

# **KENYA'S DEBT AUDIT**

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## ABBREVIATIONS & ACRONYMS

ADB:	AFRICA DEVELOPMENT BANK
ADF:	AFRICA DEVELOPMENT FUND
CAG:	CONTROLLER AND AUDITOR GENERAL
CCS:	COMMITMENT CONTROL SYSTEMS
CDF:	CONSTITUENCY DEVELOPMENT FUND
DMD:	DEBT MANAGEMENT DEPARTMENT
DSA:	DEBT SUSTAINABILITY ANALYSIS
EAC:	EAST AFRICA COMMUNITY
EEC:	EUROPEAN ECONOMIC COMMUNITY
ERSWEC:	ECONOMIC REVIEW STRATEGY FOR WEALTH AND EMPLOYMENT CREATION
ESAF:	ENHANCED STRUCTURAL ADJUSTMENT FACILITY
GDP:	GROSS DOMESTIC PRODUCT
GEF:	GROWTH EXPENDITURE FACILITY
GVT:	GOVERNMENT
HIPC:	HIGHLY IMPOVERISHED POOR COUNTRIES
HIV/AIDS:	HUMAN IMMUNODEFICIENCY VIRUS/ACQUIRED IMMUNE DEFICIENCY SYNDROME.
IBRD:	INTERNATIONAL BANK OF RECONSTRUCTION AND DEVELOPMENT
IDA:	INTERNATIONAL DEVELOPMENT ASSISTANCE
IDA:	INTERNATIONAL DEVELOPMENT AID
IFAD:	INTERNATIONAL FUND FOR AGRICULTURE DEVELOPMENT
IFC:	INTERNATIONAL FINANCE CORPORATION
IFIS:	INTERNATIONAL FINANCIAL INSTITUTIONS
IMF:	INTERNATIONAL MONETARY FUND
KPA:	KENYA PIPELINE AUTHORITY
KPLC:	KENYA POWER AND LIGHTING COMPANY
KPTC:	KENYA POST AND TELECOMMUNICATIONS CORPORATION
KVDA:	KERIO VALLEY DEVELOPMENT AUTHORITY
KSHS:	KENYAN SHILLING
LATF:	LOCAL AUTHORITY TRANSFER FUND
MDGS:	MILLENNIUM DEVELOPMENT GOALS
MOF:	MINISTRY OF FINANCE
MTEF:	MID-TERM EXPENDITURE FRAMEWORK
NBK:	NATIONAL BANK OF KENYA
NPEP:	NATIONAL POVERTY ERADICATION PLAN
NGOS:	NON-GOVERNMENTAL ORGANIZATIONS
OPEC:	OIL PRODUCING AND EXPORTING COUNTRIES
PEM:	PUBLIC EXPENDITURE MONITORING
PRGF:	POVERTY REDUCTION GROWTH FACILITY
PRSP:	POVERTY REDUCTION STRATEGY PAPER
PPOA:	PUBLIC PROCUREMENT OVERSIGHT AUTHORITY
SAF:	STRUCTURAL ADJUSTMENT FACILITY
SAP:	STRUCTURAL ADJUSTMENT PROGRAMME
SOEs:	STATE-OWNED ENTERPRISES
UK:	UNITED KINGDOM
UN:	UNITED NATIONS
USA:	UNITED STATES OF AMERICA
US\$:	UNITED STATES OF AMERICA DOLLAR

WB: WORLD BANK  
WMS: WELFARE MONITORING SURVEY

## 1.0 Executive Summary

Kenya gained its independence on 12<sup>th</sup> December 1963 after more than fifty years of effective British colonialism. Like many other African countries before and after it, the country faced tremendous challenges in its economic and social development.

In the absence of an indigenous private sector, the new State had to step in and play a big role in the country's economic and social development. Inextricably, this resulted in the creation of a large public sector and a burgeoning civil service.

Internal difficulties and a combination of severe external shocks led to the debt crises of the 1970s. In their wake, these left a collapse and tearing of the economic and social fabric of the nascent state. A situation that all too unfortunately and as a result of a combination of factors, the State has not managed through to date.

Like its sister African nations, Kenya turned to the IMF and World Bank plus a myriad of other institutions for both technical and financial assistance. Beginning in the early 1980s, a new era of trade liberalization, deregulation and privatization of public enterprises, concretized by the Sessional Paper Number 1 of 1986 Economic Management for Renewed Growth worsened both the debt and socio-economic crises.

The forced adjustments by the International Financial Institutions masked as Structural Adjustment Programmes not only dismantled but also reversed the gains that the state had made in the social and economic infrastructure. Notably, they also saddled Kenya with a debt burden that continues to cripple its ability to meet its developmental needs.

Suffice it to say that the policies, conditionalities and cross conditionalities meted by the International Financial Institutions (IFIs) have had a devastating effect on the ability of Kenya to meet its development agenda, the culpability on the part of the Kenyan leadership notwithstanding.

At the domestic level, culpability largely stems from the misuse of borrowed money to outright theft and corruption, which too have aggravated the debt crises. Poor macro-economic management and unsound project investment as evidenced by numerous stalled projects that dot the nation further attest to these. Plainly some are outright 'white elephants' both in articulation and implementation and their sole conceptualization were for purposes of siphoning and looting public coffers.

Resultantly, it becomes critical to carry out comprehensive audits on the usage of borrowed monies for reasons of firming up the articulation of how to unravel and resolve the debt crises if only to ensure that Kenya attains the capability of achieving the Millennium Development Goals that are derived out of the Millennium Declaration of which the country is signatory.

## 2.0 Analysis of Kenya's debt position

### Background

*"Kenya's burgeoning debt remains a defining feature of public finance management, often a painful testimony of prolonged plunder and senseless mismanagement of the nation's meagre resources over the last four decades".*

*Africa Forum and Network on Debt and Development (AFRODAD).  
The Challenges of Maintaining Long-Term Debt Sustainability:  
The Case of Kenya, 2005.*

Since independence, Kenya has borrowed about Ksh 1,200 billion from external creditors. Though it has repaid Ksh 3,570 billion – a whopping threefold the amount initially owed – the country still owes Ksh 450 billion. In addition to this external debt, the domestic debt stands at about Ksh 300 billion.

Kenya's economy is modestly diversified, though most employment is dependent on agriculture, which contributes 16(2004 estimates) percent of GDP. Kenya enjoyed strong economic growth from independence until the 1970s. The average GDP growth rate declined from 6.5 percent between the 1960s and the 1970s to about 2 percent in 1990-1999, below the average population growth rate of 2.5 percent. Private investments fell by 7 percent in real terms between the late 1980's and the first half of the 1990s, and domestic savings rates fell correspondingly from over 20 percent to 16 percent during the same period.

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

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.

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

On average, the country today spends about 30 per cent of its budget on external debt servicing at the expense of offering vital services to its citizens. In the current Ksh 508 billion budget 2005 – 2006, the government is spending Ksh 112 billion to service external debts, which is 16 per cent more than its Ksh 96.7 billion allocation for education, over three times its Ksh. 30 billion allocation on health and over ten times Ksh.10 billion allocation for water provision. Equally, Kenya's internal debt of about Ksh 300 billion, which is more than half of the Ksh 508 billion 2005/06 budget cannot be wished away particularly because of its negative impact on our struggling economy.

### **Evolution of the Debt Crisis in Kenya**

In the 1980s and the years preceding, Kenya was among the major aid recipients in Africa, largely to put up infrastructure so as to integrate the large rural economy into then emerging import substitution Kenyan economy. The 1990s witnessed a steady decline in development assistance to Kenya occasioned by a perception of poor governance and mismanagement of public resources and development assistance. The debt crisis of the early 1990s turned Kenya into a highly indebted nation. The debt problem was exacerbated by macroeconomic mismanagement in the 1990s, leading to a reduction of donor inflows. The government thus resorted to occasional debt rescheduling and expensive short-term domestic borrowing to finance its expenditures. Debt service has crowded out funding for capital and social expenditures. After debt servicing and salaries, there is little room left for core functions of the government, basic infrastructure, education, health and other essential services, to create an enabling environment for the private sector.

