FOR AGENDA

EBD/89/123

April 26, 1989

To: Members of the Executive Board

From: The Secretary

Subject: Kenya - Enhanced Structural Adjustment Facility - Policy Framework Paper for 1989-91

Attached for consideration by the Executive Directors is the policy framework paper under the enhanced structural adjustment facility for Kenya which, together with the staff report for the 1989 Article IV consultation with Kenya and its request for arrangements under the enhanced structural adjustment facility (EBS/89/84, 4/27/89) will be brought to the agenda for discussion on a date to be announced.

Mr. Ballali (ext. 6939) or Ms. Calika (ext. 6948) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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Department Heads

INTERNATIONAL MONETARY FUND

KENYA

Enhanced Structural Adjustment Facility

Policy Framework Paper for 1989-91 1/

Prepared by the Kenyan authorities in collaboration with the staffs of the Fund and the World Bank

April 25, 1989

I. Introduction

1. During the first half of the 1980s Kenya successfully implemented a stabilization program and a comprehensive structural adjustment program supported by the IMF and the World Bank. In 1986 there was a sharp improvement in Kenya's terms of trade, accompanied by extremely good weather conditions. These factors, combined with continuing flexible exchange rate policy, contributed in 1986 to the decline in the external current account deficit and a significant increase in foreign exchange reserves. Real GDP growth reached the highest rate in many years, and the inflation rate decelerated sharply. The financial policy stance, however, became more expansionary. The overall cash deficit of the Central Government in 1986/87 (July-June) rose to 7.6 percent of GDP from 5.4 percent in 1985/86 (excluding grants the deficit rose to 8.9 percent of GDP from 6.4 percent). Domestic credit and broad money expanded at a high rate, creating a liquidity overhang. The adverse impact of the expansionary financial policies was aggravated in 1987 by a significant deterioration in Kenya's terms of trade. The current account deficit widened to 6.0 percent of GDP, and the overall balance of payments reverted to a deficit. There was a major loss of foreign exchange reserves, and the import regime was tightened. The inflation rate accelerated and real GDP growth declined, reflecting in part less favorable weather conditions.

2. In view of the deterioration in financial and economic conditions, and in line with the objectives set out in the Government's 1986 Sessional Paper on Economic Management for Renewed Growth, the Government in late 1987 adopted a major stabilization and structural adjustment program. The overall objectives of the program were to revive prospects for accelerated growth and to provide productive employment for the rapidly growing labor force. The program was supported by an 18-month stand-by arrangement from the IMF, and a three-year arrangement under the Fund's structural adjustment facility, both of which became effective on February 1, 1988. The program was

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1/ This paper updates and extends the policy framework paper of January 7, 1988 (EBD/88/5).

also supported by IDA sectoral adjustment lending for the agricultural and industrial sectors, with cofinancing from other donors.

II. Performance Under the 1988 Adjustment Program

3. Under the structural adjustment program, the Government set out to improve the economy's growth performance, reduce the rate of inflation, and progressively narrow the current account deficit to a sustainable level. For 1988 the real GDP growth target was set at 5.1 percent, with inflation to be confined to 9 percent and the current account deficit to be reduced to 3.8 percent of GDP (7.0 percent excluding grants). To support the stabilization effort, the 1987/88 programmed budget provided for expenditure restraint and a reduction of the overall cash deficit to 4.2 percent of GDP (7.1 percent excluding grants). A tight monetary stance was also adopted to substantially reduce monetary expansion. The structural measures of the program included a phased introduction of structural reforms over the program period in agriculture, industry, government expenditure, the financial sector, and public enterprises.

4. Performance under the 1988 program was on the whole encouraging. The real GDP growth rate target was attained, owing to both favorable weather conditions and the impact of the agricultural structural measures introduced since 1986. The inflation rate of 10.4 percent, however, was higher than programmed, reflecting in part the Government's decision to move faster than programmed with the dismantling of official controls on prices. Financial policies pursued during 1988 were essentially as targeted. Thus in 1987/88 the overall cash deficit in the budget was confined to 4.0 percent of GDP (6.1 percent excluding grants). This favorable outcome was attained despite a shortfall in grants and was partly an outcome of delaying some cash outlays toward the end of the fiscal year and partly a result of better-than-programmed revenue performance. Expenditure commitments in 1987/88 rose more than anticipated owing to several factors, including the bringing forward of the general elections to March, underprovision for teachers' salaries, continuing debt payments related to the All African Games, expenditures related to the border conflict with Uganda, and the creation of four new ministries. The financing of the 1987/88 deficit was essentially as programmed, except that the domestic financing was entirely from nonbank sources and the Government's indebtedness to the banking system was slightly reduced. Reflecting the decline in bank borrowing by the Government, the expansion in broad money was confined to 4 percent in 1987/88, compared with 7.5 percent in the program and 21.5 percent the previous fiscal year. During the second half of 1988, the Government pursued a fiscal policy that was in line with the targeted fiscal deficit of 4.5 percent of GDP (6.9 percent of GDP excluding grants) for 1988/89. The Government continued to utilize during the second half of 1988 significantly less domestic resources than programmed to finance the deficit. This development, despite the greater-than-foreseen expansion of bank credit to the nongovernment sector, caused total outstanding domestic credit at end-1988 to be significantly less than

