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STABILIZATION AND ADJUSTMENT
POLICIES AND PROGRAMMES

COUNTRY STUDY

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KENYA

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STABILIZATION AND ADJUSTMENT
POLICIES AND PROGRAMMES

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PREFACE BY THE DIRECTOR

This monograph is part of a series being published by WIDER on the experience of developing countries with stabilization and adjustment programmes in the 1970s and 1980s. Each study analyzes the package of policies implemented by a specific country; its relations with the IMF and World Bank; the effects of the policies on production, employment, the balance of payments and social welfare; and what other policies might have been followed instead.

The intention of the series is to assist developing countries to devise adjustment policies that would, while accomplishing desirable adjustment and growth objectives, simultaneously remain politically viable in the particular country settings studied.

For this purpose it was thought desirable to explore policy alternatives to the adjustment programmes being implemented. Built into the design of the series, therefore - and constituting indeed its special feature - is the requirement that each study include a 'counterfactual' exercise to illustrate the effects of alternative policies. Utilizing econometric models adapted or specifically developed for each country, the probable effects of alternative policy packages are estimated; the object was to see how far the balance-of-payments adjustment and growth goals of a particular programme might have been achieved at a possibly lower social cost with a different policy mix.

Each country study is written by an independent scholar and expert in the relevant country. First drafts of the studies in this series were discussed at the WIDER conference on stabilization and adjustment policies in developing countries which was held 19-22 August, 1986 in Helsinki. Each study has been reviewed by WIDER's research advisers for the project, Professors Gerry Helleiner and Lance Taylor, and revised substantively by the author as necessary; subsequent editing has been conducted under the overall supervision of Mr Robert Pringle, Senior Fellow, who serves also as editorial adviser on WIDER publications.

A companion volume by Professor Taylor summarizing the experience of the countries surveyed will draw broader implications for the theory and practice of stabilization and adjustment policies; this volume will be published by Oxford University Press. The individual country studies in this series will subsequently be grouped into separate volumes, also for eventual publication by Oxford University Press.

Lal Jayawardena
Director
March 1987

EXECUTIVE SUMMARY

Although Kenya avoided the disastrous plunge in real GNP that many other African countries suffered in the first half of the 1980s, standards of living of nearly all sectors of the population fell because economic growth slowed to less than half of what it had been in the previous decade while population growth remained as high as ever. Inequality in the distribution of incomes also probably widened.

The balance of payments deteriorated sharply in the latter part of the 1970s and the early 1980s due to the world recession, falling real prices for coffee and tea exports, the opening of new petroleum refining capacity in the Gulf, in competition with Kenyan refined products, the closure of the border with Tanzania and the chaotic situation in Uganda. By the early 1980s the terms of trade stood at less than half their level in the early 1960s.

Initially, the trade deficit was financed by foreign borrowing but lenders cut back new commitments after the debt crisis broke in 1982. The policies adopted to reduce the deficit relied heavily on import controls as well as devaluation and credit restraint. These policies brought about a precipitous fall in imports but, surprisingly, not in investment.

On balance, Kenya maintained its very high rate of investment, but it went largely into construction and other non-tradeable sectors, not into manufacturing industry or into agriculture. Manufactured exports continued to fall.

Kenya concluded several arrangements with the IMF during this period; the 1983 standby agreement, in particular, which called for devaluation, increased agricultural prices and a reduction in the budget deficit and bank lending, was implemented in full, partly perhaps because the Treasury itself appeared to be converted to a monetarist philosophy.

Employment expanded in the government sector, which grew by some 40 per cent during the period, but contracted in agriculture and rose only a little in manufacturing. Real earnings per worker fell heavily in all sectors.

It remains puzzling why the high rate of investment failed to spur economic growth. In the view of the authors of this study, this failure is probably due mainly to restrictive policies and the very low levels of capacity utilization. They recommend giving a sharp boost to demand by stimulating public and private spending, together with a massive shift of resources to agriculture (especially small-scale agriculture). Land redistribution is also necessary to offset the growing land pressure and raise food output.

I. INTRODUCTION

Kenya has weathered the crisis of the 1980s somewhat better than many other African countries. Nevertheless, the policies it adopted to stabilize the economy and curb the payments deficit have jeopardized its medium-term as well as short-term prospects. This is particularly disappointing as Kenya's economy grew quite rapidly in the ten years to 1983. The question marks over its growth prospects, on present policies, will make it even more difficult to tackle two of the country's most intractable problems: first, its exceptionally high rate of population growth - at 4 per cent, one of the highest in the world - and, secondly, its daunting external debt problem; see Table 1.

The rest of the paper is organized as follows: section II supplies a brief overview of Kenya's development from the 1960s; section III records some major policy events in relation to stabilization and adjustment policies; section IV analyzes the development of the balance-of-payments deficit from 1979 to 1984; and section V shows how various sectors of the economy have reacted to external trends and economic policies. A final section discusses future prospects.

This paper has been specifically prepared for the UNU/WIDER Stabilization and Adjustment Policies and Programmes Project. We would like to acknowledge comments received on an earlier draft from John Harris, Gerry Helleiner, Tony Killick, Andreas Solimano and Lance Taylor, as well as from Frances Stewart and other participants at the WIDER Conference on Stabilization and Adjustment Policies, Helsinki, 19-21 August 1986.

II. SOME GENERAL CHARACTERISTICS OF THE ECONOMY

The Kenyan economy is characterized by a predominant but dualistic agricultural sector; a high investment ratio, and a very high degree of openness (see Table 2).

(i) Agriculture is still the most important sector of the economy although its relative size fell from 42 per cent of total value added in 1964 to 30 per cent in the early 1980s. Small-scale subsistence-oriented holdings generate about two thirds of agricultural value added and employ about three quarters of the labour force but occupy less than half the arable land. Large farms consist of plantations, ranches or mixed farms and are mainly export-oriented; they account for 40 per cent of coffee production and 60 per cent of tea production.

(ii) The ratio of gross investment to GDP (at market prices) is relatively stable and averaged 22 per cent between 1964 and 1985 compared with 16 per cent for low-income countries.

(iii) With respect to the openness of the economy, the country exchanges between 25 per cent to 35 per cent of its GDP with the rest of the world, compared with 14 per cent for the low-income countries (excluding China and India).

1. Kenya's growth and trade pattern

Until 1972, the terms of trade were relatively stable and GDP grew rapidly. Between 1972 and 1979, the terms of trade declined steeply, except during the coffee boom years in 1976-77, and the growth rate of GDP was also low. Since 1980, the terms of trade have been more stable but declining and GDP growth remains sluggish. The upturn in the terms of trade in 1984, due to high tea prices, did not result in a more rapid growth of GDP because of the severe drought that affected the country in that year.

It is useful to distinguish three sub-periods in the description of Kenya's trade performance, with 1973 and 1979 as the turning years. During period I (1964-73) the country in general maintained an external balance with an average coverage ratio of imports equal to 100.7 per cent. External imbalance occurred in period II (1977-79) and worsened further in period III (1980-85) when the coverage ratio fell to 89.6 and 83.6 respectively. In effect, the consequences of the first oil shock on the external balance were to some extent cushioned by the coffee boom of 1976-77.

The policy response to the growing trade deficits consisted mainly of tight import controls. Import volumes, which had risen by 8.8 per cent per annum between 1964 and 1974, fell sharply in 1974-76 as a consequence of the first oil shock and, after a recovery in 1976-78 following the coffee boom, have been declining by about 10 per cent per annum. The upturns in 1980 and 1984 were mainly caused by dry weather conditions necessitating increased food imports. As a consequence of import controls, the import intensity of real GDP fell continuously from 100 in 1974 to merely 36 in 1985. This import-strangulation, of course, constrained domestic production so that the under-utilization of labour and capital increased markedly, as we will see later.

Furthermore, import controls were selective in the sense that only essential imports were allowed. Thus the end use of imports changed in favour of intermediate and capital goods at the expense of final consumer goods. The share of the latter in total imports declined from 27 per cent in 1964 to 17 per cent in 1984 (Table 3). Private final consumption was most affected by the import controls, its share dropping from 24 per cent to 10 per cent. On the other hand, the share of intermediate goods in total imports increased substantially as a consequence not only of the oil price hike, but also of the import substitution policy that was initiated in the 1960s whereby imports of final consumer goods were progressively replaced by imports of capital and intermediate goods. Actually, the end-use composition of

imports remained surprisingly constant after the first oil shock, indicating the limited potential of an import substitution policy. Commodities such as food, textiles, shoes and soap are well suited for 'first-stage import substitution' (Balassa, 1981), because they tend to be labour intensive, and skill and capital un-intensive; they are not subject to important economies of scale. But the next stage after the process of 'easy' import substitution, i.e. 'second-stage import substitution' with the replacement of imported intermediate inputs and consumer durables such as fertilisers, cement, machinery and bicycles, is much more problematic, as such products are highly capital-intensive, and are subject to significant economies of scale. Given the relative scarcity of human and physical capital as well as small domestic markets, African economies are confronted with a serious disadvantage in attempting to move to this second stage.

Export volumes also stagnated. Besides tourism, the three major (gross) export-earners for Kenya are, in decreasing order of importance: coffee, tea, and petroleum products. On average, these three commodities account for three-fifths of total visible exports and their share increased from 50 per cent in 1964 to about 70 per cent in 1985. Table 4 shows the structure of total commodity export earnings.

Coffee exports have been hit by the widening price differential between the markets subject to quotas and the non-quota market. In the 1960s, prices were about equal in both markets but in the 1970s, non-quota prices were only half of quota prices. In the 1980s, with a price differential of 3:1, additional exports yield little foreign exchange. Because of falling real prices, the share of coffee and tea in total visible export earnings remained relatively constant at the level of 28 per cent and 15 per cent respectively.

Kenya also exports petroleum products refined from imported crude oil. But in volume terms, petroleum exports have declined by 7.6 per cent per annum since the first oil shock, mainly because of the new refining capacities in the Gulf States. Until 1973, export earnings of petroleum products paid for the cost of imported crude oil - the net oil import bill was negligible. After the first oil shock, however, net oil imports accounted for 7.6 per cent of total imports and this share went up to 17 per cent after the second oil shock. Despite the fall in export volumes, the increase in oil prices raised the share of petroleum products in total visible exports from 10.2 per cent in 1964-73 to 17.7 per cent in 1974-79 and 30 per cent immediately after the second oil shock. By 1985 its share was down to 14 per cent, because of falling oil prices.

Manufactured export volumes fell by 50 per cent between 1973 and 1985. The main causes of this disastrous performance were exogenous in nature, notably the break up of the East African Community, the closure of the border with Tanzania and the deterioration of the Ugandan market. Tanzania and Uganda absorbed 30 per cent of Kenya's exports in 1979, but only about 10 per cent in 1985. The re-opening of the Tanzania border and the signing of the PTA treaty in 1982 will provide new opportunities for Kenya's manufactured exports in the future.

In short, as a small, open economy, Kenya has been hit by a crippling deterioration in its terms of trade which by the early 1980s stood at merely half the level of the early 1960s. The only improvements occurred in 1976-77 and 1984 when the prices for coffee and tea recovered briefly before resuming their downward plunge. Developing countries cannot change the structure of their output and their exports quickly enough to offset such savage changes in the international terms of trade. Kenya is no exception to this.

Table 5 shows the export performance (in volume) by type of commodity between 1972 and 1985. Exports of food and

beverages increased steadily over time, while all other export items, such as mineral fuels, chemicals, manufactures and equipment decreased sharply. This means that the export pattern moved towards more agricultural and less industrial products, indicating that the decline in the terms of trade is not expected to reverse soon.