### 3.0 Major bilateral and multilateral creditors

Kenya like most debtor countries has both multilateral and bilateral donors. Among the Bilateral lenders to Kenya are Australia, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, Netherlands, UK, and USA among others. Multilateral lenders to the country include the African Development Bank, European Economic Committee, IBRD, International Development Aid, International Monetary Fund and World Bank among others.

Loans from multilateral agencies constitute a big portion of Kenya's external debt due to their favourable lending terms of low interest rates and long term repayment period. Loans from multilateral agencies constituted 37.1 percent of Kenya's total debt in 2005. Bilateral lenders accounted for 22.9% of the total debt. The share of multilateral aid increased moderately in the 1980s, primarily due to the large disbursements of World Bank adjustment lending, but the bilateral share rose again in the 1990s with the decline in new adjustment lending after 1991. Bilateral aid has been predominantly in the form of grants—72 percent of the total—with the share of grants actually increasing in recent years, whereas multilateral aid has been predominantly in the form of loans—86 percent. The principal source of multilateral loans has been the World Bank Group (WB), accounting for almost 80 percent of total loans in the 1970-96 period, with the African Development Bank (ADB) accounting for 11 percent. While the overall shares of multilateral and bilateral aid sources have not changed markedly over time, there have been significant changes within the two categories.

The World Bank, which accounted for 20 percent of total flows in the 1970s and 1980s, has seen its share of total disbursements reduced to 16 percent in the 1990s, due to the growing importance of certain bilateral donors, the significant reduction in disbursements for balance of payments support since the early 1990s, and a shrinking portfolio of project loans. The other principal multilateral agencies, the ADB and the European Commission (EC), have each contributed a much smaller share of Kenya's ODA. With respect to bilateral assistance, Kenya has for many years received aid from virtually all aid-giving nations and agencies. Kenya has also received aid from Australia, Austria, Belgium, China, Ireland, Korea, Spain, Switzerland and various Middle Eastern governments and aid agencies. Among the most notable trends within the bilateral group has been the decline in the share of the United Kingdom, which was Kenya's leading development partner in the immediate post-Independence years of the 1960s and early 1970s. The nominal value of UK aid has risen only modestly over the years, from an average of US\$37 million per annum in the 1970s to US\$62 million per annum in the 1980s, falling back to US\$55 million per annum in the 1990s. Over this same period Japanese aid has increased from 4 percent of gross ODA in the 1970s to 17 percent in the 1990s. Japan's annual average ODA to Kenya has increased from insignificant levels in the early 1970s to US\$60 million per annum in the 1980s and to US\$170 million per annum in the 1990s. This is not an unmixed blessing however, since Japanese aid (and the French) has a higher share of loans to grants (60 percent loans in the 1990s) than the rest of Kenya's ODA. Another significant trend has been the declining share of many medium-sized donors, including the Scandinavian countries, Canada and the Netherlands.

Sweden's aid has actually fallen in nominal terms, from an average of US\$25 million per year in the 1980s to US\$23.5 million per year in 1990-96. The trend is even more pronounced for Norway (with which Kenya actually broke diplomatic relations during 1990-95) whose aid disbursements fell from US\$25 million per annum in the 1980s to US\$2.5 million per year in 1992-96. There are obvious reasons why Kenya has received such a large inflow of aid over many years from such a wide range of aid partners.

The primary motivations for providing aid are developmental (to promote economic growth and poverty alleviation in poor countries), commercial (to cement commercial and financial relations with the aid recipient—opening markets, assuring opportunities for investors, contractors and suppliers from the aid-

giving country) and political (to maintain the allegiance of governments that are politically aligned with the aid-giver—a particularly prominent feature of aid relationships during the “Cold War” era.) Kenya, since her independence in 1963, was a logical candidate to receive aid for all of the above reasons. First, the government’s management of the economy was prudent and the economic track record was relatively good, at least through the 1970s, and, despite a mixed record on economic policy reform and macroeconomic outcomes in the 1980s, still relatively better than most of SSA.

Kenya was for many years a relatively attractive locale for foreign investment, at least within the SSA context, especially for consumer goods industries targeted at the East African market—prior to the collapse of the East African Community (EAC) in 1997. And throughout the years of the Cold War Kenya consistently aligned itself with the West both economically and politically. However, the end of the Cold War in 1989, which essentially eliminated the geopolitical motivation for aid, coincided with a weakening of economic reform efforts and a deterioration in economic performance in Kenya in 1989-92, as well as a hardening of political lines within the country at the same time that donors were adding “good governance” and democratization to their criteria for judging the worthiness of aid recipients. The result was intensification in the “stop-go” relationship between donors and the Kenyan government, which has persisted to the present time.

**Table 1: Kenya’s current Multilateral, Bilateral and Internal debt**

As at 30 <sup>th</sup> June	2001	2002	2003	2004	2005
<b>EXTERNAL DEBT:</b>					
<b>Bilateral</b>					
Germany	7,652.00	7,550.20	88,23.00	11,482.58	12,962.76
Japan	47,837.00	50,790.00	50,514.00	88,652.17	84,550.11
France	16,301.00	96,18.00	9,604.00	16,831.19	18,085.88
USA	5,172.00	4,761.00	6,651.70	6,241.99	6,050.72
Netherlands	4,087.00	2,922.00	3,738.00	4,420.05	2,205.39
Denmark	2,527.00	1,947.00	1,935.75	2,195.37	2,362.37
Finland	195.00	333.00	267.00	257.89	134.12
Other	24,405.40	23,817.30	23,765.17	36,791.95	31,353.27
<b>Total</b>	<b>108,176.40</b>	<b>101,738.50</b>	<b>105,298.62</b>	<b>166,873.18</b>	<b>157,668.62</b>
<b>Multilateral</b>					
IDA/IFAD	179,930.40	186,319.00	186,648.00	212,607.38	210,098.84
IBRD	1,560.00	3,299.00	8,566.25	33.26	38.10
OPEC	421.80	394.29	295.50	82.24	76.27
EEC/EIB	11,735.00	9,492.00	8,566.25	9,199.34	8,458.82
IMF	8,681.40	7,318.50	5,983.23	7,913.11	13,107.36
Badea	39.40	14.74	0.78	371.00	9.22
ADF/ADB	24,822.00	23,943.00	23,844.00	24,692.00	23,623.74
Total	227,250.00	230,780.53	233,910.01	254,898.33	255,412.35
Others	30,701	26,851.44	14,055.50	21,385.49	21,372.03
Total external	<b>366,127.40</b>	<b>359,370.47</b>	<b>353,264.13</b>	<b>443,157.00</b>	<b>434,453.00</b>
<b>INTERNAL DEBT</b>					
T Bills	116,440.00	82,050.00	78,744.00	62,937.00	71,938.00
T bonds	44,499.00	106,333.00	161,549.10	188,626.00	193,367.00
Non Interest	36,917.00	36,917.00	36,917.00	36,917.00	35,917.00

Bearing Debt					
Others includes stock	13,957.00	10,688.00	12,167.30	20,086.00	16,580.00
Less government deposits & on lending	-49,578.00	-35,360.00	-43,747.00	-53,919.00	-64,309.00
Total internal debt	<b>211,811.00</b>	<b>235,968.00</b>	<b>245,630.40</b>	<b>254,647.00</b>	<b>253,493.00</b>
Total unfunded debt	<b>577,940.40</b>	<b>595,338.47</b>	<b>598,894.53</b>	<b>697,804.00</b>	<b>687,946.00</b>

Source: Economic Survey 2006, p.109

**Table 2: As Percentage of External Debt (as of June)**

Bilateral	36.3	35.0	33.6	34.4	35.0	36.8
Multilateral	54.0	58.3	58.0	58.9	57.4	58.8
Commercial	8.8	6.3	7.5	6.4	0.9	0.7
Export credit	1.0	0.4	1.0	0.3	6.6	3.8

Source: Ministry of Finance Quarterly Budget Review Second Quarter 2004/2005

Table 3 shows the composition of public debt and how it has evolved under the period of focus. Over these years the stock of domestic debt as a share of the total debt had been growing as the government depended more and more on domestic borrowing to fund its operations. As part of the fiscal strategy in the ERS the government was partially substituting domestic with external concessional loans and grants. The government also innovatively lengthened the maturity of government debt substantially over three years. For example, between July 2003 and February 2004, the stock of treasury bills decreased from Ksh 78.7 billion to Ksh 67.7 billion while the stock of treasury bonds increased from kshs.161.5 billion to kshs.183 billion. While longer dated debt incurs higher interest payment than shorter ones, a shift in the maturity structure has tended to push the whole structure of interest rates down, so the overall cost of government debt finance has fallen.