programmed and broad money to increase by only 8.3 percent in 1988, compared with 12.4 percent in 1987. As a result of the successful implementation of these policies, the existing liquidity overhang has been removed, and the stage has been set for a reduction of inflationary pressures in 1989.

5. On the external side, the exchange rate continued to be flexibly managed and was depreciated by almost 12 percent in real effective terms in the 18 months ending December 1988. The programmed limits on the contracting or guaranteeing of nonconcessional loans by the Government in 1988 were observed, and Kenya continued to meet its external debt service obligations on time. The current account deficit is estimated to have narrowed to 4.5 percent of GDP (7.8 percent excluding grants), compared with a program target of 3.8 percent of GDP (7.0 percent excluding grants). The impact of higher-than-anticipated oil export volume to neighboring countries and much lower oil import payments because of falling oil prices was more than offset by other factors. Progress in liberalizing the import system contributed to a significant increase in private non-oil imports while Government imports were also higher than projected. Meanwhile, the capital account surplus was above the level envisaged in the program. In these circumstances, the overall balance of payments was in deficit by an estimated SDR 43 million in 1988, slightly larger than the targeted deficit. Gross foreign reserves, which were targeted to rise by SDR 35 million, rose by SDR 20 million, facilitated by a purchase from the IMF in October 1988 equivalent to SDR 40 million under the compensatory window of the compensatory and contingency financing facility, based on a net shortfall in merchandise exports and cereal imports for the year ended April 1988.

6. Considerable progress was made in 1988 in implementing the program's structural measures. In particular, in the agricultural sector, production incentives were maintained by an annual review of grain producer prices and the continuing determination of producer prices for coffee and tea on the basis of auctions. Subsidization in consumer tea prices was eliminated. In order to reduce the fiscal burden of public sector grain marketing operations and to increase private sector participation in the system, the roles of participants in the system were defined, an organizational and financial reorganization of the National Cereals and Produce Board (NCPB) begun, and a food security plan is being developed. A fertilizer policy strategy was prepared for the long-term development of marketing and pricing arrangements. In the industrial sector, a program supported by an industrial sector adjustment credit (ISAC) from the World Bank was adopted in mid-1988. Under the program, to encourage manufacturing exports and investment, new import licensing schedules were introduced, the number of tariff categories was reduced, procedures were introduced to enhance manufacturing in bond, the effective rate of corporation tax was lowered, a one-stop investment center was established, the Foreign Investment Protection Act was amended, and the prices of 20 items under the General Order were decontrolled. Structural measures on the fiscal side included a sharp increase in 1988/89 of provisions for nonwage

operating expenditures in the recurrent account of selected ministries. In the financial sector, the band between the maximum lending rate and the minimum savings rate was widened, the Central Bank's rediscount facility was reactivated, the auction of treasury bonds was initiated, and work was begun on strengthening the Central Bank's supervisory capacity. The Capital Markets Development Advisory Council was established with strong participation from the private sector. The Council will prepare legislation to establish a Capital Markets Development Authority (CMDA).

III. Objectives and Policies for 1989-91

7. As indicated in Kenya's policy framework paper covering the period 1988-90, Kenya's development strategy for the remainder of this century is contained in the Government's 1986 Sessional Paper on Economic Management for Renewed Growth, which outlines policies to be followed to provide accelerated growth to ensure productive employment for a sharply increasing labor force. The paper stresses the dominant role of the private sector in revitalizing the economy and the need for the Government to establish market-based incentives to promote private sector activity. Emphasis is being placed on increased productivity in agriculture and in rural nonfarm activity, a dynamic informal sector, and the restructuring of industry to improve its export competitiveness.