Thus, the picture that emerges from Table 5 is that the export mix did not prove to be very price elastic during the past decade. In addition, non-oil terms of trade deteriorated as rapidly as the total terms of trade. Clearly, it would be incorrect to attribute the worsening trade balance of the oil-importing developing countries solely to the oil shocks. Exports were unresponsive to changes in prices and the exchange rate.

Kenya's major export sectors are agriculture and manufactures. While production of individual crops is quite price responsive (mainly through intensified harvesting), exports are often governed by quotas and by poorly-managed parastatals (uncertain marketing, lower prices and late payments). Having lost its major export markets (Tanzania and Uganda), manufacturing remains severely constrained by irregular and uncertain supply of imported inputs.

2. Development of fiscal and monetary policies

External shocks, starting with the first oil shock of 1973 and continuing with the coffee boom in 1976-77, the second oil shock in 1979 and the tea boom in 1984 occurred while domestic conditions deteriorated due to the demographic explosion, the growing land pressure and the general bias of most economic policies in favour of the urbanised economy. Hence, it is difficult, if not impossible, to disentangle the exogenous factors from the domestic ones in assessing the causes of economic instability. In response, government policies were introduced to cushion the impact of these shocks.

Budgetary policies

Both government expenditures and revenues were increased, giving rise to a widening budget deficit. Tax revenue increased from 15 per cent of GDP in 1965 to about 35 per cent in the early 1980s. In general, tax revenue was not very elastic and increases in the tax ratio stemmed essentially from discretionary tax changes. The major tax change occurred in 1973 with the introduction of the sales tax, so that total indirect taxes increased in importance from 45.6 per cent of total revenue before 1973 to 52.8 per cent and 58.4 per cent in 1974-79 and 1980-85 respectively. On the other hand, non-sales tax ratio of GDP remained surprisingly constant at the level of approximately 20 per cent. The increased reliance on indirect taxes suggests that the secondary distribution of income is worsening over time as indirect taxes in Kenya are less progressive than direct taxes.

While government revenue increased annually by 16 per cent between 1964 and 1985, total expenditure increased by 17 per cent and its structure underwent significant changes, as is shown in Table 6. In the first decade, expenditure on basic needs services (i.e. education, health, housing and social welfare) increased by 22 per cent annually while general services (including administration and defence), interest payments and economic services grew by 10 per cent, 11 per cent and 15 per cent respectively.

However, expenditure priorities were reversed during the second decade from 1974 to 1984. General services and interest payments out-performed all other types of expenditure with an annual growth rate of 15 per cent and 27 per cent respectively. Basic needs and economic services increased only by 14 per cent and 12 per cent respectively. As the inflation rate averaged 13 per cent per year between 1974 and 1984 and the population grew at 4 per cent, real basic needs services per capita in 1985 fell by more than one-quarter below their 1974 level. Clearly, living

standards of the poor suffered even more than those of middle and higher income groups, since the poor tend to benefit relatively more from basic needs services (though not from all public services). As a rule, governments do not trim their expenditure in a proportional way. Also quality in social services suffered more since reductions in non-wage components were larger than for wage components which hampered effective provision of services (clinics without medicine, schools without books, etc.).

Monetary policies

The expansion of domestic credit was high in the first half of the 1970s, in 1978 and in 1981-82 (see Table 7). Moreover, government borrowing, mainly for the purpose of deficit financing, steadily increased from a negligible level in 1970 to one-third in 1984, while the credit share going to the private sector declined continuously. But a tight credit squeeze has been imposed since 1982.

3. Development of wages

The cost of labour has been severely restrained due to the policy of wage control introduced in 1973, relaxed in 1976 and strictly enforced since 1982 when the average wage rate dropped by 15 per cent and further declined by approximately 4 per cent per annum in 1983 and 1985. The government has encountered little or no resistance in cutting real wages since 1982 because of the excess supply of labour, especially of educated labour. Furthermore, trade unions are government controlled and industrial action by civil servants is prohibited. It should be added that public employment in an African country has also a communal dimension, maintaining the welfare of the (ethnic) group (in the form of less unemployment) is considered at least as important as the welfare of the individual (in the form of a higher wage level).¹ Because of all these factors, income competition in an African economy is much weaker than, for instance, in a Latin American country.

Formal wage employment represents about 15 per cent of the total labour force in Kenya, which is high by African standards. Wage employment has risen annually at a respectable rate of 3.7 per cent since independence but this was only a little faster than the growth of the labour force in Kenya of 3.5 per cent. The pattern of wage employment, based on first-stage import substitution and on government-sponsored employment, provides little scope for future expansion. Indeed, guaranteed employment by the government for post-primary school leavers produces over-staffing, affects efficiency and morale and ultimately yields negative marginal labour productivity. The trend in the past by which the government increased the share of public wage employment from 30 per cent in 1964 to about 50 per cent in the early 1980s will not continue.

The informal sector shows a remarkable dynamism and a considerable capacity to absorb and even to train large numbers of young urban dwellers. Employment in this sector increased by approximately 10 per cent per annum over the last decade. The importance of the informal sector as a generator of income-earning opportunities was first reported in Ghana (Hart, 1973) and strongly emphasized by the ILO Employment Mission to Kenya (ILO, 1972). A simplified and erroneous interpretation of the latter report gave rise to 'informal sectorism' which uncritically considers the promotion of informal activities as a strategy for development and employment creation, without considering the nature of employment.

The average size of an urban informal establishment in Kenya equals 2.1 persons and the dominance of one-person enterprises is a regular feature of African countries. Income levels of informal sector workers compare relatively well with formal sector wage levels. An informal sector survey in Nairobi showed that about 45 per cent of the workers earned less than the prevailing minimum wage (House, 1978), compared to workers in private wage employment. Expansion usually takes place through an increase in the

number of establishments rather than through an increase in the size of the existing establishments. Consequently, the expansion in numbers employed in the sector does not always mean that the sector is dynamic, but merely indicates its role as residual recipient of labour. Expansion of the informal sector could in some cases just reflect a transformation of open unemployment to under-employment through 'worksharing'. Activity and employment levels of the informal sector depend heavily upon the purchasing power of the urban population, which is currently dwindling. Hence, saturation might be reached and the prevalence of under-employment in the urban informal sector might increase.

Regarding the rural areas, it should be noted that although the migration rate from the rural areas to the towns is high and accelerating over time, the degree of urbanization is still relatively low. The rural economy has been able to absorb most of the additional labour supply. This absorption of labour has been described as the rural sponge-effect (Livingstone, 1981). The sponge-effect operates through a progressive subdivision of the family holding. In the absence of economies of scale in agriculture, the degree of divisibility is so high that the subdivision of the holding greatly intensifies small-scale agriculture and enhances its absorptive capacity.

The medium size of the family holding decreased from about 2 to less than 1.5 hectares between 1975 and 1982. Livestock plays an important role in the intensification of small-scale agriculture and more than one-third of total household income consists in off-farm income. Furthermore, one-tenth of household income stems from urban-rural remittances. In short, rural incomes and employment levels increased substantially because of an intensification of agriculture, a diversification of gainful off-farm activities and strong ties between urban and rural families. The question arises, however, whether the rural sponge is near saturation. Kenya is already very densely populated

with respect to the supporting capacities of land, but agricultural dualism constitutes an important safety valve. It already appears that some large farms are informally being subdivided.

III. AN OVERVIEW OF STABILIZATION AND ADJUSTMENT PROGRAMMES IN KENYA²

Kenya was one of the first countries to benefit from the IMF extended Fund facility in 1975, for which approval was readily given on the basis of performance targets in the revision of the 1974-78 plan indicated in Sessional Paper No. 4 of 1975 on 'Economic prospect and policies', coupled with an additional devaluation of the shilling by 12 per cent. A small drawing was made but the coffee boom in 1977 did not necessitate any further drawing on IMF facilities and in 1978 a small IMF stand-by credit of SDR 17.25 million was drawn, while in 1979 an agreement enabling larger drawing in the upper credit tranche of SDR 122.5 million was signed. This agreement included ceilings on the net domestic assets of the central bank and on net government borrowing from the banking system with implicit understanding on good management of exchange rate policies and the elimination of the import deposit scheme introduced in late 1978.

In the meantime, Kenya was also one of the first countries to become eligible for a structural adjustment loan of the World Bank, for which the policies were put forward in sessional Paper No. 4 of 1980, notably a revision of the 1979-83 development plan, and including, besides a reduction in the government deficit and a change in the way of deficit financing, trade liberalization measures, an export promotion scheme, and a reform of interest rate policies.

In negotiations with the IMF, the 1979 programme was replaced by a new and bigger stand-by arrangement to the amount of SDR 241.5 million for which the Sessional Paper No. 4 of 1980 also formed a basis and which had again performance criteria not only on ceilings of the central bank's net domestic assets and lending to the central government but also on the implementation of trade liberalization, a condition of the structural adjustment

programme of the World Bank, indicating the close relation between the two programmes.

Again, however, it proved difficult to adhere to the ceilings of the 1980 agreement, especially with respect to bank borrowing by the government. Although in 1981 some drawings were made, in 1982 no more drawings were allowed because of massive government bank borrowing in order to finance salary increases, increases in defence spending and increases in food imports. A new programme was negotiated and concluded in 1982 for a total amount of SDR 151.5 million. In this programme conditionality was much more strict, again including ceilings on bank borrowing by the government and a reduction of the government budget deficit from 10.6 per cent to 7.5 per cent of GDP and commitments for progressive import liberalization in the medium term. A pre-condition was a devaluation of the shilling in two tranches of 14 per cent in September 1982 and a further devaluation of 15 per cent in September 1982.

Because of the 1982 coup attempt and ensuing political difficulties it was difficult to draw fully from the earlier concluded IMF programme and in March 1983 a new stand-by arrangement was reached of SDR 179.5 million calling for a realignment of the exchange rate, increased agricultural prices, reduction of bank lending and reforms in credit policy. This was the first programme for many years which was actually implemented, partly due, however, to increasing export prices. In some cases the performance was better than the targets (government budget deficit, for example).

In February 1985 a new stand-by arrangement for SDR 85.2 million was concluded to offset the consequences of the 1984 drought; in its preamble this praised Kenya for its good performance on the previous stand-by arrangement. The programme included restraining expenditure to generate savings for emergency relief, stronger marketing and price initiatives, a reorientation of the Kenyan economy towards

export markets, import liberalization and the maintenance of Kenya's external competitive position.

In December 1985, Kenya was allowed to draw SDR 37.9 million under the compensatory financing facility in respect of an excess in cereal import costs.

In order to review the 1984-88 Development Plan and to provide a basis for increased donor support, Kenya has recently issued Sessional Paper No. 1 of 1986 on economic management for renewed growth, which is examined in sections V and VI of this paper.

In recent years Kenya has been able to comply with Fund conditionality to a fuller extent than it had earlier. Godfrey (1986) ascribes this not only to external events but also to the monetarist policies of the senior management of the Treasury, Development Planning and the central bank. He recalls that Killick (1983) indicated that contacts with the World Bank were more cordial than with the Fund, but indicates that the roles have changed. The present leadership views traditional Fund conditionality on performance criteria in the financial sphere to be more acceptable than the large number of conditions of World Bank loans, which interfere much more directly in fundamental issues of design of growth policies and of which consequences are often less clear. As for the example illustrated by Mosley (1986) who comments upon the relation between Kenya, the World Bank and USAID, and demonstrates that in the World Bank's second Structural Adjustment Loan the conditions on the privatization of mass marketing, posed in order to raise agricultural growth, were of less relevance in Kenya than in other African countries since the controlled price in Kenya has been mostly at the level that could have been expected to be a free market equilibrium price. Furthermore, the delay in delivery of certain types of fertilizers in 1983 as a consequence of a conflict between USAID and the Kenyan government on its selling price

has hurt more the small-scale farmers who had been crowded out of the market by the large-scale farmers.