**Table 3: Public Debt in Ksh billions**

	June 2000	2001	2002	2003	2004 (provisional)
Domestic debt	206	212	236	289	301
As %of GDP	27.7	25.2	25.5	28.4	26.9
T-Bill	131	138	118	106	105
T Bonds	37	45	106	162	183
Govt stocks	3	2	2	1	1
Overdraft advances	15	13	9	11	12
Non interest bearing debt	20	16	1	10	0
External debt	403	394	378	400	407

As % of GDP	54.2	46.9	40.8	39.3	36.4
Bilateral	146	132	130	143	152
Multilateral	224	229	223	226	228
Commercial banks	32	29	24	27	26
Export credit	1	4	1	4	2
<b>Total Public Debt</b>	<b>609</b>	<b>609</b>	<b>614</b>	<b>618</b>	<b>708</b>
<b>As % of GDP</b>	<b>82</b>	<b>72.5</b>	<b>66.3</b>	<b>67.7</b>	<b>63.3</b>

*Source: Public Expenditure Review 2004, p.11*

According to the Public Expenditure Review 2003 there was an increased level of domestic debt and this had main consequences of fiscal imbalance. The stock of gross domestic debt tripled during the 1990s. Domestic debt rose from 61 billion Ksh in 1990/01 to Ksh 146 billion in 1997/1978 and then to an estimated Ksh 226 billion in 2002/03. The stock of domestic credit declined as a share of GDP. It fell from 23.2 % of GDP by December 2002. Domestic debt in this context excludes payment arrears caused by weakness in budget implementation.

Though the stock of external debt is higher than the stock of domestic debt, it is falling. External debt declined from 53.7% of GDP at the end of 1997/1998 to an estimated 37.4% of GDP in December 2002/03. The strong downward trend in the stock of external debt has resulted in the total debt falling from 76.9 % of GDP in 1997/98 to an estimated 60.4% of GDP 2002/03.

**Table 4: External Debt Summary 1990-2002 (US\$ Millions)**

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Total debt stocks	7,058	7,453	6,898	7,111	7,202	7,412	6,931	6,603	6,881	6,153	6,320	5,644	6,207
Long term debt	5,642	6,252	5,728	5,846	6,119	6,405	6,060	5,549	5,841	5,569	5,5380	4,863	5,256
Public debt and public guaranteed	4,762	5,265	5,149	5,246	5,589	5,960	5,685	5,224	5,561	5,349	5,205	4,754	5,207
Private non guaranteed	880	987	579	600	530	445	375	325	280	220	175	109	49
Use of IMF credit	482	493	393	363	405	374	337	250	196	131	127	99	88
Short term debt	934	708	777	903	679	634	534	803	844	812	813	682	863
Short term debt of which interest arrears on long term debt	95	141	189	242	83	32	16	34	68	102	62	113	164
Official creditors	49	59	62	59	20	23	9	21	30	48	18	62	95
Private creditors	50	114	191	313	0	4	12	30	66	102	172	159	209
<b>Total debt flows</b>													
Disbursements	778	952	502	448	294	698	467	219	231	282	409	247	185
Long term debt	642	904	502	416	262	698	431	219	231	282	364	247	185
IMF purchases	136	48	0	32	32	0	36	0	0	0	44	0	0
<b>Principal repayments</b>	457	399	410	366	552	600	567	449	467	529	350	311	220
Long term debt	352	359	327	304	538	561	506	381	404	470	307	287	202
IMF repurchases	105	40	83	62	14	39	61	67	63	60	42	24	18
Net flows on debt	290	545	175	112	(277)	137	(185)	21	(229)	313	99	247	95
Of which short term debt	294			73	(65)	6	84	251	7	66	41	182	130
Interest payments	334	321	260	265	330	301	277	221	205	175	131	106	79
Long term debt	230	248	201	208	290	263	245	190	165	134	89	79	59
IMF charges	26	18	10	4	2	2	2	1	1	1	1	1	0

Short term debt	78	55	49	53	38	36	30	29	39	40	41	26	19
Net transfers on debt	281	...	...	(111)	(651)	(197)	462	199	434	487	32	353	16
Total debt service paid	791	720	670	631	882	901	845	669	672	704	481	417	299
Long term debt	582	607	528	512	828	824	752	571	569	603	396	367	261
IMF repurchases and charges	131	58	93	66	16	41	63	69	64	61	43	24	19
Short term debt interest only	78	55	49	53	38	36	30	29	39	40	41	26	19

Source: World Bank Data Reporting System-(Report No.25840-KE Kenya A Policy Agenda to Restore Growth, August 18, 2003 World Bank: Washington DC, p.158

Table 5: Debt outstanding and disbursements, 1990-2002 (US\$ Millions)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Debt outstanding	5,642	6,252	5,728	5,846	5,776	6,405	6,060	5,549	5,841	5,569	5,380	4,863	5,256
Long term													
Public and publicly guaranteed	4,762	5,265	5,149	5,246	5,246	5,960	5,685	5,224	5,561	5,349	5,205	4,754	5,207
Official creditors	3,715	3,979	3,960	4,150	4,853	5,252	5,106	4,745	5,007	4,827	4,684	4,387	4,774
Multilateral	2,492	2,616	2,514	2,615	2,762	2,919	2,943	2,855	2,999	2,844	2,831	2,764	2,986
Concessional	1,395	1,598	1,638	1,853	2,040	2,248	2,402	2,390	2,584	2,575	2,607	2,599	2,830
Bilateral	1,222	1,363	1,446	1,535	2,091	2,333	2,164	1,890	2,008	1,943	1,853	1,623	1,788
Concessional	985	1,115	1,149	1,237	1,354	1,630	1,536	1,372	1,539	1,582	1,507	1,339	1,481
Private creditors	1,047	1,285	1,190	1,097	736	708	578	480	554	522	521	367	433
Commercial banks	924	1,137	1,028	956	653	607	500	445	472	424	432	287	311
Other private	124	148	162	142	83	101	79	35	82	98	89	80	122
<b>Private non guaranteed</b>	880	987	579	600	530	445	375	325	280	220	179	109	49
Commercial bank and other	880	987	579	600	530	445	375	325	280	220	179	109	49
IBRD	871	783	656	566	501	435	312	213	154	91	47	23	13
IDA	1,185	1,370	1,411	1,631	1,789	1,977	2,062	2,032	2,210	2,220	2,262	2,263	2,447
<b>Disbursements</b>	642	904	502	416	261	698	431	219	231	282	364	247	185
<b>Public and publicly guaranteed</b>	587	844	442	351	261	698	431	219	231	282	364	247	185
Official creditors	405	466	329	329	256	566	359	171	194	144	308	234	102
Multilateral	297	230	132	239	160	220	197	142	142	87	188	125	87
Concessional	264	199	106	234	124	181	181	128	132	84	184	125	87
Bilateral	108	236	197	90	96	346	161	29	53	56	120	108	14
Concessional	106	192	123	76	74	346	108	29	35	40	102	108	9

Private creditors	182	378	113	22	5	132	72	48	36	139	56	13	83
Commercial banks	119	333	66	17	5	72	72	48	14	77	52	13	49
Other private	63	45	47	5	0	60	0	0	22	61	4	0	35
<b>Private non guaranteed</b>	55	60	60	65	0	0	0	0	0	0	0	0	0
Commercial bank and other	55	60	60	65	0	0	0	0	0	0	0	0	0
IBRD	4	0	0	0	0	0	0	0	0	0	0	0	0
IDA	235	178	91	226	97	159	156	84	123	78	170	116	66

Source: World Bank Data Reporting System-(Report No.25840-KE Kenya A Policy Agenda To Restore Growth, August 18, 2003 World Bank: Washington DC, P.159)