8. During the period 1989-91, in line with the Sessional Paper, the Government's overall objective will be to provide a favorable and balanced macroeconomic environment by addressing adequately the structural problems constraining growth. In particular, the Government's policy aims at reducing the rate of inflation from 10.4 percent in 1988 to approximately the level of Kenya's trading partners by 1991, strengthening the balance of payments, and progressively reducing the current account deficit to a sustainable level (2.7 percent of GDP by 1991). In addition, the Government intends to implement sector-specific measures to ensure the attainment of a real GDP growth of about 5 percent per annum. Agricultural output, which grew by an average of 4.3 percent annually in 1986 and 1987, is expected to increase at about the same annual rate over 1988-91, owing to increased yields primarily on smallholdings. Manufacturing output, which increased by 5.7 percent annually during 1986 and 1987, is anticipated to increase by an average of 5.9 percent over 1988-91, reflecting the processing of agricultural products, a gradual recovery in manufacturing exports, and a revival of manufacturing investment. The gradual acceleration of overall growth is expected to come mainly from improvement in the efficiency of investment, particularly in the agricultural and industrial sectors, while the savings rate is expected to rise slowly during the program period. The behavior of exports will be strongly influenced by the prospects for coffee and tea. Export volume is expected to increase on average by about 5 percent annually in the 1989-91 period, with manufactured exports increasing by more than 6 percent annually in real terms.

9. In order to achieve these objectives, the Government intends to take action in a number of areas, including:

(a) reduction of the budget deficit, so that it is compatible with the sustainable level of foreign financing and noninflationary domestic financing, and will not crowd out the private sector;

(b) implementation of budget rationalization, so that efficient delivery of essential government services can be enhanced, in an environment of expenditure restraint;

(c) limitation of the use of new nonconcessional sources of external finance, together with increased mobilization of concessional finance from official sources;

(d) movement toward greater reliance on market forces in allocating financial resources to their most productive uses and the development of money and capital markets under a program to be supported by a financial sector adjustment credit from the World Bank and technical assistance from the IMF;

(e) reorientation of trade and other industrial incentives to encourage increased efficiency and promote the growth of manufactured exports, together with measures to encourage a revival of industrial investment;

(f) maintenance of an appropriate exchange rate policy, to support reforms in the trade regime, in order to encourage exports and allow an appropriate level of imports without the economic costs arising from administrative import allocation; and

(g) further improvement in farmer incentives, agricultural input supply, and agricultural services, particularly for smallholders.

Budgetary policies

10. The Government's objective of having the private sector play the dominant role in revitalizing Kenya's economy has implications for the share of available resources claimed by government expenditure. Whereas the Sessional Paper envisaged maintaining government expenditure at about 28 percent of GDP (the ratio achieved in 1984/85), total government expenditure has steadily increased to more than 30 percent of GDP in recent years, thus substantially widening the overall budgetary deficit.

11. The Government is determined to reduce the overall budgetary deficit to a level compatible with the available foreign financing and noninflationary domestic financing so as not to crowd out the private sector. The Central Government's overall cash deficit will be steadily reduced from 4.5 percent of GDP in 1988/89 (6.9 percent excluding grants) to 4.2 percent of GDP in 1989/90 (6.7 percent excluding grants)

and to a more sustainable level, presently estimated at about 3.2 percent of GDP, by 1991/92 (5.7 percent excluding grants). The Government aims at sharply reducing domestic financing of the deficit by 1991/92, with virtually all additional domestic bank credit being channeled to the private sector. In addition, the Government intends to monitor a broader public sector deficit (see paragraph 19 below).

12. To accomplish the central government deficit reduction objective, revenue collection will be increased from 23.2 percent of GDP in 1987/88 to 24.5 percent of GDP by 1991/92. In the 1988/89 budget, tax revenue has been increased by the introduction and revision of existing regulations on sales tax, excise tariffs, and passenger service charges, tariffs, and trade licensing. These measures are anticipated to increase revenue collection to 23.8 percent of GDP. Additional revenue measures, in taxation and user charges and fees, will be taken in the next three budgets to attain and maintain the revenue target. Regarding user charges, the Government envisages that a rising share of recurrent expenditures will be financed through user charges for health, education, and other public services. Substantial progress has already been made in agriculture (especially livestock) and transport (roads). In the 1989/90 budget, the Government intends to introduce user charges in health, in education, and in other sectors. Structural reforms in taxation policy will also be implemented to broaden the tax base and increase the elasticity of the tax system. The Government has decided to embark on a process to replace the sales tax with a value-added tax. The necessary studies are under way with technical assistance from bilateral sources, with a view to implementing this change commencing with the 1989/90 budget. The institutional capacity for tax policy analysis in the Treasury will also be strengthened, and computerization and other administrative improvements will be introduced in the Income Tax, Sales Tax, and Customs and Excise Departments.