IV. CAUSES OF BALANCE-OF-PAYMENTS DEFICITS

In this section we will look more closely at some of the causes of balance of payments deficits. We have analyzed the different effects of external shocks, increased debt burden, export penetration and domestic stabilization policies on changes in the balance of payments deficit over the period 1979-80 to 1983-84 (see Table 9).³

The balance of payments deteriorated sharply in 1980, improved in the following three years but deteriorated again in 1984 and 1985. The deterioration in 1980 was due mainly to external causes, especially the terms of trade and fall of world trade, amounting to minus 6.4 per cent of GDP. Increased debt payments and a shrinking of Kenya's share of exports in total world trade added another 1.4 per cent of GDP to the deficit. These shocks were not offset by domestic policies.

However, in the next three years successful and sizeable efforts were made to reduce the balance-of-payments deficit. In 1981 the major emphasis was on import restriction, mostly affecting imports of intermediate products but also other import categories, levels of domestic consumption and investment were, however, also reduced. In 1982 there was still a deterioration of the terms of trade, though less than in previous years; the increases in interest rates, shrinking world trade and increased debt burden became more important. Export penetration improved somewhat, but again, the effects of domestic policies were extremely important and amounted to 7.4 per cent of GDP. Contraction in final demand fell mostly on investment while import restrictions resulted in reducing the import ratios of consumption and of intermediate products to a total effect equal to 6.7 per cent of GDP.

The balance of payments also improved in 1983 due to a favourable shift in terms of trade and interest rate effect and through domestic measures of which the size was,

however, much smaller. Decrease of world trade, increased debt burden and smaller export penetration had negative effects on the balance of payments but the overall effect was still a sizeable reduction in the balance of payments deficit. Improved terms of trade and an improvement in world trade were also positive factors in 1984, while the effect of domestic policies on balance was neutral, but the balance-of-payments deficit increased because of a substantial drop in Kenya's share of export markets and, to a lesser extent, of an increased debt burden. In 1985 Kenya suffered from a large deterioration in the external terms of trade compounded by other external effects, leading to a negative external shock of over 7 per cent of GDP. However, domestic policies, mainly in the form of reducing the share of intermediate imports and reducing investments, as well as an improvement in export penetration, limited the deterioration in the balance of payments to 0.7 per cent of GDP.

In general, by domestic policy measures, Kenya compensated rather well for external shocks. But all of these policies were directed at domestic contraction or at domestic import restriction. Kenya did not manage to increase steadily its share of export markets. On balance, the export penetration went down significantly over the period, resulting in an annual loss equal to 1.25 per cent of GDP, 40 per cent of the average growth.

What the above analysis makes clear is that Kenya managed to stabilize its economy by contraction and especially by import reduction. Kenya's system of import control has been effective in reducing imports through an allocation mechanism in which imports are subdivided into four different import categories, the composition of which depends on local availability of the imported good and the demand of the various industries. Through a stricter application of the rules the system of import controls appears to have worked in Kenya better than in many other African countries, although the continued existence of

effective protection of the local industrial sector has made any analysts critical of the system of import controls, a point which we will discuss in section VI. One notices also a tendency to lift control on certain items as soon as the foreign exchange situation improves, only to be reintroduced when the foreign exchange situation deteriorates.

Kenya, however, did not improve export performance over the period considered, confirming the observations made by Rwegasira (1983) who analyzed adjustment policies in Kenya and Tanzania over the period 1974-78, and noted that during that time 'Kenya was therefore still performing poorly with respect to export volume growth mainly as a result of the decline in manufactured exports'. Part of the decline was the consequence of incidental factors such as the breaking up of the East African Community, but Rwegasira argues that a large part was also due to domestic policies and to difficulties Kenyan exporters found in entering new markets.

In conclusion, we can characterize the period 1979-85 as 'stabilization without proper adjustment', since a reduced import level, without structural changes, reduces short and medium term prospects for economic growth.

V. STABILIZATION POLICIES AND ECONOMIC DEVELOPMENT

Stabilization policies implied changes in exchange and interest rates. Although Kenya has always publicly maintained that changes in the exchange rate have been minimal, in effect, as table 10 shows, the shilling was devalued from 1980 to 1984 by 47 per cent in terms of dollars per shilling, and by 34 per cent in terms of SDR per shilling, with major devaluations taking place in 1981, 1982 and 1983. However, as Kenya's inflation rate has increased more than that of industrialized countries, the value of the real effective exchange rate dropped, from 1980 to 1983 by 21 per cent in SDR terms and by 37 per cent in dollar terms, remained stable in 1984 and dropped again in 1985. The increase in inflation can be attributed to changes in the cost structure due to changes in price for capital (i.e. interest rates), labour and imported consumer and intermediate goods as well as to changes in the money supply.

Government policy switched from low to higher interest rates which, with a levelling off of inflation, resulted in positive real interest rates from 1983 onwards (see Table 10). Labour costs decreased in many cases as we will discuss in section V.5, while prices for imported consumer goods and intermediate goods indeed increased at levels equal to or higher than the CPI as we will show in section V.7.

1. Monetary policies

To discuss some changes in the monetary sphere we follow the framework which is usually set up by the IMF for programming performance, but which can, as Taylor (1985) indicated, also be a useful ex-post accounting framework, providing some information on the working of the economy.

We first consider changes in international reserves which are caused by the surplus on the current account

(deficits presented as negative surpluses) and by net capital inflows. Since Kenya has considerable foreign obligations we have singled out net investment income from abroad from the current account surplus.

Three things should be noted from table 11, which gives the movement of these variables from 1979 to 1985. First, capital inflows in nominal terms decreased, with a particularly large drop from 1981 to 1982, when the international financial community became aware of the debt crisis. Second, the current account deficit also fell from 1980 onwards. Third, in 1983 and 1984 Kenya had in effect a surplus in goods and services, making its situation comparable to that of many Latin American countries.

As was shown in section IV, the drop in the current account deficit was, except for 1979-80, the consequence of domestic policy measures helped in the last two years by an improvement in the terms of trade.

Domestic credit and changes in international reserves determine the money supply which moved rather erratically during these years, as table 12 shows, due mainly to shifts in the international reserve position and in credit to the government (Table 12).

2. Budgetary policies

The share of expenditure on basic needs dropped from 28.1 to 26.4 per cent from 1979 to 1984, and given the increasingly higher salary component, the quality and quantity of basic needs services declined more than the drop in relative share indicates.

Limited possibilities for government borrowing from 1983 onwards resulted in a reduction in spending on most programmes and often in a halt to all spending - except, naturally, on civil servants' salaries: outlays on salaries as a share of ministries' recurrent expenditure has grown

steadily from 47 per cent in 1979-80 to 60 per cent in 1984-85.

In Sessional Paper No. 1 of 1986, the government argues that 'with population growing at 3.7 per cent, even maintaining per capita levels of outlays for basic needs will be difficult without endangering growth', and argues for increased contributions by families, though realising that 'cost for primary and secondary education are for most families major and for many prohibitive, and competing with more productive outlays as investment in family farms and small businesses', so that in the family also important decisions must be made between expenditure on long-term basic needs and on more immediately productive activities (Republic of Kenya, 1986, pp. 12, 13).

3. Effects on saving and investment

The current account deficit and the contractionary policies adopted to curb the deficit have affected domestic savings, and in particular private savings, and capital formation.⁴

Gross capital formation (GCF) rose rapidly in 1980 and 1981 because of increased borrowing from abroad and increased domestic savings.⁵ In 1982 capital formation returned to its normal (but still high) level of around 25 per cent. The years 1983 and 1984 saw a further contraction of foreign savings balanced again by an increase in domestic savings with private savings increasing again somewhat and public savings decreasing. In 1985, foreign savings increased but private savings dropped resulting in lower nominal gross capital formation than in 1984.

Changes in the composition of savings and in the rate of capital formation affected the distribution of assets and the growth capacity of the economy.

The substantial increase in private savings implied increased accumulation of assets by those who save. As real wages of all groups of workers fell and most workers save little or nothing, the increased private savings came mainly from entrepreneurs and self-employed, both in urban and rural areas. Increased savings were channelled into capital formation either directly or indirectly through the banking system.

In most years the ratio of gross capital formation to GDP was 25 per cent, though it jumped to an historically high level of 35.3 per cent and 33.1 per cent of GDP in 1980 and 1981. Even allowing for above average ICORs (incremental capital-output ratios) such rates should have led to a spurt in growth in the following years, but they did not. This is explained by the decline in capacity utilization as we can infer from the 50 per cent reduction in the import ratio of intermediate products, and similar reductions in the ratio of consumer goods and of capital goods.

The high level of gross capital formation might have caused an inefficient investment pattern through the sudden availability of funds, as well as through the conditions attached to funds provided by foreign savings, partly explaining the high ICOR during the stabilization phase. This is looked into in the next section where we discuss some effects on the real side of the economy.

4. Effects on the real side of the economy

Unfortunately, investment did not switch to sectors which provided most of Kenya's exports (agriculture and manufacturing) but to non-tradeable sectors which confirms our view that Kenya achieved stabilization without proper adjustment.

Investment fell in manufacturing (with the exception of 1983) and in transport and communications (up to 1984) as well as in ownership of dwellings. By contrast, investment

in construction as well as in the traditional economy (which consists mainly of traditional dwellings) increased, as it did in finance and other services. The investment share of agriculture remained more or less stable until 1984, when it dropped.

The evidence suggests that stabilization policies did not change factor shares much. Remuneration of employees in non-agriculture increased somewhat faster than the operating surplus while in agriculture it increased somewhat slower than operating surplus.

Relatively stable factor shares, however, may hide variation in income distribution: the number of people depending on the different factors may change; or changes may take place between sectors of the economy; or different factors may face different prices and, although in current prices the picture might look unchanged, it may change when deflating actual incomes with price deflator. Since stabilization policies affect price levels and as price regimes are not equal for all sectors in the economy we expect this factor also to play an important role.

Overall GDP growth was weak and only in 1980-81 positive in terms of per capita growth. Five sectors of the economy/agriculture, manufacturing, construction, trade and tourism, and government services, comprise 73 per cent of total GDP and contribute 80 per cent of all employment in the modern sector.

Agriculture showed the largest variation, partly due to weather conditions. The period 1981-82 especially showed a weak performance in manufacturing and negative growth in construction and trade, showing the recessionary effects of the contraction in imports and the decrease in capital inflows. The recessionary climate is also expressed by the continuous steep decrease in real GDP of construction following the drop in the rate of gross fixed capital formation from 33.1 per cent to 25.3 per cent from 1981 to

1982. However, the fact that the real GDP growth rate of construction remains negative so long must perhaps also point to other factors which have to deal with the various price regimes.

Construction and trade, which can both be regarded as flex price sectors, have much larger GDP deflators (Table A.3) than the fix price sectors, agriculture, manufacturing and government services. When we look at growth rates in current shillings it appears that construction does not perform worse than other sectors. We could conjecture that sustained high investment ratios can allow entrepreneurs in the construction sector rapidly to increase their assets. Indeed, the investment/GDP ratio in construction is high and after some decrease in 1981 and 1982, rapidly increased in 1983 and 1984, while for the fix price sectors the investment ratio decreased (agriculture, manufacturing and government) (Table A.5).

5. Real wages, real wage costs and employment

The difference in development patterns of the various sectors also caused different patterns in employment and wages in the various sectors. Table 17 gives wage employment for the various sectors as well as average gross earnings per employee deflated by the sectoral GDP deflator (and thus indicating the cost aspect for the employer of employment) and by the consumer price index (and thus indicating the real income for the worker). Regarding the employment situation we note the decline in agricultural employment over the period caused by large drops in 1980 and 1982. The drop in 1982 is a consequence of the contraction of the economy which took place affecting also employment in manufacturing (hardly any increase) and confirming the declining trend of employment in the construction sector. The government was, however, able to absorb the negative developments in other sectors, causing positive employment growth for the economy as a whole.