**Table 6: External public debt service payments by creditor type 1990-2002 (US\$ Millions)**

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Amortization	352	359	327	304	538	561	506	381	404	470	307	287	202
Suppliers credits	20	20	16	20	48	45	23	15	27	43	6	4	2
Financial institutions	115	110	78	56	169	160	150	88	82	103	67	46	39
Multilateral loans	126	127	133	140	151	150	135	127	124	124	106	88	71
IBRD	95	96	98	100	106	100	88	74	66	58	40	22	12
IDA	4	5	6	7	8	9	10	11	15	23	29	35	42
Other	27	26	29	32	36	41	36	42	43	42	37	30	17
Bilateral loans	53	62	40	38	100	120	128	102	127	138	83	84	30
Export credits	37	40	60	50	70	85	70	50	45	61	45	66	60
Interest	230	248	201	209	289	262	245	190	165	134	89	79	59
Suppliers credit	6	6	6	6	14	7	5	2	2	1	2	0	0
Financial institutions	53	42	28	22	69	48	45	40	27	24	17	11	6
Multilateral loans	100	94	85	85	80	77	73	58	50	43	35	28	27
IBRD	78	68	61	55	49	43	34	23	17	12	7	3	1
IDA	7	9	10	11	13	14	15	15	15	16	16	16	17
Other	15	16	14	18	19	19	25	20	18	15	12	9	8
Bilateral loans	34	61	26	42	80	89	90	59	60	44	17	26	19
Export credits	38	45	56	54	46	41	32	31	26	21	19	13	8
Total public debt service	582	607	528	513	827	823	752	571	569	603	396	367	261

Source: World Bank Data Reporting System-(Report No.25840-KE Kenya A Policy Agenda To Restore Growth, August 18, 2003 World Bank: Washington DC, P.160)

### Timetables, amounts and final destination of resources borrowed and amounts actually paid

Table 7 shows the time, amounts borrowed and amounts actually paid in terms of repayments and interest back to the IMF through the Poverty Reduction and Growth Facility/Enhanced Structural Adjustment Facility by the Kenya government between 1984 and 2006. It shows a consistency on the part of Kenya in terms of repayment of its debt to the IMF except for 1992. The table demonstrates that repayments are made even in instances where borrowing has not taken place.

**Table 7: Amounts borrowed from the IMF and the interest paid back on them (Kshs Millions).**

Year	Poverty Reduction and Growth Facility/ Enhanced Structural Adjustment Facility Total Structural Adjustment Facility/Trust Fund					
	Loans		Interest Paid	Purchases and Loans		Charges and Interest Paid
	Disbursements	Repayments		Disbursements	Repayments	
2006	0	5,852,500	270,863	<u>0</u>	<u>5,852,500</u>	<u>270,863</u>
2005	50,000,000	4,985,000	560,901	<u>50,000,000</u>	<u>4,985,000</u>	<u>560,901</u>
2004	0	9,508,000	360,569	<u>0</u>	<u>9,508,000</u>	<u>360,569</u>
2003	25,000,000	14,031,000	307,986	<u>25,000,000</u>	<u>14,031,000</u>	<u>307,986</u>
2002	0	14,031,000	369,922	<u>0</u>	<u>14,031,000</u>	<u>369,922</u>
2001	0	18,585,169	448,885	<u>0</u>	<u>18,585,169</u>	<u>448,885</u>
2000	33,600,000	32,162,672	459,990	<u>33,600,000</u>	<u>32,162,672</u>	<u>459,990</u>
1999	0	43,733,004	612,890	<u>0</u>	<u>43,733,004</u>	<u>612,890</u>
1998	0	46,073,330	834,433	<u>0</u>	<u>46,073,330</u>	<u>834,433</u>
1997	0	48,913,330	1,073,123	<u>0</u>	<u>48,913,330</u>	<u>1,073,123</u>
1996	24,925,000	41,866,664	1,258,516	<u>24,925,000</u>	<u>41,866,664</u>	<u>1,258,516</u>
1995	0	25,796,665	1,337,388	<u>0</u>	<u>25,796,665</u>	<u>1,337,388</u>
1994	22,615,000	9,703,333	1,311,060	<u>22,615,000</u>	<u>9,703,333</u>	<u>1,319,324</u>
1993	22,615,000	2,840,000	1,217,566	<u>22,615,000</u>	<u>44,358,750</u>	<u>2,772,463</u>
1992	0	0	1,222,833	<u>0</u>	<u>58,756,250</u>	<u>7,396,321</u>
1991	35,233,333	181,238	1,491,682	<u>35,233,333</u>	<u>29,274,988</u>	<u>12,988,916</u>
1990	100,466,667	1,459,200	494,712	<u>100,466,667</u>	<u>77,703,581</u>	<u>18,804,370</u>

1989	80,466,667	4,752,000	117,472	<u>80,466,667</u>	<u>102,793,382</u>	<u>24,157,879</u>
1988	28,400,000	8,001,352	156,933	<u>131,000,000</u>	<u>75,440,169</u>	<u>20,701,777</u>
1987	0	9,090,954	88,533	<u>0</u>	<u>93,016,565</u>	<u>23,625,020</u>
1986	0	9,028,554	134,582	<u>0</u>	<u>98,832,456</u>	<u>33,679,910</u>
1985	0	8,202,954	179,658	<u>123,100,000</u>	<u>77,919,291</u>	<u>38,045,633</u>
1984	0	2,603,877	211,680	<u>46,150,000</u>	<u>42,187,109</u>	<u>20,820,802</u>

Source: IMF Website

**Table 8: Repayments and Interest paid back on Kenya's Debt – 2001 – 2004 (US \$ Millions)**

Year	Annual debt servicing charges			Interest and loan repayments receipts			Net servicing charges		
	External	Internal	Total	External	Internal	Total	External	Internal	Total
2001	16,116.50	64,386.84	80,503.34		438.10	438.10	16,116.50	63,948.74	80,065.24
2002	29261.45	85,996.74	115,258.19		1,014.84	1,014.84	29,261.45	84,981.90	114,243.35
2003	32256.18	59,340.76	91,596.94		389.61	389.61	32,256.18	58,951.15	91,207.33
2004	26,734.60	88,124.32	114,858.92		719.40	719.40	26,734.60	88,124.32	114,858.92
2005	23,404.19	88,823.34	112,227.53		1,706.77	1,706.77	23,404.19	87,116.58	110,520.77

Source: Economic Survey 2006

### Kenya's budget committed to external debt repayment

On average, Kenya spends about 30 per cent of its budget on external debt servicing at the expense of offering vital services to its citizens. In the current Ksh 508 billion budget 2005 – 2006, the government is spending Ksh 112 billion to service external debts, which is 3 per cent more than its Ksh 96.7 billion allocation for education, over three times its Ksh. 30 billion allocation for health and over ten times Ksh.10 billion allocation for water provision. Equally, Kenya's internal debt of about Ksh 300 billion, which is more than half of the Ksh 508 billion 2005/06 budget cannot be wished away particularly because of its negative impact on our struggling economy.

World Bank data for 2000 indicate that Kenya's gross domestic product was \$10.4 billion, and that it had an external debt of \$6.34 billion. For the year 2000, debt servicing and interest payments totalled \$706 million (over 14% of GDP) flowing out of Kenya to its creditors. Of Kenya's \$6.34 billion international debt, \$2.61 billion (41%) is owed to the World Bank and the IMF.

The large amount of capital outflows through debt servicing and interest payments in Kenya have had an adverse impact on the country's ability to develop. Government expenditures on education, health, and other social sectors have to be cut in order to meet conditions of donor countries and international lending institutions. The government could allocate more funds to health, education, and other development programs if it were not for the net loss of capital outflows in terms of debt services and interest payments.

**Table 9: Trends in Government Expenditure on debt servicing as percentage of GDP, Exports and Revenue**

	Debt/ GDP	External Debt Servicing / Exports	Debt servicing /Revenue	Debt Servicing/ GDP	Interest/ GDP	Development Expenditure/ GDP
1997/98	73%	17%	93%	22%	6%	5%
1998/99	78%	16%	57%	13%	6%	4%
1999/00	72%	20%	79%	14%	4%	2%
2000/01	71%	8%	49%	10%	3%	4%
2001/02	68%	13%	55%	10%	4%	3%
2002/03	63%	10%	46%	9%	3%	3%
2003/04	58%	9%	42%	8%	3%	3%

Source: MTEF Fiscal Strategy Paper 2001/2002 – 2003/2004

Table 8 demonstrates that debt eats into more than half of Kenya's overall GDP, with a small but consistent reduction over the years since 1998/99. Debt servicing as percentage of GDP is higher than development expenditure as percentage of GDP. This confirms the view that Kenya spends more on debt servicing than on development.