13. On the expenditure side, the Government will reduce the share of available resources claimed by government expenditure, restructure the composition of expenditure to make it more efficient, and attempt to contain the problem of the float (unprocessed payment orders and unpresented checks). In order to enhance the expenditure rationalization effort, the Government will review the economic composition of expenditure (personnel expenditure; nonwage operating and maintenance expenditure; interest payments; expenditure on central government capital formation; and transfers to parastatals, local authorities, and nongovernmental organizations) in the Annual Estimates and Forward Budget processes, for programs (sub-votes), ministries, and the Central Government as a whole.

14. In order to help correct the prevailing imbalance between wage and nonwage current expenditure, the Government has introduced ceilings on salaries in the three-year Forward Budget. Between 1981 and 1987 employment in the Central Government and the Teachers' Service Commission (TSC) grew annually by 4.2 percent and 7.7 percent respectively, while the average wages in those sectors grew by an average annual rate

of 6.2 percent and 4.8 percent, respectively. Over the medium term (1989-91), increases of about 4 percent in average wages must be anticipated annually, in view of normal annual increments, promotions, and retirements, but excluding salary revisions for particular jobs where necessary to restore or maintain competitiveness with the private sector. In order to achieve its objective of correcting the imbalance between wage and nonwage expenditure not only in the Forward Budget plan but also in the adopted Annual Estimates, the Government will decelerate the growth of central government employment to 2 percent, and the growth of TSC employment to 5 percent, in 1989/90 (the final year of introduction of the new 8-4-4 education system, which has necessitated an exceptional increase in the employment of teachers). For the remainder of the three-year period, the growth of central government employment will continue to be contained at no more than 2 percent annually, while the growth of TSC employment will be decelerated further. The Government has already announced that government employment is not guaranteed to university graduates. The rate of hiring at the lower grades (A-F) and the intake of preservice trainees into the civil service will be sharply reduced, while on the other hand, preservice training allowances will be reviewed and training institutions will be reoriented gradually toward in-service training. Furthermore, the Government has recently raised the rents charged to civil servants living in government-owned housing, and will continue to rationalize housing benefits over the medium term. Additionally, over the next three years, the Government will steadily increase, in real terms, nonwage operating and maintenance expenditures in priority sectors, including education, health, agricultural services, road maintenance, and water supply. These policies will gradually reduce the share of the budget going to personnel expenditure while improving the efficiency of the public service.

15. Recent experience has demonstrated that the ranking and selection of donor-assisted activities, whether their economic nature is capital, current, or mixed, and also the ranking and selection of purely locally funded capital expenditures, needs to be strengthened. The Government is concerned that donor-assisted activities should be consistent with government priorities, that the number of donor-assisted activities should not overload the Government's administrative capacity, and that the pace of government capital formation should be consistent with the Government's financial capacity to subsequently operate and maintain the capital stock. With these concerns in mind, ministries will be required to prepare lists of ongoing and proposed projects (donor-assisted activities, plus purely locally funded capital expenditures), with the projects corresponding to identifiable heads or subheads in the budget, costed out on the assumption that they will be implemented expeditiously, and ranked into groups on the basis of priority in relation to sectoral strategies. In the Annual Estimates and Forward Budget processes, financial cut-off lines will be applied to the project lists, so that the Government will implement only the number of projects that it can afford at any point in time to implement expeditiously. Those projects selected for implementation in the Annual Estimates and Forward

Budget will be documented as the Public Sector Project List. In addition, the capital expenditures of the Central Government and the major nonfinancial parastatals will be documented as the Public Investment Program.

16. Kenya's debt-servicing capacity will be strengthened in the period ahead. The bulk of Kenya's external public debt is in the form of bilateral and multilateral loans and is mostly on highly concessional terms, with long maturities and grace periods, and a significant grant element. Although commitments from official sources have remained highly concessional, the overall degree of concessionality has been declining because of increased borrowing from commercial sources, and debt service payments have risen sharply in the 1980s. Consequently, in the period 1989-91 Kenya will adhere to a policy of minimizing nonconcessional borrowing in order to ensure a decline in the debt service ratio over the medium term. The debt service ratio (defined in terms of exports of goods, nonfactor services, and private transfers) for public and publicly guaranteed debt, which was approximately 32 percent in 1988, is projected to gradually decline to about 24 percent by 1991, thus contributing to the strengthening of the balance of payments position over the medium term.