Real average earnings per worker (deflated by the consumer price index) decreased in all sectors and most of all in government services and in the construction industries. The picture changes somewhat when we look at average earnings deflated by the sectoral GDP deflator (which can be interpreted as cost for the employer and which we call average real wage costs).

In the fix price sectors (agriculture, manufacturing and government services) average real wage costs are above average real earnings. For manufacturing, average real wage costs have increased. Comparing increases in average wage costs and increases in value added for each sector can tell us whether workers were able to maintain their share in value added and whether lower wage costs resulted in higher employment.

We therefore look at how real wage costs, employment, the real wage bill and GDP have developed from 1979-84 (see Table 18).

In all sectors, with the exception of manufacturing, the real wage bill lagged behind real GDP growth, decreasing workers' share in value added. This was most pronounced in agriculture and construction, where employment fell despite lower average wage costs, implying that in these sectors capital owners have increased their relative position more than in other sectors. The real wage bill also lagged behind in trade and in government services, but less than in construction and agriculture. Employment was positive in these sectors (and growing faster on average over the last five years than the labour force). In manufacturing the real wage bill kept pace with real GDP, which is the highest of all sectors. Although real average wage costs increased the increased real wage bill could still provide room for increased employment, although at a much slower level than in trade and in government services.

6. Consequence for farmers

Agriculture provides about 20-25 per cent of total wage employment and its role as provider of income to the majority of the Kenyan population remains predominant. It provides between 40 and 65 per cent of total export earnings and various items of stabilization packages are justified on the grounds that they will have a positive impact on the agricultural sector (increase in producer prices, devaluation, liberalized trade, etc.).

In the agricultural sector, prices for industrial crops and food crops are set by various boards, while prices for export crops follow price development on the world markets. Prices for export crops, which in 1979 were almost equal to prices of domestic crops in 1976 values, lagged behind domestic crops in 1980 and 1981 but picked up rather fast thereafter. Thus, in 1984 prices for export crops were 65 per cent higher than in 1981 and prices for domestic crops were 51 per cent higher than in 1981. For export crops this matched reasonably the increase of the index of rural consumer goods which increased by 62 per cent from 1981 to 1984. However, in 1985, partly as a consequence of the 1984 drought, prices for domestic crops shot up.

Since, until 1984, only export crop prices kept up with the index of consumer goods, the rural-urban terms of trade deteriorated, as table 19 shows, but because of 1985 agricultural price increases, especially of domestic crops, the rural-urban terms of trade did not deteriorate in 1985.

However, the concept and calculation of urban-rural terms of trade is subject to a large debate (Sharpley, 1986; Jabara, 1985). The 'official' terms of trade index is calculated by dividing the agricultural output price index (which appears to be of the same magnitude as the agricultural GDP deflator) by a weighted index of purchased inputs and rural consumer goods price indices (Table 19). Prices of agricultural inputs, however, have increased less

than prices of outputs since 1981 and Jabara (1985) therefore argues that the pessimism expressed by ever-decreasing rural-urban terms of trade is not justified, since, when considering cost factors only, Kenyan farmers appear to have received adequate remuneration. We could argue, however, that although this observation is correct, the relative income position is the one that matters when considering consequences of policies, and will also influence behaviour of farmers.

How did farmers respond to the switch in price regime? Table 20 gives the sales to marketing boards of cereals (domestic), temporary industrial crops (partly domestic, partly exported) and permanent crops (exported).⁶ We see in 1983 and 1984 a considerable increase in sales to marketing boards of permanent crops while temporary industrial crops scarcely caught up their 1981 level. Cereal production in 1984 was low mainly because of drought. However, it is doubtful whether the increase in sales of permanent crops can be ascribed to the price changes, since it takes several years from planting new seedlings to harvesting. What most likely happened was an intensification of treatment at the cost of other agricultural activities.⁷

7. Effects on export performance

The overall volume of exports in 1984 was 90 per cent and in 1985 93 per cent of that in 1979, but when excluding exports of oil products (Kenya has refining capacity for other African countries) the picture is slightly rosier. Exports in 1984 were 4 per cent and in 1985 14 per cent higher in volume terms than in 1979. However, the entire increase was due to increased exports of food and beverages.

The decrease of these export categories is partly explained by the economic and political difficulties of neighbouring countries, but also partly by the fall in imports -- given the high import content of intermediate

products in these sectors. This does not auger well for future prospects.

8. Causes and consequences of inflation

Increased import prices resulting from increased international prices and devaluation certainly had consequences for inflation in Kenya. One usual problem with inflation is the choice of a proper indicator. In the rest of this paragraph we consider two measures: the low-income Consumer Price Index and the GDP deflator. As table 22 shows, changes in the GDP deflator are always lower than the Consumer Price Index, although the two move always in the same direction with the exception of 1984-85. As the next column shows, lower money supply appeared to influence the inflation rate (GDP deflator) but only when the influences of increases in import prices on the GDP deflator is also less. This illustrates the working of the political process in Kenya in which the government finds it difficult to resist claims based upon cost pricing for higher prices when import prices go up. This has often led to over-shooting of price increases. Although this is difficult to document we have tried to get an impression of this phenomenon by looking at how the various price components of gross output have reacted. We have the following relation:

$$\text{Gross output} = \text{imported intermediate goods} + \text{domestic intermediate goods} + \text{wages} + \text{operating surplus}.$$

We know the prices of gross output and of domestic intermediate goods (GDP deflator), of imported intermediate goods (import price) and of wages (or rather earnings per employee). We do not know the price of the operating surplus but this can then be calculated as a residual according to the following equation, in which symbols correspond to the relation described above.

$$O * po = I * pi + D * po + W * pb + S * ps$$

after rearranging we get:

$$po = [I/(O-D)] * pi + [W/O-D] * pw + [S/(O-D)] * ps$$

in which (O-D) stands for gross output minus domestic intermediate goods which equals value added plus intermediate goods.

Although the weights in the price equation are not equal for each year, as the share of intermediate imports decreases, they are for the mid-period 18 per cent for the weight of imported intermediate imports, 33 per cent for the weight of wages and 49 per cent for the weight of the operating surplus.

Knowing po , pi and pw , we are then able to calculate ps the implicit price of the operating surplus for each year (see Table 22). What we notice is that after 1981 the increase in ps has been much more substantial than the increase in wage earnings except for 1983 when both were small. This means that the relative position of the non-wage earners has increased relatively to that of the wage earners and that non-wage earners (entrepreneurs and farmers) have been able to protect themselves better than wage earners against external influences on prices.

VI. CONCLUSIONS AND FUTURE PROSPECTS

Thus, during the period under consideration, Kenya stabilized its economy and brought down its current account deficit, but it did not succeed in restructuring its economy in response to changed external conditions or in increasing non-agricultural exports. Growth suffered and employment creation slowed.

Stabilization measures included the restriction of imports, a fall in real minimum wages, increase in real interest rates, control of government expenditure and devaluation. The latter resulted in a shift in income distribution to producers of tradeables (agricultural exporters) from non-tradeables, but the supply response was limited. Likewise, increases in the real rate of interest in 1983 and 1984 came after, rather than before, the large increases in savings which took place in 1981 and 1982, benefiting those who had been able to accumulate assets in the past. Since in all sectors real wage costs increased less than sectoral GDP and employment usually also lagged behind, income distribution changed in favour of non-wage earners.

Due to the fall in urban real wages, rural-urban differences decreased, but overall income inequality has probably increased. First, in urban areas the position of wage-earners has deteriorated in relation to that of non-wage earners. Second, in the agricultural sector exporters of tradeables profited from price increases in 1983 and 1984 and from devaluation. Export crops are now grown by a minority of prosperous small farmers (less than 20 per cent) who have large plots of land and by large farms. Increased attention to export crops would increase inequality within the rural areas. Godfrey (1986) reports that plantations, which often had difficulties in hiring labour in 1980 and therefore recruited foreign labour, appear to have had no difficulty in hiring labour since

1984. Also the lower real urban wages, as shown in section V, may tend to lower supply price of rural labour.

During 1979-84 funds available for investment shot up, initially because of increased foreign borrowing and later because import restrictions limited the supply of domestic output and of final consumer goods. In 1983 and 1984 investment rates returned to 'normal' Kenyan values of around 25 per cent. It remains puzzling why Kenya is unable to grow faster and to create more employment with such a high investment rate.

In 1985-86, the economy benefited greatly from the increase in coffee prices. Because of the increase, the International Coffee organization lifted quotas and Kenya was able, on top of normal exports, to sell off coffee stock from 1985, which resulted in a doubling of proceeds from coffee exports in 1986 as compared to 1985. In contrast with the coffee boom of 1976-77 and the tea boom in 1984, the government does not intend to pass on in 1986 all price increases to coffee exporters. Instead, it wants to use part of the increased revenue to pay off external public debts. However, since exporters form an important political group it is too early to say how much of the windfall gain will in fact be used to reduce external public debt.

Current projections of coffee and tea prices are not encouraging. IBRD (1986^b) estimates are, for coffee, 291 cents in 1990 and 312 cents in 1995 compared to 298 cents in 1984, and for tea, 231 cents in 1990 and 141 cents in 1995 compared to 294 cents in 1984 (all in terms of constant dollars). For both products Kenya is under normal circumstances restricted in quota markets - with substantially lower prices for above-quota sales. Because of the 1986 coffee boom, the government is more optimistic about increased marketing possibilities, above quota obligations, than the World Bank (Government of Kenya, 1986; IBRD 1986^b). Kenyan authorities have started to make the case for increased quotas arguing that when present trends

in production continue Kenya will be able at the end of the decade to sell only 50 per cent of its production through its quota on the world market.

Another serious problem is that the volume of Kenya's exports of agricultural products has kept up better than the volume of non-agricultural exports, which had better price prospects. Although lower real wages could be a comparative advantage for Kenya, this has not happened as yet, mainly because of restrictions in surrounding markets and because of the difficulties confronting Kenyan products in competing in industrial country markets. New regional marketing arrangements could give a spur to Kenyan exports, but the depressed economic situation of many of Kenya's neighbouring countries do not allow for much optimism on this side. Thus, at least for the immediate future, Kenya has to rely on agricultural exports as the major source of foreign exchange. This suggests that, excluding some positive shocks, such as bad harvests in other parts of the world, its trade prospects are not favourable.

Another serious problem is that of food production. Although food self-sufficiency is not absolutely necessary (since food can be imported and paid for with proceeds from exports), it has become accepted, for African countries at least, as a legitimate objective. The rapid population growth in Kenya (about 4 per cent per annum) underlines the importance of the drive for food self-sufficiency. As we showed earlier, at the beginning of the period 1979-81, food prices were increased in order to boost food production, and to catch up with agricultural export prices which increased in 1976-77, while after 1981 export crop prices were increased in order to stimulate production of export crops. The drought in 1984 pushed food prices up again. The important policy question is whether stimulus of export crops (tea and coffee) can be achieved without detriment to food production. Evidence on this is mixed (IBRD, 1986^b). Rwegasira (1983) in his comparative study of adjustment experiences in Kenya and Tanzania during 1974-78 underlines

the importance of fixing appropriate relative prices for food and non-food crops in order to avoid a deterioration in food production.

This dilemma is compounded by the fact that Kenya is quickly reaching its limit of arable land and increased production has to come from intensification, which means inputs and improved technologies, but which in the medium term could also be promoted by land redistribution, since small farmers have higher yields than large-scale farmers. IBRD (1986^b) estimates that a 10 per cent reduction in the holding size raises output per hectare by 7 per cent and employment by over 8 per cent. The recent sessional paper on Economic Management for Renewed Growth is, however, much less outspoken and puts the emphasis on intensification (Republic of Kenya, 1986).

