toward poverty reduction programmes, including health and education, rural infrastructure, rural credit programmes. Etc.

6. Strategies for overcoming poverty, e.g. social sector programmes, actions to promote growth and capacity building, rural development, local infrastructure, job creation by the private sector, increasing participation and good governance.

7. Outcome indicators set and monitored through participatory processes.


5.5 Conclusions

Today, we are now certainly living in the age of globalization. With the rapid development of technology in electronic communication and transportation, everyone in the world becomes more and more interconnected and interdependent. A small event in New York’s Wall Street can affect the daily life of an ordinary citizen in Kenya. The trend of globalization is developing very fast, and the aspects are very complex. So the process of globalization is bringing uncertainty and volatility in our lives.

It seems that globalization of the world economy is undermining the traditional power and functions of nation states. However, it does not seem that a well-organized supra-national institution will take the place of nation states in the near future, functioning as a kind of universal state. The global situation of some 200 nation states competing each other looks, in some way, like a situation of anarchy. At present, there is no international authority that can control the confusing trend of globalization, even though some regional authorities like EU and various other international organizations are working in limited spheres. This is another factor that raises volatility in our lives in this age of globalization.
The changes and volatility caused by globalization are providing opportunities and threats together to every individual and every group. The ones who can take advantage of the trends well enjoy the opportunities, while the others marginalized from the trends seem to be entrenched in worse situation. It is apparent that the globalization of the world economy has not been occurring evenly in all parts of the world, and that this uneven process has enhanced the development gap especially within the Third World. At the moment, it would seem that globalization has been a nightmare especially to some poor developing countries.

Many authors indicate that globalization is enhancing inequality and development gap between nations, groups, and individuals, while reinforcing control on labourers. Capitals moving fast across the world seeking for higher profits can disrupt national economies, ruining the life of many people there. And they usually demand higher discipline on labourers. State governments that are eager to grasp the fast moving capitals comply with the demands of capitalists.

The volatility and disruption caused by globalization has been well illustrated by the Asian crisis of 1997, in which the financial markets of several Asian countries fell into turmoil mainly by the rapid flight of internationally crumbling money. This crisis led to serious economic difficulties in those Asian countries, causing bankruptcies of numerous companies and the resultant high unemployment. (Lewis 1998).

So, it seems that the process of globalization is developing with an inequitable, unstable, and inhumane aspect. To adjust this trend toward an equitable, stable, and humane process will be a job of international elites at present and in the future. The Structural Adjustment Programmes of the IMF and World Bank should also be “structurally adjusted” toward such an equitable, stable, and humane direction, in which marginalized Third World countries can benefit also from the process of globalization. (Hazzard and Kaufman 1992).
The challenges of budget deficit, trade deficit, indebtedness and poverty in Kenya will require greater democratization of our political institutions; prudent and frugal management of our economic resources together with a leadership that will cherish fundamental human rights and an intelligent comprehension of the globalization phenomenon.
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1 http://www.imf.org “International Monetary Fund.”

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3 Ibid., p.56

4 Cold war Disillusionment and Africa” PP.25-49)

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7 Barkan, “Kenya: Lessons from a flawed Election”,


10 The Economist, June 25, 1995, PP. 42, 45.


12 Kibutha Kibwana, Smokin Wanjala, and Other Owiti, editors, The Anatomy of Corruption in Kenya; Legal, Political and Socio – Economic Perspectives


16 Peter Hawthorne, "Saba Bloody Saba", Timec, July 21, 1997, P.26

17 www.wsw.org “Kenya’s President Moi announces Economic Cutbacks in bid for IMF Funding.” 1999


19 The ESAF (enhanced structural adjustment facility) is a concessional IMF facility for assisting eligible members that are undertaking reform programs to strengthen their balance of payments and improve their growth prospects. ESAF loans carry an interest rate of 0.5 percent and are repayable over 10 years, with a 5-1/2-year grace period.

20 The ESAF (enhanced structural adjustment facility) is a concessional IMF facility for assisting eligible members that are undertaking reform programs to strengthen their balance of payments and improve their growth prospects. ESAF loans carry an interest rate of 0.5 percent and are repayable over 10 years, with a 5-1/2-year grace period.


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The rise and impending decline of market solutions, Development Policy Review 4, no. 2 (June 1986).


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APPENDICES

APPENDIX 1

Chronology of Political And Economic Developments

May 1963 First national election, won by KANU.

December 12, 1963 Kenya’s independence from the UK.


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 kinking 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.


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.

122
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.

December 2002 3rd Multi-Party election – KANU defeated by NARC
APPENDIX 2
Sources: All data in current prices. Total ODA includes both concessional loans (those with a grant element of at least 25% 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.

TABLE 1
Total Aid Flows to Kenya
1970-1996
(USS millions)

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Sources: See Table 1 for sources and definitions. All data are in current prices.
### TABLE 3
Gross and Net ODA Flows to Kenya
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(USS millions)

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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.
## TABLE 4
Distribution of ODA to Kenya by Source
(Multilateral and Bilateral Donors)

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Sources: See Table 1 for sources and definitions
TABLE 6
Grant Aid to Kenya for Technical Assistance
1970-1996
US$ millions

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Source: See Table 1 for sources and definitions
TABLE 7
Balance of Payments Aid to Kenya
Bilateral, Multilateral and IMF Loans
1970-1996
(USS millions)

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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.