Both domestic and external debt service ratio for Kenya is well above the sustainable level. Unless debt service is reduced significantly, Kenya's capacity to fund emerging priorities is limited, unless the country receives heavy donor involvement.

#### **Debt contracted for investment against agreed interest and actual paid interest**

Table 10 can be used to demonstrate the debt contracted from the IMF under the Poverty Reduction and Growth Facility/ Enhanced Structural Adjustment Facility Initiative. Repayments and their accrued interests have been paid consistently over the years, while disbursements have fluctuated from year to year. For instance in 2005, the country received US \$ 50 million in form of disbursements but made a repayment of US \$ 4.985 million plus an interest of US \$ 0.569 million. On overall, Kenya has received a total of US \$ 423,321,667, but has repaid back US \$ 361,401,796 plus an accrued interest of US \$ 14, 522,077 between 1984 and 2006.

**Table 10: Amounts borrowed from the IMF under the Poverty Reduction and Growth Facility Initiative and the interest paid back on them (US \$ millions).**

Year	Poverty Reduction and Growth Facility/ Enhanced Structural Adjustment Facility Structural Adjustment Facility/Trust Fund		
	Loans		Interest Paid
	Disbursements	Repayments	
2006	0	5,852,500	270,863
2005	50,000,000	4,985,000	560,901
2004	0	9,508,000	360,569

2003	25,000,000	14,031,000	307,986
2002	0	14,031,000	369,922
2001	0	18,585,169	448,885
2000	33,600,000	32,162,672	459,990
1999	0	43,733,004	612,890
1998	0	46,073,330	834,433
1997	0	48,913,330	1,073,123
1996	24,925,000	41,866,664	1,258,516
1995	0	25,796,665	1,337,388
1994	22,615,000	9,703,333	1,311,060
1993	22,615,000	2,840,000	1,217,566
1992	0	0	1,222,833
1991	35,233,333	181,238	1,491,682
1990	100,466,667	1,459,200	494,712
1989	80,466,667	4,752,000	117,472
1988	28,400,000	8,001,352	156,933
1987	0	9,090,954	88,533
1986	0	9,028,554	134,582
1985	0	8,202,954	179,658
1984	0	2,603,877	211,680

Source: IMF Website

## 4.0 Unilateral Alterations of the Contract Clauses

In October 2003, the IMF delayed talks with the new Kenyan Government about resumption of aid to Kenya. It was said they were unhappy with the way the Government had handled its debts to commercial and private creditors.

When the IMF finally agreed to a meeting several weeks later, the government, needing to fill a 65 billion shilling shortfall in the annual budget and improve its credit rating, gave in to IMF pressure and accepted the imposition of conditions. In return for a three-year lending arrangement of 19.25bn shillings (US\$252 million), the government promised to lay off thousands of civil servants, freeze employment and suspend salary increases. They also agreed to remove protection for maize and sugarcane farmers, by accepting to open the markets of imports to the two essential commodities. The implementation of "comprehensive trade reforms" is now due to take place by 2005/06 as part of the PRGF programme.

On January 15, 2004, the Paris Club of creditors concluded that Kenya's debt was sustainable in the medium term. The creditors further tailored a treatment under Houston terms to cover their share of Kenya's financing needs on the basis of the IMF programme. This agreement rescheduled US\$ 350 million of arrears and maturities falling due between January 1, 2004 and December 31, 2006 on a total debt of US\$ 484 million due to Paris Club creditors during this period. The rescheduling was to reduce the debt service due by Kenya to Paris Club creditors between January 1, 2004 and December 31, 2006 to US\$ 147 million (including moratorium interest). The rescheduling was conducted according to Houston terms: ODA credits are to be repaid over 20 years, including 10 years of grace, at interest rates at least as favourable as the concessional rates applying to those loans; commercial credits are to be repaid over 15 years, including 5 years of grace with progressive repayment, at an appropriate market interest rate (the repayment profile of the restructured amount is attached).

In February 2005, the US Ambassador to Kenya criticised the Kenyan Government for a delay in spending US\$54 million allocated to fight HIV/AIDS, malaria and tuberculosis. Kenya's Health Ministry acknowledged the money had not been spent. The Ministry however blamed this on the World Bank and IMF conditions, which laid guidelines over the use of the money, such as contracting an agency to ensure the money was well spent, and hiring 78 accountants to manage the funds. It took the Government nine months to meet donor conditions over the fund.

The World Bank is adamant that there is no debt crisis in Kenya. The Bank argues that the country can manage to pay for her debt, despite the fact that civil society in Kenya holds the contrary view. The Bank blames Kenya's debt burden on domestic debts, which it claims accumulated when funding for the country stopped for 12 years in 1991. The Bank states that due to this, the country resorted to borrowing internally through the Treasury Bill, whose loans need to be paid within a period of 90days.

IMF-World Bank cooperation – the two leading IFIs have increasingly come together thus raising the spectre of cross conditionality in their dealings with the developing world. Among areas of cooperation for the two institutions is the PRGF, which gives IMF the responsibility of advising governments on macroeconomic policies and related structural reforms such as exchange rate and tax policy, fiscal management, budget execution, fiscal transparency, and tax and customs administration. The IMF often draws on World Bank expertise in designing PRGF-supported programs, and the staffs of the Fund and Bank cooperate closely on conditionality. The Bank staff takes the lead in advising the authorities in the design of poverty reduction strategies in areas such as poverty assessments, monitoring, structural and sectoral issues, social issues, and costing priority poverty-reducing spending. Eligibility into the PRGF is determined by the IMF's assessment of a country's per capita income, drawing on the cut-off point for eligibility to World Bank concessional lending (currently 2003 per capita gross national income of \$895). Loans under the PRGF

carry an annual interest rate of 0.5 percent, with repayments made semi-annually, beginning 5½ years and ending 10 years after the disbursement.

## **5.0 Conditions Unforeseen by Contracts**

Whereas is not very easy to discern specific conditionalities that are not established in the formalized contracts, the general thinking especially in the contemporary context, is that the problem of cross-conditionalities is informing the new phase of IMF/World Bank leverage over contracting.

This especially has emanated from the failure of collapse of multi-lateral engagements like at the WTO where the same agenda is downloaded to the government at the bilateral level.

Centrally, the issue of either one of the institutions using the sentiments of the other to decide its contractual obligations is appalling. For example the World Bank withholding of funding on the basis of Governance issues, has seen the IMF go slow on the disbursement of the financing tranche agreed in 2003. Definitely this has meant that the whole flow of the agreed implementation suffers.

## 6.0 Legal and Institutional Framework

The loan contraction process in Kenya is explicitly laid down in the Kenyan Constitution. Four core acts are the pillar of the contraction process. Namely;

- The IMF Loans Act
- The Guarantee Loans Act
- The External Loans Act

All these Acts have their basis on the IMF Loans Act that is inherently borrowed from the MOU between the Kenyan Government and the IMF. The Guarantees Loan Act underpins that constitutionally the Government has the obligation to guarantee all the loans that are borrowed. Similarly the External Loans Act which also embodies the Domestic borrowing makes provisions of such guarantee, which hinge on the fact that the government cannot expunge or renege on loan contracts.

Whereas these Acts provide the legal framework, they are weak on the duties and obligations of the other actors involved in loan contraction other than the Government. Poignantly too they are silent on implementation and to most critics, such loopholes have provided the conduit through which money borrowed is siphoned or diverted from intended and identified projects.

One of the core failures of the loan contraction legal framework is the fact that it's heavy with the IFIs' agenda. The result of these is that all the responsibility is shouldered by the Government. By tacitly indemnifying the IFIs, it means that there is no recourse to any alternative that government may take to counter the agreements or conditionalities.