The formulation of a strategy or set of scenarios for future development should take into account the basic characteristics of the economy: namely its large and dynamic small-scale agricultural sector, its high savings rates, high population growth and the land shortage.

This would suggest increased attention to small-scale agriculture. This should go beyond the present emphasis on domestic and foreign pricing policies, to include a much larger transfer of national savings to agriculture and to the agricultural sector as a whole. This should be accompanied by policies for land redistribution in order to increase output and to provide income opportunities to the fast-growing population.

These policies would be facilitated by an increased inflow of foreign aid and capital but initiatives are not blocked by lack of funds. Increased investment in agriculture can be stimulated by offering special benefits or be financed from increased taxes on non-wage income, which has increased in several urban sectors as we indicated earlier. This would mean a lowering of the investment rate

in urban areas, which would not necessarily decrease growth as ICORs have been rather high and could be lowered through better capacity utilization and improved efficiency.

Land redistribution may run into financial bottlenecks. Hunt (1984) reckons the cost of distribution of 2.2 million hectares of land in 1979 at 139 million, about 7.5 per cent of GDP. If the funds required were to be borrowed externally this would, given Kenya's high debt/GDP ratio of 57.5 per cent, bring the rate up to 65 per cent in one year, greatly exacerbating the debt problem. However, if the programme were to form part of a foreign aid donor programme stretched out over several years, a programme of land reform would be economically feasible.

In the modern sector lack of investible capital is less relevant than lack of foreign exchange, resulting in low capacity utilization ratios. Another reason for low capacity utilization is the stand-still in real consumer demand by workers who have seen their incomes reduced from 1979 to 1984 by values up to 20 per cent. Increasing private consumer demand should be stimulated, not necessarily by wage regulation but rather by changes in the fiscal regime, where the wage tax on lower income groups would be reduced and that on higher income groups and on accumulated wealth and assets increased. Another, not necessarily opposed, variant would be to stimulate public consumption rather than private consumption (non-inflationary if financed by fiscal reforms) in order to maintain provision of basic services, such as education and health at present levels or to increase these slightly. Although the direct productivity effects of the provision of such services are difficult to measure, indirect effects in the form of increased social mobility have been noted by several authors.

The policies discussed above would of course have implications for the balance of payments. An expansion of final demand to reduce excess capacity may cause import demand to increase above sustainable levels when access to

foreign exchange remains constrained. However, in such cases import restrictions or prohibitive tariff structures could be imposed, coupled with policies to expand supply by allowing a greater role for the informal sector, which has already shown signs of increased dynamism during the stabilization period and is meeting the demands of many low-income consumers. The import problem would be less if public consumption (non-inflationary financed) is increased rather than private consumption but a combination of both seems likely to be most acceptable socially.⁸

FOOTNOTES

- 1 For a clear typology of economic decision making in an African context see R. Sandbrook (1986).
- 2 This overview is based upon Killick (1984), Nelson (1984) Godfrey (1986) and IMF Surveys.
- 3 A full description of the methodology and of some of the restricting assumptions is given in Appendix II.
- 4 In the usual publications giving details on savings and investments, domestic savings and gross fixed capital formation are not split into private and public. For this analysis we thought this to be necessary and made the following adjustment. From other sources figures on public gross capital formation is available and we have deducted this from total gross fixed capital formation in order to arrive at private gross fixed capital formation. We have consequently defined public savings as revenue minus the current expenditure, in contradiction to various publications where public savings or dissavings are defined as the cash deficit reflecting current revenue minus current expenditure and public investment combined.
- 5 Because of the excess of savings changes in stocks were considerable but gross capital formation still increased by more than 17 per cent.
- 6 Since the definitions are not equal to that of table 19 we have included again here the various price indices to allow for comparison.
- 7 Some 'increases' in output might also be the consequence of increased smuggling from Uganda and Tanzania as relative prices changed in the region.
- 8 Preliminary results of a model simulation exercise, evaluating effects of changes in domestic policies towards small-scale agriculture and in provision of basic services and the effects of consequences of

increased foreign exchange inflows show that domestic policies can have as powerful effects as changes in the external scenario (Appendix I). Furthermore, changes in domestic policies and external changes both resulted in increased growth and in reducing poverty, although the effect of the domestic policy is much more powerful. An experiment of combining domestic policy changes of the type described above and a scenario of increasing foreign exchange showed that policy changes and external scenarios reinforced each other.

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TABLE 1: KENYA'S DEVELOPMENT EXPERIENCE COMPARED TO SUB-SAHARAN AFRICA'S EXPERIENCE

	GDP per capita 1984	Per capita GDP growth 1965-84	GDP growth, 1973-83			
			Overall	Agriculture	Industry	Services
Kenya	300	2.3	4.6	3.4	5.3	5.3
Sub-Saharan Africa ¹	420	1.8	2.1	2.9	1.4	3.5
Low income ¹	200	...	2.1	1.5	1.6	2.4
Middle income oil importer ¹	620	1.2	3.0	2.4	1.0	3.3

	% increase exports 1973-83	% increase imports 1973-83	Debt service % GNP 1983	Debt service % exports 1983	Annual inflation rate, 1973-83
Kenya	-4.8	-4.6	6.1	22.9	10.8
Sub-Saharan Africa	-5.0	+3.3	4.2	18.1	14.8
Low income	-3.8	-2.1	2.8	15.1	18.5
Middle income oil importer	-0.8	-1.9	7.0	15.0	10.8

	% growth in food production 1973-83	% growth agricultural production 1973-83	Population growth 1983	Crude birth rate 1983	Crude death rate 1983	Public revenue % GDP 1983	Public account deficit 1985
Kenya	2.7	2.4	4.0	55	12	27.8	-8.4
Sub-Saharan Africa	1.2	1.0	2.9	47	17	14.4	-7.0
Low income	0.2	-0.2	2.8	47	18	11.5	-6.1
Middle income oil importer	3.4	2.5	3.5	47	15	29.3	-13.3

¹ Middle income oil importers: Mauritania, Liberia, Zambia, Lesotho, Côte d'Ivoire, Zimbabwe, Swaziland, Botswana, Mauritius. Low-income countries: All sub-Saharan African countries except middle income oil importers and middle income oil exporters (Nigeria, Cameroon, People's Republic of Congo, Gabon and Angola).

Source. World Bank 1986: Financing adjustment with growth in sub-Saharan Africa, 1986-1990 (Washington, D.C.).

Table 2. Characteristics of the Kenyan economy, 1964-84

Year	Share in total GDP of				Public consumption	Public gross fixed capital formation as per cent of total GFCF
	Agri-culture	Gross investment	Imports	Exports		
1964	42.0	13.1	26.4	32.1	13.6	25.3
1965	37.2	14.2	30.6	32.1	14.6	26.3
1966	39.9	18.1	30.5	33.0	13.5	32.0
1967	38.2	18.4	27.3	27.2	13.1	35.0
1968	36.1	19.6	27.7	27.8	15.0	37.1
1969	35.4	18.7	26.6	28.0	16.2	33.0
1970	34.8	23.7	29.1	28.3	16.1	30.6
1971	32.7	23.7	33.5	27.2	17.8	38.9
1972	33.8	22.6	28.7	26.6	17.6	38.5
1973	33.9	26.0	28.5	27.2	16.4	45.3
1974	33.9	25.7	40.7	33.5	17.0	45.2
1975	32.8	18.1	34.5	29.8	18.3	41.9
1976	36.5	20.2	31.8	32.5	17.5	42.2
1977	40.9	23.8	31.7	35.1	17.4	42.3
1978	35.5	19.8	38.7	29.0	19.5	37.7
1979	32.9	22.7	32.4	26.4	19.7	46.0
1980	30.8	30.0	40.0	28.6	20.3	45.2
1981	30.7	28.3	34.4	25.5	19.0	44.5
1982	30.8	22.4	29.5	24.8	19.0	45.0
1983	31.1	21.2	26.7	25.6	19.3	38.0
1984	29.7	22.6	30.8	28.3	19.9	37.7
1985	29.1	18.5	27.8	25.4	18.1	41.8

Source. Vandemoortele (1985).

Table 3. Imports by end use, 1964-84 (per cent of total)

Year	Intermediate consumption	Capital goods	Final consumption	of which: Private consumption	Public consumption
1964	57.9	15.1	27.0	24.0	3.0
1965	61.4	12.8	25.8	21.5	4.3
1966	56.6	16.2	27.2	21.2	6.0
1967	56.5	21.6	21.9	17.7	4.2
1968	58.4	17.6	24.0	19.6	4.4
1969	59.5	17.7	22.8	18.7	4.1
1970	57.7	19.4	22.9	18.8	4.1
1971	56.3	19.7	23.9	19.3	4.6
1972	55.3	22.5	22.2	17.7	4.5
1973	61.8	20.6	17.6	13.2	4.3
1974	72.2	13.3	14.5	10.0	4.5
1975	66.7	18.1	15.3	10.1	5.1
1976	63.1	19.0	17.9	12.1	5.9
1977	60.9	25.3	13.9	10.5	3.4
1978	55.5	29.3	15.2	10.1	5.1
1979	63.1	21.9	14.9	9.5	5.5
1980	69.8	15.4	14.8	9.0	5.8
1981	58.2	21.7	20.2	10.9	9.3
1982	61.5	22.1	16.5	9.7	6.7
1983	61.9	21.4	16.7	10.5	6.2
1984	64.3	21.5	14.2	9.8	4.4

Source. As table 2.

Table 4. Structure of commodity export earnings, 1964-85 (per cent of total)

Year	Coffee	Tea	Oil	Other
1964	32.7	13.0	4.7	49.6
1965	29.9	12.9	10.0	47.2
1966	32.3	14.9	10.1	42.7
1967	29.5	13.9	13.5	43.1
1968	22.1	17.3	10.9	49.7
1969	26.5	17.9	12.0	43.6
1970	31.1	17.7	11.5	39.7
1971	26.6	16.3	12.2	44.9
1972	27.4	18.1	9.8	44.7
1973	29.2	13.9	7.7	49.2
1974	23.6	11.9	16.1	48.4
1975	16.4	10.7	22.7	50.2
1976	29.3	10.0	18.1	42.6
1977	42.5	14.9	15.1	27.5
1978	33.7	17.1	16.3	32.9
1979	28.7	16.3	17.7	37.3
1980	22.2	11.9	31.1	34.8
1981	21.3	11.9	30.7	36.1
1982	26.5	14.2	26.0	33.3
1983	25.3	19.5	19.6	35.6
1984	27.0	25.1	17.4	30.5
1985	29.7	24.7	14.0	31.6

Source. As table 2.

¹ Unless the quota are lifted, as we will discuss in section 6.

Table 5: Export volumes by economic category (1976=100)

YEAR	FOOD	BEVER- AGES	CRUDE MATERIAL	FUELS	EDIBLE FATS & OILS	CHEMI CALS	MANU- FACTURED GOODS	EQUIP- MENT	MISC	ALL EXPORTS
1972	86	152	82	109	52	115	98	68	145	93
1973	101	191	92	112	86	141	119	116	174	109
1974	88	141	109	111	79	149	103	120	155	104
1975	86	94	98	102	69	105	101	97	130	94
1976	100	100	100	100	100	100	100	100	100	100
1977	116	155	85	107	25	85	74	53	78	104
1978	112	120	81	89	13	89	68	46	77	96
1979	115	129	93	80	18	75	66	41	81	94
1980	105	319	90	102	16	66	82	68	103	97
1981	117	192	89	77	19	65	66	45	93	92
1982	131	236	77	55	9	52	74	44	86	89
1983	138	366	78	47	14	48	61	22	65	85
1984	134	248	85	46	41	49	58	17	71	84
1985	149	545	89	38	18	55	57	19	89	88

Table 6. Level and structure of government revenue and expenditure, 1964-84 (per cent)

Year	Ratios of			Tax structure		Expenditure structure			
	Public revenue as per cent of GDP	Public expen- diture as per cent of GDP	Public deficit as per cent of GDP	Direct taxes as per cent of revenue	Indirect taxes as per cent of revenue	General expenditure	Interest Payments	Basic needs expenditure	Economic expenditure
						as per cent of total public expenditure			
1964	14.1	20.1	6.0	29.4	51.9	25.3	6.3	17.5	33.2
1965	16.3	22.5	6.2	29.8	48.1	25.0	6.1	17.3	31.6
1966	16.3	21.0	4.7	30.4	49.9	26.2	6.2	19.0	32.4
1967	17.9	22.0	4.1	31.3	45.6	25.7	5.7	19.6	34.6
1968	18.0	22.3	4.3	30.4	46.1	23.2	5.7	21.7	36.1
1969	19.4	24.1	4.7	33.1	44.4	22.7	5.4	26.0	33.9
1970	22.6	28.6	6.0	33.3	41.2	19.4	4.8	28.2	35.5
1971	23.5	30.0	6.5	33.9	41.8	22.1	4.8	31.1	34.5
1972	21.6	29.3	7.7	36.8	41.8	21.2	5.3	31.2	35.7
1973	23.9	29.0	5.1	30.8	53.6	21.0	5.2	31.0	35.8
1974	24.0	32.0	8.0	34.0	52.9	21.3	4.8	32.1	34.7
1975	25.5	35.3	9.8	33.5	51.4	25.1	5.2	29.6	33.3
1976	25.1	32.1	7.0	33.7	49.2	25.8	5.8	30.4	31.6
1977	28.9	36.1	7.2	30.3	54.4	29.1	5.4	25.8	32.4
1978	28.7	39.2	10.5	29.7	52.5	29.4	6.1	25.0	33.5
1979	30.9	39.6	8.7	28.4	55.9	30.6	6.1	28.1	27.9
1980	31.4	43.5	12.1	28.3	58.5	26.1	7.0	28.6	30.4
1981	29.6	43.5	13.9	26.4	62.2	26.8	10.6	27.5	27.6
1982	28.4	40.9	12.5	28.1	57.1	23.3	12.3	26.8	22.9
1983	27.4	37.5	10.1	27.6	59.9	24.3	14.0	26.8	24.8
1984	27.9	42.2	14.3	26.2	59.9	21.5	13.2	26.4	29.1
1985	-	-	-	27.9	56.4	21.6	14.9	29.8	24.8

Source. As table 2.

Table 7. Growth and composition of domestic credit, 1968-84
(per cent)

Year	Annual growth	Composition		
		Government	Other public	Private sector
1968	4.0	2.5	4.6	92.9
1969	6.7	4.3	3.1	92.6
1970	30.7	1.7	5.8	92.5
1971	35.1	5.3	7.1	87.6
1972	19.5	11.5	6.3	82.2
1973	27.9	12.4	6.1	81.5
1974	28.7	18.7	4.5	76.8
1975	29.1	27.5	4.7	67.8
1976	16.5	25.4	2.9	71.7
1977	23.8	19.4	2.8	77.8
1978	35.8	25.6	1.7	72.7
1979	14.2	25.4	1.7	72.9
1980	13.1	24.4	2.2	73.4
1981	26.9	34.5	1.7	63.8
1982	29.7	42.5	2.1	55.4
1983	0.0	33.6	4.5	61.9
1984	10.8	34.1	5.7	60.2
1985	12.9	30.4		69.5

Source. As table 2.

Table 8. Wage rate and wage employment by sector, 1964-84

Year	Real wage (K.sh/month) in 1976 prices			Wage employment ('000s)			Gini ratio
	Total	Private	Public	Total	Private	Public	
1964	710.4	593.8	960.4	575.4	393.4	182.0	0.60
1965	755.1	613.2	1 049.4	582.1	393.9	188.2	0.60
1966	811.5	670.6	1 081.3	585.4	385.0	200.4	0.60
1967	834.0	698.8	1 081.1	597.4	385.3	212.1	0.60
1968	871.6	743.3	1 093.9	606.4	384.5	221.9	0.61
1969	857.7	734.3	1 058.8	672.2	390.1	237.1	0.61
1970	868.3	745.8	1 063.1	644.5	397.0	247.5	0.60
1971	857.1	724.7	1 078.4	691.2	423.6	276.6	0.58
1972	827.9	704.9	1 009.8	719.8	432.8	287.0	0.56
1973	828.7	683.6	1 043.2	761.7	462.5	299.2	0.58
1974	782.0	669.7	937.9	826.3	496.2	330.1	0.55
1975	754.6	652.6	888.2	819.1	476.7	342.4	0.53
1976	842.0	729.0	975.0	857.5	501.0	356.5	0.50
1977	838.5	739.6	954.6	902.9	526.4	376.5	0.50
1978	823.6	726.0	936.8	911.6	521.6	390.0	0.49
1979	822.9	740.1	916.4	972.3	547.4	424.9	0.46
1980	845.6	817.4	874.6	1 005.7	534.0	471.7	0.49
1981	874.7	802.9	946.5	1 024.3	540.0	484.3	0.49
1982	728.0	684.3	769.2	1 046.0	540.4	505.6	0.50
1983	700.5	651.0	747.6	1 093.3	565.5	527.8	0.50
1984	660.3	620.9	696.7	1 119.7	578.2	541.5	0.51
1985	644.5	611.5	673.4	1 174.4	599.8	574.6	n.a.

Source. As table 2.

Table 9. Balance of payments deficit, external shocks and domestic policy actions (1979-1985)

(All variables represent one year changes as per cent of national income)

	79-80	80-81	81-82	82-83	83-84	84-85
Change in BoP deficit as % of GDP	+5.0	-2.4	-3.4	-4.8	+1.3	+0.7
-Total external effects of which:	+5.4	+5.2	+3.7	-3.0	-3.0	+7.4
Terms of trade effect	+4.2	+4.8	+1.6	-1.5	-0.8	+5.7
Interest rate	-1.0	-0.6	+0.9	-2.0	+0.4	+1.2
World trade	+2.2	+1.0	+1.2	+0.5	-2.6	+0.5
-Increased debt burden	+0.6	+0.9	+1.4	+0.8	+0.9	+0.1
-Export penetration	+0.8	+3.8	-0.6	+1.2	+3.9	-1.7
-Total domestic policies of which:	-0.8	-11.9	-7.4	-4.1	+0.2	-5.0
Domestic consumption	-0.6	-0.4	+0.1	-0.0	+0.2	+0.2
Domestic investment	+1.8	-0.5	-2.2	-0.6	+1.4	-1.2
Domestic intermediate products	+0.5	+0.5	+0.7	-0.6	+1.3	+1.5
Import ratio consumption	+1.1	-1.0	-2.9	-0.6	-0.1	-1.4
Import ratio investment	-4.5	-0.4	+0.7	-0.4	-1.5	-0.1
Import ratio intermediate products	+0.9	-10.1	-3.8	-1.9	-1.1	-4.0
-Residual (and second order terms)	-1.0	-0.4	-0.5	+0.3	-0.7	-0.1

Note. For all variables a positive sign indicates a contribution to an increase in the balance of payments deficit and a negative sign a contribution to a decrease of the balance of payments deficit.

See Appendix II for a full description of the methodology of the data sources and of the definitions used. The latter may differ slightly from definitions applied in other tables in this paper.

Source. Based upon national accounts, economic survey and balance of payments statistics.

Table 10. Exchange and interest rates, nominal and real, 1979-85

	1979	1980	1981	1982	1983	1984	1985
Exchange rate							
Shillings per SDR	9.66	9.66	10.62	12.05	14.22	14.70	16.46
Shilling per US\$	7.47	7.42	9.05	10.9	13.3	14.4	16.43
Real effective exchange rate							
SDR per shilling	100	101	94	84	76	79	71
US\$ per shilling	100	102	84	72	63	63	54
Discount rate for							
Treasury bills	7.00	8.00	11.25	13.75	15.00	12.50	14.14
Real rate	-0.79	-5.70	-0.55	-6.55	+3.50	+2.40	+1.5

Note. Exchange rate: period average.
 Real Effective exchange rate: calculated by adjusting the SDR value and the US\$ value per shilling to GDP deflator of industrial countries and the Kenya GDP deflator.
 Real interest rate: discount rate for Treasury bills deflated with average consumer price index.

Source. IMF: International Financial Statistics Yearbook, 1986.
 Government of Kenya: Economic Survey, various issues.

Table 11. Factors contributing to changes in international reserves, 1979-85 (Kf million, current prices)

Year	Monetary movement of BoP (increase in international reserves)	Current account deficit			Capital flows
			(of which net investment income abroad (%))		
1979	+70.6	-178.30	-49.20	27.5	250.91
1980	-72.2	-328.70	-75.50	22.9	252.80
1981	-99.1	-326.20	-88.70	27.2	225.00
1982	-104.82	-260.50	-129.25	49.6	152.96
1983	+68.20	-88.89	-120.00	134.9	158.08
1984	+39.04	-128.26	-143.71	112.0	167.93
1985	-86.25	-169.31	-168.82	99.7	85.94

Source. Calculated from Government of Kenya: Economic Survey, various issues.

Table 12. Factors contributing to changes in money supply, 1979-85
(Kf million, current prices)

Year	Changes in money supply	Increase in international reserves ¹	Change in credit	of which to:		
				Private sector	Government	Public enterprise
1979	151.12	+72.96	+78.16	+43.68	+10.67	+23.81
1980	21.99	-66.17	+88.16	+99.22	+9.84	-20.90
1981	90.72	-98.21	+191.96	+66.33	+127.94	-2.31
1982	167.50	-115.97	+283.48	+66.57	190.21	+26.70
1983	90.61	+89.62	+0.99	+50.15	-92.65	+42.50
1984	167.00	+31.51	+135.49	+78.20	+44.52	+12.77
1985	91.75	-88.40	+180.15	+123.48	+42.48	+14.19

¹ because of "errors and omissions" this column differs slightly from column 1 in table 11.

Source. As table 11.

Table 13. Savings and investment balance, 1979-85
(Kf million at current prices)

Year	Private sector savings (a)	Private sector GCF (b)	Public sector GCF (c)	Public savings (d)	Public deficit (e)	Net borrowing from abroad (f)	Grants (g)
1979	108.29	267.51	248.74	214.26	34.48	178.30	15.40
1980	197.78	507.64	281.56	240.82	40.74	328.70	21.90
1981	314.38	536.35	322.46	196.83	125.63	326.90	20.70
1982	394.51	463.68	300.85	83.94	216.91	260.50	25.50
1983	337.50	536.19	274.16	324.31	-50.15	88.89	59.80
1984	416.10	565.60	363.34	306.05	57.29	128.26	78.53
1985	320.04	527.74	354.83	298.16	56.67	179.79	84.58

Private sector savings: $a = b + e - f - g$.

Public deficit: $e = d - c$.

Source. As table 11.

Table 14. Some important ratios

	1979	1980	1981	1982	1983	1984	1985
CCF/GDP	26.1	35.3	33.1	26.3	24.4	25.1	19.2
Domestic savings rate	16.2	19.6	21.8	16.4	19.8	19.5	13.4
Private	5.4	8.8	12.2	13.5	10.1	11.2	6.9
Public	10.8	10.7	7.6	2.8	9.7	8.3	6.5
Foreign savings rate	9.0	14.7	12.6	8.9	2.6	3.5	3.9
ICOR one year lagged	...	7.9	6.4	18.3	7.5	27.1	4.6
Per cent imports in:							
Consumer goods	6.3	7.4	6.5	4.1	3.6	3.5	2.6
Investment goods	35.6	22.5	21.4	23.6	22.1	17.9	17.5
Intermediate goods	22.5	23.3	15.7	13.1	11.8	11.1	9.1

Source. Tables 13 and 16, and Appendix II.