In the contemporary situation there is a key concern over the question of cross-conditionalities whereby the stranglehold exercised over the government leaves it with little room for manoeuvre. Failure of agreements at the multi-lateral level now rear their ugly face at the bilateral level as pre-conditions. This is clearly shown by how the IMF harps on the Governance agenda as a pre condition simply because the World Bank says so. Failures at the WTO have also been presented as reform conditionalities for any progress to be made.

### **The relationship between economic policy adopted and the debt contracting process**

In the early post-Independence years economic policy making was managed by the Cabinet Economic Sub-Committee, which had substantial influence. The framework of the economy in the early post-independence years was influenced both by the prevailing development paradigm of the period and by the economic system inherited from the colonial era. At the time of Kenya's independence most newly independent African countries were following the path of "African socialism." The Kenyan Government accepted the label, but opted for a mixed economy which was more market-based, supportive of the private sector, and open to foreign investment than was the strict socialist model followed in other African countries such as Tanzania. Nevertheless, the government did wish to achieve "economic sovereignty;" that is, to expand the participation in economic life and economic benefits of the African population while reducing the role of the former colonialists, resident Asians and multi-national corporations. Given the lack of entrepreneurial and other job-related skills in the indigenous population policy makers believed that this would require, for some time, a strong government role in the economy on their behalf. Such a strong central role was also a natural continuation of the economic policies of the colonial regime. The colonial government had supported the creation of institutions specifically designed to deliver benefits to the settler community. These included public agencies established to control (and sometimes subsidize) economic activities such as the Maize Board, Wheat Board, Dairy Board, Tea Board, Meat Commission, Pyrethrum Board, etc., and producers' organizations established to interact with the government in the interest of their constituents such as the Kenya Farmers' Association and the Kenya Cooperative Creameries. Following

independence these public institutions were maintained and the private associations or cooperatives were converted into quasi-public bodies. During this early post-independence period the government also expanded its involvement in productive activities through the establishment of new state-owned enterprises (SOEs) and joint public/private ventures in manufacturing and commerce. Government authority over the economy was also increased through the regulatory framework and the steady expansion of controls on domestic prices, interest rates, foreign exchange, imports and exports. Some of these controls were introduced in response to shocks, such as the capital flight which followed the assassination of Minister Mboya in 1969 and the first oil shock in 1973. Controls, regulations, and state ownership of enterprises opened up opportunities for rent-seeking.

Another important aspect of Kenyan economic policy in the 1960s and 1970s was the industrialization strategy which was based on import substitution—trade protection for domestic “infant industries” which were established to produce substitutes for previously imported consumer goods. This overall economic policy framework—significant government intervention in directly productive activities as well as in the management of the economy and the import substitution approach to industrialization—was developed by Kenyan technocrats and politicians, supported by advisers funded by donor technical assistance, and was endorsed by the WB/IMF and the donor community at large. Multilateral and bilateral donor financial support of the strategy is evidenced in the amount of aid channelled to and through SOEs and also in the fact that early WB/IMF program lending in the mid-1970s basically accepted the existing controls on prices, interest rates and foreign exchange and did not impose conditions requiring the divestiture of state enterprises.

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

Within this generally quite positive set of economic trends there were some disruptions. Economic growth slowed in the mid-1970s, to an average of 3.4 percent per annum in 1973-76. One of the principal causes was the negative impact of the five-fold increase in oil prices in 1973; this first oil shock was a serious blow to the Kenyan economy given the country's total dependence on imported petroleum products. Then, in the late 1970s, further severe economic shocks adversely affected Kenya's economic situation and prospects for the future. The first was the boom/bust cycle in coffee and tea prices in 1976-79, which sparked a ratcheting up of both consumer and government spending in the boom (the fiscal deficit rose to 9.5 percent of GDP in 1975/76). The government then proved unable to reduce spending sufficiently when coffee and tea export revenues fell sharply after 1977. The economy was also set back by the break up of the EAC in August 1977 which ended the favoured access for Kenyan exporters to the Ugandan and Tanzanian markets, raised infrastructure costs, and forced the Kenyan government to absorb much of the overstaffed work force of the EAC Railways, Ports, and Posts and Telecommunications agencies. A further contributing factor was the second oil shock in 1979.

As a direct result of this rapid succession of economic shocks the balance of payments current account deficit rose from 3 percent of GDP on average in 1975-77 to 10-11 percent in 1978-82. While concessional loans and grants from aid donors were rising, some of the deficit was financed with a commercial loan at a floating interest rate, contributing to a rise in the debt service ratio from 2.6 percent of export revenues in 1977 to 14 percent in 1983. Inflationary pressures were also increasing despite the now comprehensive price controls.

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

By the end of the 1970s it had become clear to many Kenyan technocrats, if not to politicians, that significant changes in the direction of economic policy would be required to address this complexity of problems. During the 1978-82 period the government reviewed virtually all its economic policies; these reviews were incorporated in the 1979 Development Plan and in various working party reports and Sessional Papers. In 1979 PS Treasury chaired a working party which highlighted the shortcomings of public enterprises. He chaired a second working party on government expenditures in 1982 which addressed the problems of fiscal indiscipline in macroeconomic management. These latter two reports indicate a clear awareness of the adverse consequence of the decline of public sector institutions in the country. These internal reviews did produce a framework for addressing the country's economic crisis, although sufficient conviction and political will to implement the recommendations in these reports was wanting.

The record of macroeconomic performance in Kenya since 1980 has been extremely mixed, with fluctuations in the GDP growth rate, fiscal deficit, balance of payments deficit, and inflation. In general, the best macroeconomic performance has occurred during and immediately following the periods of stronger implementation of reform measures (1986-89 and 1993-96), but all the macroeconomic indicators have not necessarily moved in unison. These economic strains contributed to the pressures that precipitated the coup attempt of August 1982. In response the government undertook a stabilization program with IMF support, which succeeded in reducing the fiscal deficit to 3 percent in FY 1983, but at the expense of investment and growth. GDP growth averaged only 2.3 percent per annum during 1982-84, with a severe drought in 1984 also adversely affecting the growth rate. For the entire 1980-85 sub-period the average growth rate was only 3.6 percent. In retrospect it seems clear that the fiscal squeeze was too great and proved unsustainable. The government was pushed by the IMF to adopt an excessively tight demand management policy. Recovery in the second half of the 1980s brought the average GDP growth rate up to 5 percent, but in the 1990s the GDP growth record has been highly erratic. In the early 1990s the economy fell into severe recession, with the growth rate falling from 4.2 percent in 1990 to 0.5 percent in 1992 and 0.2 percent in 1993. With the renewed reform efforts in 1993 the economy began to recover, attaining an average growth rate of 4.2 percent in 1994-96. However, the economy fell again into recession in the following two years with the growth rate falling to 2.4 percent in 1997 and 1.8 percent in 1998. With modest per-capita income growth over this entire period, the incidence of poverty has increased since 1980. On the fiscal front the record has also been mixed; it has proven difficult for the government to sustain fiscal stabilization, and there have been substantial swings in the fiscal deficit over the past 20 years. The ratio of total revenue to GDP remained fairly stable at around 22 percent from 1979/80 to 1992/93, but increased sharply to 27 percent in 1993/94, where it has remained through fiscal year 1997/98; however, expenditure growth outpaced that of revenues.

Following the stabilization of 1982-84, fiscal management weakened in the second half of the 1980s, with deficits averaging over 5 percent of GDP. In the early 1990s the fiscal position remained difficult, with the average deficit rising to almost 6 percent in FY 1991-94. Inflation was contained in the mid-1980s but began to rise in the last years of the decade before accelerating dramatically in the early 1990s. Fuelled by excessive monetary expansion to finance the fiscal deficit and the 1992 election, the inflation rate rose to 34 percent in 1992 and 55 percent in 1993. In the second quarter of 1993 the annualized inflation rate reached 101 percent—far beyond anything Kenya had ever experienced in the past. Money supply growth and the resulting inflation were finally brought under control in the second half of 1993, with the CPI reduced to an annualized rate of 16 percent by year's end, through the floating of massive amounts of short-term Treasury Bills at very high interest rates. This, however, has left the government with a heavy overhang of domestic debt that has risen from Ksh 40 billion in 1990 to Ksh 160 billion in 1998. (Another form of domestic debt is unpaid or "pending" bills for goods and services provided to the government, which have expanded from an estimated Ksh 1.2 billion in 1990 to an estimated Ksh 7.3 billion in January 1998.)