Table 15. Index of factor remuneration, 1979-85 (1979 = 100)

	1979	1980	1981	1982	1983	1984	1985
Traditional economy	100	111	127	138	165	191	215
Operating surplus	100	110	125	143	166	178	202
Agricultural	100	105	122	142	163	171	191
Non-agricultural	100	118	130	146	171	189	220
Rental surplus	100	119	148	161	177	193	207
Remuneration of employees of which:	100	117	137	152	171	191	216
Agriculture	100	116	131	130	143	154	159
Non-agriculture	100	117	138	154	178	210	229
Private households	100	130	132	151	164	207	243
Government	100	115	136	154	168	187	211
GDP	100	133	131	147	168	187	209

Source. Table A.1.

Table 16. Real annual growth of GDP in selected sectors of the economy, 1979-80 to 1984-85

Sector	% GDP 1984	Real GDP growth rates					
		1979- 1980	1980- 1981	1981- 1982	1982- 1983	1983- 1984	1984- 1985
Traditional economy	(6.2)	3.6	3.5	3.3	3.6	3.3	4.0
Agriculture	(29.7)	-1.3	6.2	4.6	4.2	-3.7	3.5
Manufacturing	(12.6)	5.7	5.0	2.3	4.5	4.3	4.5
Construction	(4.1)	6.4	8.2	-11.8	-8.8	-6.8	1.1
Trade, hotels and restaurants	(11.5)	3.5	0.7	-7.2	2.8	4.0	8.1
Government services	(14.5)	5.6	5.3	3.8	4.2	2.9	4.5
Total economy		3.3	5.5	1.8	3.5	0.9	4.1
GDP per capita		-0.4	+1.7	-2.1	-0.7	-3.1	0.2

Source. As table 11.

Table 17. Employment and real wages in selected sectors, 1979-85

(Employment in 000s, earnings in Kf per annum)

	1979	1980	1981	1982	1983	1984	1985
<u>Agriculture</u>							
Employment	254.6	231.4	235.5	223.8	231.1	235.7	240.9
(% increase)		-10.1	1.8	-5.0	+3.3	+2.0	+2.2
Average wagebill deflated by sectoral GDP deflator	201	197	202	192	189	188	191
Average wagebill deflated by CPI	172	163	156	140	135	132	127
<u>Manufacturing</u>							
Employment	138.4	141.3	146.3	146.8	148.8	153.1	158.8
(% increase)		+2.1	+3.5	0.3	1.4	2.9	+3.7
Average wagebill deflated by sectoral GDP deflator	529	542	539	544	561	580	569
Average wagebill deflated by CPI	452	470	450	430	418	414	394
<u>Construction</u>							
Employment	61.30	53.2	61.3	60.4	60.2	49.2	49.9
(% increase)		3.1	-3.0	-1.5	-0.3	-18.3	+1.4
Average wagebill deflated by sectoral GDP deflator	423	356	409	327	283	278	323
Average wagebill deflated by CPI	408	371	391	336	328	332	313
<u>Trade and tourism</u>							
Employment	68.70	70.50	72.6	74.9	80.3	84.8	89.7
(% increase)		+2.6	13.0	+3.2	+7.2	+5.6	+5.7
Average wagebill deflated by sectoral GDP deflator	580	706	702	651	567	510	550
Average wagebill deflated by CPI	580	635	605	540	520	516	487
<u>Government services</u>							
Employment	255.1	296.2	303.4	327.5	345.8	356.5	386.7
(% increase)		16.1	+2.4	+7.9	+5.6	+3.1	+6.9
Average wagebill deflated by sectoral GDP deflator	411	363	400	366	362	319	333
Average wagebill deflated by CPI	374	324	343	295	274	243	232

Source. As table 11.

Table 18. Real average wages, real average wage costs, real wage bill and real GDP in 1984 as a fraction of value in 1979

Sector	Average real wage costs	Employment	Real wage bill	Real GDP
Agriculture	0.93	0.92	0.86	1.09
Manufacturing	1.10	1.11	1.21	1.21
Construction	0.65	0.80	0.52	0.87
Trade and hotels	0.79	1.23	0.97	1.09
Government	0.77	1.39	1.08	1.18

Table 19. Agricultural price indices (1976 = 100)

	1979	1980	1981	1982	1983	1984	1985
Total crops	116.4	122.3	129.7	138.0	161.5	193.3	235.7
Domestic	115.9	130.7	141.3	147.8	204.2	213.4	267.8
Exports	116.8	117.4	112.3	134.6	145.2	186.0	198.3
Livestock	135.6	140.6	151.3	166.7	163.0	191.9	182.5
Average of crops and livestock	120.0	126.2	134.4	145.0	168.1	196.8	217.8
Output price index	123.1	133.1	145.8	159.5	172.2	189.2	207.4
Purchased inputs	124.5	139.9	153.3	182.1	188.5	193.0	208.7
Index of consumer goods	130.1	146.1	169.9	205.5	233.9	258.6	285.0
Average of inputs and consumer goods	128.7	144.1	165.8	199.7	221.0	238.8	261.2
Agricultural terms of trade	95.6	92.4	87.9	80.0	78.0	80.0	80.0

Source. As table 11.

Table 20. Indices of volumes and prices of sales to marketing boards and of prices for major groups of crops (1976 = 100)

	1979	1980	1981	1982	1983	1984	1985
<u>Sales</u>							
Cereals	68.9	68.7	92.2	106.4	112.5	88.7	98.8
Temporary							
industrial crop	153.3	192.2	194.8	176.4	168.6	184.9	178.2
Permanent crop	108.8	121.1	121.2	121.5	141.4	152.9	153.3
All	104.1	115.3	121.9	123.2	137.2	142.0	145.2
<u>Prices</u>							
Cereals	112.6	130.5	134.4	143.2	185.9	207.1	266.4
Temporary							
industrial crops	141.8	147.4	166.1	186.2	187.5	189.6	204.2
Permanent crops	118.7	119.4	110.6	125.5	148.1	239.1	198.3
All	120.5	124.5	120.0	134.4	175.5	266.7	231.0

Source. As table 11.

Table 21. Quantum and price indices of exports (1976 = 100)

	1979	1980	1981	1982	1983	1984	1985
<u>Quantum index</u>							
Food and livestock	115	105	117	131	138	134	150
Beverages and tobacco	129	319	192	236	366	148	326
Crude materials	93	90	89	77	78	85	90
Mineral fuels	80	102	77	55	47	46	38
Animal and vegetable oils	18	16	19	9	14	41	18
Chemicals	75	66	65	52	48	49	55
Manufactured goods	66	82	66	74	61	58	57
Machinery and transport	41	68	45	44	24	17	20
All exports	94	97	92	89	85	85	88
All non-oil exports	97	95	97	103	103	101	111
<u>Price index</u>							
Food and livestock	117	124	123	130	206	217	201
Beverages and tobacco	108	107	117	119	129	157	174
Crude materials	127	177	192	201	215	215	235
Mineral fuels	145	223	307	381	408	427	435
Animal and vegetable oils	135	149	176	221	254	281	314
Chemicals	134	139	147	193	232	241	258
Manufactured goods	149	147	166	183	225	234	281
Machinery and transport	144	144	157	181	324	404	377
All exports	128	154	170	186	223	277	273
All non-oil exports	124	135	138	149	185	229	225
<u>Memorandum item</u>							
Quantum index imports:							
All	116	133	104	88	69	80	74
Non-oil	118	136	104	89	64	81	72
Price index imports:							
All	132	173	220	254	356	363	430
Non-oil	132	157	186	210	294	300	363
Terms of trade:							
All	97	89	77	73	68	80	67
Non-oil	94	86	74	71	62	77	62

Source. As table 11.

Table 22. Increases in various prices and money supply

Year	Increase in CPI	Increase GDP deflator	Increase in supply of money and quasi- money	Import prices * share of of import in GDP	Increase in wages (pw)	Increase in in price of import prices (pi)	Increase in price of operating surplus (ps)
79-80	11.1	9.5	1.2	5.2	14.7	31.0	1.4
80-81	16.3	10.3	13.3	12.4	16.6	27.2	12.0
81-82	15.8	9.2	16.1	9.2	6.8	15.4	22.2
83-84	10.6	12.7	12.9	10.7	9.5	2.1	14.4
84-85	13.0	5.7	6.6	0.6	8.2	18.4	14.3

APPENDIX I

A comparison of effects of changes in domestic policies and of external conditions on growth and poverty by means of a long-term simulation model

A long-term simulation model, (van der Hoeven, 1987) showed the following results on GDP and on poverty by applying a scenario of domestic basic needs policies and an increased external resources scenario.

Basic needs scenario:

- increase in taxation of corporate tax by 25 per cent
- increase in taxes for richest rural group (about 1 per cent of the population having 25 per cent of income) by 12.5 per cent and of richest urban group (2.5 per cent of population with 20 per cent of total urban income) by 20 per cent
- shift in government expenditure towards basic needs augmenting it by 10 per cent
- decrease in urban-rural terms of trade by 10 per cent
- land redistribution of 7 per cent of land of large-scale farmers

External scenario:

- increase in non-agricultural export growth by 33 per cent
- increased capital inflows of 25 per cent of GDP
- increased foreign aid of 1.25 per cent of GDP

Combining the scenarios gives the results for a five-year simulation (1985-90), (see Table A) where figures indicate percentage deviation from the current policies and existing external conditions.

We notice that easing the foreign exchange constraint combined with increased export demand and stepping up public

consumption combined with improved agricultural performance have different effects over a cumulated period of five years. Domestic policies would seem to have more impact on poverty alleviation than relying only on lifting the foreign exchange constraint, while the latter improves GDP performance but hardly decreases poverty. A combination of changes in policies and external scenarios would reinforce both positive aspects.

APPENDIX II
Decomposition of changes in current account
deficits in Kenya

In order to measure the exogenous shocks and the domestic policy reactions to the current account deficit a decomposition analysis has been applied which followed in broad lines the methodology developed by Bacha in the annex to Balance of payments experience and growth prospects of developing countries - Methodological note (UNDP/UNCTAD, 14 May 1985; INT 84/021).

In order to have the most recent estimates and to allow for a greater decomposition on the import side all data, unlike similar studies, have been collected from national sources and not from the IMF's International financial statistics or the World Bank's World tables.

Because of this we could only consider the effect of imports of goods and services, exports of goods and services and factor payments on the balance of payments. The omission of workers' remittances and transfer payments did not affect the results to a large extent, especially since we are dealing with changes in BoP deficits.

We have the following relations.

- (1) $D(t) = M(t) + V(t) - E(t)$
- (2) $M(t) = M_1(t) + M_2(t) + M_3(t)$
- (3) $M_1(t) = P_m(t) MR_1(t)$
- (4) $MR_1(t) = m_1(t) CR(t)$
- (5) $MR_2(t) = m_2(t) INVR(t)$
- (6) $MR_3(t) = m_3(t) INTPRD(t)$
- (7) $E(t) = P_x(t) ER(t)$
- (8) $ER(t) = x(t) W(t)$
- (9) $V(t) = r(t) F(t-1)$

Equation (1) describes the balance of payments deficit (D) as the difference between imports (M) and net factor payments abroad (V) and exports (E).

Equation (2) splits imports (M) into imports of consumer goods (M_1), imports of capital goods (M_2), and imports of intermediate products (M_3).

Equation (3) describes the value of imports of each category as the product of prices (Pm) and of volume (MR_1). Ideally different prices for the three import categories should be distinguished but information for this was difficult to come by and would make the decomposition unnecessarily cumbersome.