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

However, SAPs have only a medium-term focus, and are not intended to deal directly with more fundamental development priorities such as poverty alleviation, reducing unemployment, and human capital development.

Much of aid conditionality in the 1980s was focused on persuading sometimes reluctant governments to adopt and then implement this policy framework of liberalization and reorientation of the government's role. Undertaking major policy reforms simultaneously across the entire span of the economy proved beyond the capacity of many developing country governments, even if the need for the full package of reforms was generally accepted. Furthermore, even a well-designed and faithfully implemented program could be thrown off track by a decline in the terms of trade, adverse weather conditions, public resistance, or political shocks such as the 1982 coup attempt in Kenya.

Since 1980 Kenya has been carrying out, with varying degrees of success, a comprehensive SAP program. Virtually all of the macroeconomic and sectoral policy recommendations found in SAPs in other countries can be found in the Kenyan program. In the Kenyan context structural adjustment meant unbundling the pervasive control system and reducing the prominent role of government in the economy. The Kenyan government and the World Bank were already working in 1979 on an industrial sector policy operation intended to support the outward-oriented industrial development strategy set out in the 1979-83 Development Plan. This industrial sector operation, with only slight modifications, became the first structural adjustment credit to Kenya (SAC I).

The focus was on reducing protection of the manufacturing sector and promoting manufactured exports. The primary policy actions were replacement of quantitative restrictions on imports (QRs) with equivalent tariffs and rationalization of the tariff structure to reduce the wide variations in effective protection to different industries. An IMF program, focused on fiscal and monetary management, was negotiated in 1979 but was cancelled because of the government's failure to meet the agreed credit ceilings and replaced by a new program in October 1980.

Following these initial operations the government entered into a continuing series of adjustment programs with the World Bank and IMF between 1982 and 1996. The policy framework throughout emphasized macroeconomic stabilization through fiscal and monetary and exchange rate management, the purview of the IMF, and trade liberalization supported by the World Bank. But the policy agenda also encompassed interest rate deregulation; domestic price decontrol; cereals market liberalization; decontrol of markets for agricultural inputs and other agricultural outputs such as meat, dairy products, cotton, and sugar; export incentive schemes; reform of financial sector management and regulatory reforms, even family planning and financing for reforms in the health and education sectors. Midway through the first decade of structural adjustment the Kenyan government articulated its analytical framework for this comprehensive reform program in Sessional Paper #1 of 1986, Economic Management for Renewed Growth. This paper presented the broad outlines of the increasingly liberalized economy that was to take shape in the 1990s. Throughout the entire SAP period the timing and sequencing of the various reform measures varied significantly. For example, in the area of public sector management, while the case was made, in the government working party reports issued between 1978 and 1982, for civil service reforms and SOE reform/divestiture, these problems were not confronted until the 1990s. Also, the pace of implementation of reforms has been extremely uneven, both with respect to different policy reform areas and to time periods, with sub-periods of steady, and sometimes rapid, progress followed by stagnation and occasional reversals. Therefore it is difficult to come to an overall judgment regarding Kenya's performance as a reformer, or to compare Kenya with other reforming countries in SSA. The sum of all reforms in economic policy carried out over the past twenty years is impressive, with backtracking only on trade liberalization (for valid reasons in 1980-82), in cost sharing and in cereals market reforms. However, if one looks at the length of time required to achieve various reforms in relation to the government's own time-table or to the specific conditionalities of adjustment operations, Kenya can be made to fit the mould of a reluctant reformer whose overall record has been no better than the SSA average.

Today, Kenya's economy is fairly open. Due to perception of resource mismanagement and poor governance in the country at the time when Kenya has been adopting liberalization, donor inflows into the country have tremendously reduced, thus complicating Kenya's worsening socio-economic status. The country has since become a recipient of conditionalities that are attached to the aid it receives from its lenders. Some of the conditionalities have compelled the country to reflect on its debt contraction processes. At the moment, the government has adopted a number of measures aimed at regulating and managing the debt that the country contracts. The Interim Poverty Reduction Strategy Paper (IPRSP) 2000 for instance directs that the Debt Management Division (DMD) of the Treasury should vet and reconcile all debt records especially for external loans. The IPRSP also prohibits contraction of new loan obligations unless the new procedures have been adhered to.

### **The national legal framework for loan contraction and debt repayment**

Loan contraction process in Kenya has a basis in the Kenyan Constitution. Three core acts are the pillar of the contraction process. These are;

- The IMF Loans Act
- The Guarantee Loans Act
- The External Loans Act

All these Acts are founded on the IMF Loans Act which is inherently borrowed from the MOU between the Kenyan Government and the IMF. The Guarantees Loan Act underpins that constitutionally the Government has the obligation to guarantee all the loans that are borrowed. Similarly the External Loans Act which also embodies the Domestic borrowing makes provisions of such guarantee which hinge on the fact that the government cannot expunge or renege on loan contracts.

However, whereas these Acts provide the legal framework, they are weak on the duties and obligations of the other actors involved in loan contraction other than the Government. They are silent on implementation and to most critics; such loopholes have provided the conduit through which money borrowed is siphoned or diverted from intended and identified projects.

The loan contraction legal framework is heavy with the IFIs agenda. The result of these is that all the responsibility is shouldered by the Government. They tacitly indemnify the IFIs, thus cutting out any other recourse to which the government may prefer in dealing with the IFIs.

### **Evidence of reckless borrowing**

Poverty Reduction Strategy Paper 2000 and the CAG decry anomalies in debt service records at the Treasury, which is an indication of possible loopholes for servicing illegitimate obligations. In particular, the CAG noted that although the consolidated statement of June 30, 1998, indicated Ksh. 359 million for the 1997/98 loan redemption, the loan redemption receipts issued on the same day showed Ksh. 594 million—a staggering difference of Ksh.235 million between the two sets of government records. Even if the reconciliation was eventually effected, this demonstrates the confusion in record keeping and the potential for servicing phantom obligations.

The flaws in external loan arrangements can also be demonstrated by the loan for the construction of the Turkwel Gorge Hydroelectric Project. Though the borrower, on behalf of the Kenya government, was the Treasury, there was no lending agreement between the government and Kerio Valley Development Authority (KVDA).

This anomaly may have led to the difference in 1994/96 of Ksh. 3.04 billion as confirmed by the accounting officer (Treasury) in response to a PIC query regarding the 1996/97 accounts. It was also confirmed that all loan records related to the project had since been transferred to the Investment Secretary, Treasury, who is responsible for loan reconciliations.

As is common knowledge in the banking industry, incomplete and inaccurate records provide an ideal avenue for over-payments and enable excess money to be subsequently transferred to personal accounts.

On Domestic loans, there exists a potential danger of informal loans through pending bills. In addition, the overall management of domestic loans presents another challenge. While the government contracts domestic loans to meet shortfalls in the budget, it continues to advance money or take over loan obligations from state corporations. The loan obligations and the exact circumstances under which they were contracted are not clear. In some cases, the loan contracts are not even availed to the CAG during audits.

For example, Treasury was called upon to settle a debt of about 15 million Kenyan pounds owed by the Nzoia Sugar Company to a local bank in 1997. The CAG, in his report for 1997/98, states that he did not see any loan agreement between the lender and the loanee and that it appeared that no proper loan arrangements had been made. He also doubted whether Nzoia Sugar Company would ever repay the money to Treasury, considering that the company was in financial difficulties.

Another case is cited whereby in 1996/97 the KPTC appealed for a tax waiver of Ksh. 15 billion. This amount was largely money collected in form of tax by the KPTC on behalf of government and therefore belonged to Treasury. In 1997/98, a new arrangement was made such that KPTC would repay the money

through monthly instalments of Ksh. 55 million, which translates to a repayment period of at least 20 years. It is now apparent that this loan may never be repaid. KPTC has legally ceased to exist and has been succeeded by Telkom Kenya Limited, Postal Corporation of Kenya and the Communications Commission of Kenya. Telkom Kenya, which is the main successor of KPTC, is slated for privatization and the government is expected to take over all its debt obligations. It has never been explained why the KPTC withheld such a large amount of taxes collected on behalf of the Treasury. Eventually, the Treasury will end up with obligations of the former KPTC. The statement of revenue on loan redemption receipts for 1997/98 on loans advanced to institutions by the Treasury indicates that total actual collections were Ksh. 4.6 billion while outstanding loans were Ksh. 13.3 billion, a difference of Ksh.8.7 billion. Besides, the arrears were increasing at an alarming rate. Failure to repay loans to the Treasury can be deliberate, perhaps because the institutions have unilaterally decided to use the money for other purposes. In a monumental show of reckless borrowing from the domestic market, the National Bank of Kenya (NBK) was made to pay large sums of money to various parastatals on instructions from the Treasury in the 1990s.