Equations (4), (5) and (6) explain real imports of consumer goods (MR_1) as a fraction of real private and public consumption (CR), real imports of investment goods (MR_2) as a fraction of real gross investment (INVR) and real import of intermediate products (MR_3) as a fraction of real intermediate products (INTPRD).

Equation (7) describes exports (E) split by price (Px) and volume effects (ER), while equation (8) explains real exports as a fraction of the volume of world trade.

Equation (9) describes net factor payments abroad as a simple fraction of the total foreign debt of the previous period. It was not possible to decompose this further, and we have implicitly assumed that changes in the ratio (r) are the consequence of the change in the interest rate (and thus implicitly assuming that other conditions of loans remained the same and that a constant ratio exists between remitted profits and the foreign debt). This should be kept in mind when interpreting the figures.

Substitution of (2) to (9) into (1) and dividing through GNP in current prices gives the following results:

$$\begin{aligned}
 (10) \quad D(t)/Y(t) &= m_1(t) pm(t) (CR(t)/Z(t)) \\
 &\quad + m_2(t) pm(t) (INVR(t)/Z(t)) \\
 &\quad + m_3(t) pm(t) (INTPRO(t)/Z(t)) \\
 &\quad + r(t) (F(t-1)/Y(t-1)) \\
 &\quad - x(t) px(t) (W(t)/Z(t))
 \end{aligned}$$

$$\text{with } Y(t) = py(t) Z(t)$$

$$\text{and } pm(t) = Pm(t)/py(t)$$

$$px(t) = Px(t)/py(t)$$

where $py(t)$ is the GNP deflator and $pm(t)$ and $px(t)$ represent import and export prices expressed as multiples of domestic prices.

By taking first differences of equation (10) we arrive at the final formula expressing the various elements of the decomposition.

$$\begin{aligned}
 (11) \quad d(D(t)/Y(t)) &= m_1(s) (CR(s)/Z(s)) d pm(t) \\
 &\quad + m_2(s) (INVR(s)/Z(s)) d pm(t) \\
 &\quad + m_3(s) (INTPRO(s)/Z(s)) d pm(t) \\
 &\quad - (ER(s)/Z(s)) d px(t) \\
 &\quad - x(s) px(s) d (W(t)/Z(t)) \\
 &\quad + (F(s-1)/Y(s-1)) dr(t) \\
 &\quad + r(s) d (F(t-1)/Y(t-1)) \\
 &\quad - px(s) (W(s)/Z(s)) dx(t) \\
 &\quad + m_1(s) pm(s) d(CR(t)/Z(t)) \\
 &\quad + m_2(s) pm(s) d(INCR(t)/Z(t)) \\
 &\quad + m_3(s) pm(s) d(INTPRD(t)/Z(t)) \\
 &\quad + pm(s) (CR(s)/Z(s)) d m_1(t) \\
 &\quad + pm(s) (INVR(s)/Z(s)) d m_2(t) \\
 &\quad + pm(s) (INTPR(s)/Z(s)) d m_3(t) \\
 &\quad + \text{second and higher order terms.}
 \end{aligned}$$

The symbol d before a variable indicates the yearly change from 1979 to 1985 in the particular variable while the symbol s between the brackets indicates the year for the weights of the decomposition term. Changes have been

calculated both for s being the past year (t-1) as well as for s being the current year (t). For all years the latter weighting system resulted in lower residual terms and has thus been applied throughout.

The interpretation of the decomposition is as follows:

Change in the current account deficit ratio to GNP

- = terms of trade deterioration (first four terms)
- + retardation in world trade growth
- + interest rate changes on debt
- + effects of increased debt burden
- + increase in world trade share
- + changes in consumption coefficient
- + changes in investment coefficient
- + changes in intermediate product coefficient
- + changes in import coefficient consumer goods
- + changes in import coefficient investment goods
- + changes in import coefficient intermediate products

Source of data

All data have been taken from various issues of the Economic Survey and the Statistical Abstracts both published annually. In case of conflicting values most recent values have been chosen (unless representing clear misprints).

- M_1 = import of consumer goods in current prices
- M_2 = import of capital goods in current prices
- M_3 = import of intermediate goods in current prices
- M = total imports (in cases when the above three import categories did not sum up to total imports in the national accounts, the categories have been adjusted)
- E = exports of goods and services at current prices
- V = net factor payments abroad in current prices

D	=	balance of payments deficit calculated according to equation (1)
Pm	=	index of import prices (1976 = 100)
Px	=	index of export prices (1976 = 100)
MR _i	=	real imports calculated according to (3)
INVR	=	gross investment expressed in 1976 prices
INTPRD	=	intermediate deliveries in current prices deflated with 1976 GNP deflator
m _i (t)	=	various import coefficients calculated according to (4), (5) and (6)
ER(t)	=	real exports in 1976 value calculated according to (7)
W(t)	=	index of volume of world trade from GATT Annual Report
x(t)	=	market share in exports in 1976 values calculated according to (8)
F(t)	=	foreign debt in current prices
r(t)	=	coefficient of factor payments calculated according to (9)
Y(t)	=	GNP in current prices
Z(t)	=	GNP in constant 1976 prices
py(t)	=	GNP deflator

TABLE A: RESULTS FOR 5-YEAR SIMULATION (1985-90)

	Existing external conditions		External scenario	
Current policies	-		Change in GDP	+4.1%
	-		% of total population moving out of poverty	+0.2%
Basic needs scenario	Change in GDP	+0.7%	Change in GDP	+6.0%
	% of total population moving out of poverty	+5.7%	% of total population moving out of poverty	+6.1%

Table A.1. Factor incomes: Kenya, 1979-85
(Kf million at current prices)

	1979	1980	1981	1982	1983	1984	1985
Factor incomes							
A. Traditional economy	118.96	131.67	150.77	164.58	196.83	227.48	256.20
B. Operating surplus	965.53	1 064.42	1 206.08	1 380.68	1 604.98	1 721.09	1 952.40
of which:							
Agriculture	585.41	616.27	713.52	830.80	955.24	1 000.34	1 115.65
Non-agriculture	380.12	448.15	492.6	549.88	649.74	718.75	836.75
C. Rental surplus	87.20	103.41	127.42	140.69	154.24	168.19	180.82
D. Remuneration of employees	803.20	935.87	1 097.78	1 224.73	1 370.56	1 537.78	1 736.78
of which:							
Agriculture	77.78	90.21	101.76	105.78	111.22	119.80	123.50
Other enterprises	420.61	492.24	581.27	649.01	749.37	884.38	963.42
Private households	21.72	28.15	28.62	32.75	35.71	44.89	52.80
Government sector	283.09	325.17	386.13	437.19	474.26	528.71	597.06
GDP at market prices	1 974.87	2 235.37	2 582.05	2 2910.68	3 326.61	3 694.54	4 126.20

Source. Government of Kenya: Economic Survey, various issues.

Table A.2. Functional distribution of income: Kenya, 1979-85
(per cent)

	1979	1980	1981	1982	1983	1984	1985
Factor incomes							
A. Traditional economy	6.0	5.9	5.8	5.7	5.9	6.1	6.2
B. Operating surplus	48.9	47.6	46.7	47.4	48.3	46.8	47.3
of which:							
Agriculture	29.6	27.5	27.6	28.5	28.7	27.0	27.0
Other	19.3	20.1	19.1	18.9	19.6	19.8	20.3
C. Rental surplus	4.4	4.6	4.9	4.8	4.6	4.5	4.4
D. Remuneration of employees							
of which:	40.7	41.9	42.5	42.0	41.2	42.5	42.1
Agriculture	3.9	4.0	3.9	3.6	3.3	3.2	3.0
Other enterprises	21.3	22.0	22.6	22.3	22.5	23.9	23.3
Private households	1.0	1.3	1.1	1.1	1.2	1.2	1.3
Government services	14.3	14.5	14.9	15.0	14.2	14.2	14.5

Source. Table A.1.

Table A.3. Various GDP deflators and prices indices (1976 = 100)

	1979	1980	1981	1982	1983	1984	1985
GDP deflator	128.3	140.5	155.0	169.2	182.8	206.0	217.8
Traditional economy	152.9	162.3	181.4	191.4	216.7	245.2	267.4
Agriculture	122.6	131.8	142.8	156.7	171.0	186.5	199.2
Manufacturing	124.0	138.5	155.1	170.3	178.6	189.6	208.2
Construction	138.5	166.4	177.0	199.6	278.8	318.3	290.7
Trade and tourism	129.2	143.9	160.1	178.1	220.4	269.2	266.2
Government services	130.8	142.4	159.0	172.9	181.1	202.1	210.2
<u>Consumer price index¹</u>							
Low income	143.8	159.9	186.0	215.5	240.5	266.2	300.8
Middle income	129.1	143.2	169.5	205.5	233.9	258.6	287.3
High income	131.1	148.3	172.4	203.7	231.1	251.1	271.2
<u>Annual % increase</u>							
Consumer prices index							
Low income		11.1	16.3	15.8	11.6	10.6	13.0
Middle income		10.9	18.3	21.2	13.8	10.3	11.1
High income		13.1	16.2	18.2	13.5	8.8	8.0

¹ The CPI is re-indexed to 1976, while mid-year values have also been calculated (rather than the end of year values usually published) in order to make the CPI more comparable to the various GDP deflators.

Source. Calculated from various issues of Government of Kenya: Statistical Abstract and Economic Survey.

Table A.4. Per cent share of investment in some major sectors of the economy, 1979-84

Sector	1979	1980	1981	1982	1983	1984	1985
Traditional economy	7.3	7.0	7.0	8.1	9.2	9.3	10.1
Agriculture	7.8	7.5	7.5	7.7	7.7	6.8	7.9
Forestry	0.1	0.2	0.1	0.0	0.0	0.0	0.0
Mining	0.7	0.8	0.7	0.6	0.7	0.9	0.5
Manufacturing	16.4	12.4	12.2	9.9	15.5	11.9	11.8
Construction	4.8	5.4	4.5	4.3	8.3	7.9	3.8
Trade and tourism	3.2	4.5	3.0	3.6	4.1	3.7	4.7
Transport	18.8	16.5	15.7	15.2	15.4	15.7	13.8
Ownership of dwelling	10.2	10.1	9.7	10.9	6.7	6.2	7.1
Electricity	5.9	6.6	9.0	11.3	7.9	5.5	5.9
Finance	1.5	1.6	3.3	1.4	2.3	2.2	2.0
Other services	5.9	6.6	6.8	7.9	8.1	7.0	10.0
Government	17.3	20.7	20.5	18.9	17.6	22.6	22.2

Table A.5. Investment/GDP ratios in current and constant (1976) prices, 1979-84

Sector	1979	1980	1981	1982	1983	1984	1985
<u>Current prices</u>							
Agriculture	6.5	6.8	6.9	5.6	5.3	5.3	5.6
Manufacturing	35.4	26.0	26.9	17.7	27.3	21.5	19.3
Construction	31.2	31.7	27.1	23.9	38.6	40.2	21.3
Trade and tourism	8.0	11.5	7.8	8.0	7.7	6.3	7.6
Government	32.4	38.6	37.9	28.7	21.4	35.7	31.3
Total	27.4	27.8	37.9	28.7	21.4	35.7	20.6
<u>Constant prices</u>							
Agriculture	5.9	6.0	6.5	5.6	4.6	4.6	4.9
Manufacturing	31.0	23.1	29.5	17.7	20.7	16.9	15.1
Construction	30.3	33.7	29.4	23.9	38.0	43.9	19.9
Trade and tourism	7.8	10.5	7.9	8.0	7.7	7.1	7.9
Government	30.9	35.7	39.8	28.7	19.1	29.8	26.3
Total	24.9	24.8	29.5	22.9	19.2	20.3	18.2