Among the corporations engaged in financing large projects while not remitting statutory funds to the Treasury during the mid-to-late 1990s were KPTC, KPA and KPLC.

## 7.0 Current IMF and WB Agreements with Kenya

The World Bank granted its first loan to Kenya in 1960. The World Bank currently supports 13 projects (including GEF (define this)) in Kenya with a total commitment of \$711 million. Infrastructure accounts for 41 percent of the commitment, economic management 29%, social sectors 18 percent, and agriculture/environment 12 percent. In August 2000, the World Bank approved an Economic and Public Sector Reform Credit of US\$150 million to support Kenya's economic recovery efforts. This was the first new credit to Kenya from the World Bank for three years - with the exception of the El Nino Emergency Infrastructure Credit that was approved in 1998 to assist in the reconstruction of vital infrastructure destroyed by floods.

The Bank is also helping the Government to address HIV/AIDS through two credits of US\$50 million each: a multi-sector HIV/AIDS credit, and a Decentralized HIV/AIDS and Reproductive Health credit. In addition, an Emergency Power Supply credit for US\$72 million was approved in October 2000 to assist the government in implementing emergency measures to address the power supply crisis brought on by a devastating drought. A Regional Trade Facilitation Project and a Public Sector Management Technical Assistance Project have also been approved.

The International Finance Corporation, the World Bank Group's private-sector lending arm, is also active in Kenya with an investment of \$112 million in 34 projects, plus an additional \$24 million in participations.

### Checks and balances on reckless borrowing

The Interim Poverty Reduction Strategy Paper (IPRSP) 2000 directs that the Debt Management Division (DMD) of the Treasury should vet and reconcile all debt records especially for external loans. The IPRSP also prohibits contraction of new loan obligations unless the new procedures have been adhered to.

So far, Government has undertaken a number of measures and come up with debt management policies. On the overall these policies aim at improving expenditure and financial management reforms. This is by:

- Strengthening the public sector budget and financial management system through timely production of accounts by all public institutions, auditing and presentation to Parliament of the accounts, and production of comprehensive annual and medium term expenditure framework, consistent with the ERS priorities.
- Classification of the budget to improve transparency from 2005/06 and expenditure outlays towards non-core activities reduced including rationalization of the diplomatic missions, cost containment in operations and maintenance, sale of most stalled non-priority projects, and transfers to parastatal will be sharply curtailed;
- Reorientation of public expenditure towards priority areas and in particular, the human capital sectors. In addition, emphasis will be placed on efficient flow of funds, especially to service provision centres such as healthcare facilities. A comprehensive study will be carried out to rationalize fund accounts, including to improve their allocative efficiency, review their revenue and expenditures;
- Rolling out the IFMIS to line ministries as soon as possible, undertaking expenditure tracking surveys, transforming the internal audit approach from pre-audit to risk based systems and compliance reviews and developing a cash management system;
- Furthermore, the government will use decentralization as a policy instrument to strengthen budget transparency and improve accountability by increasing proximity between government representatives and the citizen or the electorate, thus raising the probability of increasing

- accountability. To this end, decentralization will be strengthened, including through better monitoring of the Local Authority Transfer Fund as well as the Constituency Development Fund;
- To deepen procurement reforms, the government has submitted to Parliament for enactment the Public Procurement and Disposal of Assets Bill, which is expected to provide for the establishment of the Public Procurement Oversight Authority (PPOA) with autonomy on matters of public procurement including formulation of policy, regulations and procedures;
  - Deepening reforms in tax administration will include modernizing tax and customs administration including developing and implementing an integrated information technology architecture to provide single taxpayer audit trail and entrenchment of the on-going organization reorganization along functional lines. Emphasis will also be put on simplification of tax procedures and implementation of appropriate tax regime for the informal sector; Reviewing the business entry procedures with a view to streamlining and minimizing registration requirements, including a review of Kenya's Companies Act and finalizing a draft new legislation on the companies and insolvency and introduce in Parliament;

**Table 1: Social Indicators**

	1969	1979	1989	1999	2001	2005
Total Population (Millions)	10.9	16.2	23.2	28.7	31	NA
Health Expenditure as Total % of Government Expenditure	0.5%	4.9%	NA	NA	4.9	10.77
Health expenditure as total % of GDP						
Education expenditure as total % of GDP						
Education expenditure as total % of Government expenditure	1.6%	3.2%			10.8	10.58
HIV Prevalence Rate %	0	0			7.1	6.9
Life expectancy at birth	50	54	60	56.6	44.6	44.6
% Of Population living under US\$1 a day	28				53	53

Source: Kenya Demographic Health Survey, 2003; The State of East Africa Report 2006, Society for International Development, P.38  
Estimates of development Expenditure for Respective Years, GoK, Nairobi  
Key: NA stands for Not Available

**Table 2: Kenya's Debt (million USD)**

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
External Debt Stock				5,170		
Domestic Debt Stock				3,920		
Total Debt Stock						
Domestic Debt Stock/Total Debt Stock (in %)						

**Table 3: Debt Indicators (Kshs Billions)**

	2000	2001	2002	2003	2004
Total External Debt Stock	403	394	378	400	407
Bilateral Debt	146	132	130	143	152
Multilateral Debt	224	229	223	226	228
Total Debt Service Paid		80,503.34	115,258.19	91,596.94	114,858.92
Total Debt Service					
External Debt as % of GNP	54.2	46.9	40.8	39.3	36.4
External Debt as % of Exports (goods and services)					
Total Debt amount rescheduled					
Debt amount forgiven					

Source: Public Expenditure Review

## 8.0 Conclusion

Amongst most debt actors, a general consensus is emerging that in the Post-Glencoe arena, the creditors might have gone the full length on their concessions. Resultantly it's imperative that debtor countries move away from the creditor's imperative to a debtor's position. Debt Repudiation is gaining consensus as one key plank for debtor countries to pursue. Thus, if the creditors are not willing to cancel the debts then the debtors will repudiate. This has adverse effects in the short, medium and long term. As such it needs a careful analysis from all angles before it's taken as a campaign issue. Fundamentally countries like Kenya and Nigeria that have missed on the HIPC initiative could embrace this.

Related to this earlier point is the question of illegitimacy and odiousness of debts. This calls for comprehensive citizens' audits that will expose the culpability of all the actors in loan and debt contraction and ascertain what constitutes illegitimate or odious debt. This then will inform the basis of the call for repudiation for it exposes and allocates both the duty and responsibilities of each actor.

For more concrete and less harmful outputs, it is imperative that the grounding of the debt audits is multi-stakeholder. Government, Civil Society and the International Financial Institutions should be involved, either independently or collectively. This broadens legitimacy and unmasking secrecy. It also undermines the all-too-often ability to indemnify some actors and blame others.

There is a critical need to develop a new more comprehensive debt intervention initiative. Unlike the HIPC that is creditor centric and confers the role and responsibility of Judge and Juror to the creditors, debtor countries need to be encouraged to develop a more time bound framework like an initiative that is tied to the Millennium Development Goals. This would comprehensively infuse innovative notions of how money released from Debt Cancellation would be used.

The question of governance needs to be entrenched but at all levels of the actors involved. Prudent management of resources has to be viewed as a governance issue and not a whipping stick or carrot for dangling by the stronger actors over the weak.

There exists an urgent need to revisit the legal framework that underpins the loan contraction process. It has to be re-thought on the basis of whether it requires total repealing or thorough amendments. This is so given that if it draws from the IMF position then in actual reality it indemnifies the International Financial Institutions from any responsibility whereas their culpability cannot be gainsaid. This is a major pillar in rethinking the governance agenda.

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