Parastatals

17. In recent years, the Government has taken steps to clarify the financial situation of parastatals and the Government's relationships with them. The particular measures include the following:

(a) In those cases where the Government in past years has lent funds to parastatals without clear terms, the Treasury is entering into formal agreements with the parastatals defining the terms of these loans.

(b) The State Corporations Act, which provides a clearer legal framework for Government supervision of wholly owned parastatals, was enacted in 1986.

(c) The largest 42 parastatals have been brought into the Forward Budget system.

(d) Restructuring plans are being implemented in a number of individual parastatals, including the National Cereals and Produce Board, the South Nyanza Sugar Company, and Kenya Railways.

18. Over the next three years, the Government will accelerate its efforts to strengthen the economic efficiency and financial performance of the parastatals. Building upon the largely case-by-case approach that has been applied thus far to parastatal reform in Kenya, as well as the experience of other developing countries that have initiated comprehensive public enterprise reform programs, the Government will formulate a statement on its policy toward parastatals. The statement

will address issues such as the following: the circumstances under which state corporations would be the preferred vehicle to private sector entities or government departments for carrying out an activity; the objectives of state corporations in general, and the formulation of specific objectives for individual entities in their corporate plans; systems for evaluating and encouraging progress toward agreed (usually profitability) objectives; assignment of financial responsibility to the Government for financially nonviable activities undertaken by state corporations at the Government's behest; tax treatment and dividend policy of state corporations; and criteria and procedures for divestiture and liquidation.

19. In order to achieve a better appreciation of the impact of parastatal financing operations on the economy, the Government will begin in mid-1989 to monitor the aggregated flow of funds for the largest nonfinancial parastatals, and the consolidated public sector deficit. The Government will also clarify its position as a creditor of parastatals by completing the process of defining loan terms for past undefined lending, by strictly enforcing collection, and by systematically monitoring its portfolio of loans to parastatals, including classifying these loans as to whether they are performing or nonperforming. Moreover, with the objective of making the financial support provided by Government to parastatals transparent, future lending by Government to parastatals of domestically mobilized funds will be at market-equivalent interest rates, with any subsidy necessary for public policy purposes provided in the form of grants.

Monetary and financial sector policies

20. To further improve the efficiency of resource mobilization and allocation, and to broaden the range of financial instruments available to savers and investors, the Government will adopt a financial sector adjustment program in 1989. The program will be supported by a financial sector operation from IDA, and technical assistance from the IMF. The principal objective will be increased reliance on market forces in allocating financial resources. Noninflationary sources of government financing will be emphasized; and generalized, indirect monetary policy instruments will be used, with a view to controlling the money supply mainly through open market operations. To enhance the soundness and stability of Kenya's financial system, the regulatory framework will be improved, the supervisory capacity of the Central Bank will be strengthened, and weak financial institutions will be restructured. Steps will also be taken to help stimulate capital market activity.

21. In line with these objectives, the authorities have already adopted a wide range of measures, including introducing market-related instruments beginning in 1986. In December 1986 the cash ratio was introduced, in January 1988 the band between the minimum savings interest rate and the maximum lending interest rate was widened, in March 1988 the Central Bank's rediscount facility was reactivated, and

in early 1988 the auction of treasury bonds was initiated. In 1988 increased reliance was also placed on financing the budget deficit through government bonds rather than short-term treasury bills. These instruments, however, have not been used actively for monetary management. Monetary policy targets have so far been attained mainly through direct credit controls. In the period ahead, monetary programming and, in particular, reserve money management will be adopted to make daily money management consistent with the longer-run targets for monetary policy. At the same time, the available monetary policy instruments will be refined and their use will be increased. A Monetary Policy Committee established in 1988 will be responsible for selecting the appropriate instruments and interventions to achieve monetary policy objectives. In tandem with these developments, actions will be taken on interest rates such that they will be maintained positive in real terms. In April 1989 the maximum lending rate for commercial bank loans with maturities greater than four years was raised to 18 percent. By June 1991 interest rates will be market determined.

22. The dichotomy in regulations and supervision between banks and nonbanks has been rationalized to some extent by the implementation of the Banking (Amendment) Act of 1985. The amendment, which has been implemented over time, has introduced measures to strengthen the capital base, improve the quality of the portfolio, and increase the regulations by the monetary authority. In September 1986, the Deposit Protection Fund, which was part of the Banking (Amendment) Act, was introduced to protect deposits with any commercial bank, financial institution, or any other eligible deposit-taking institution in Kenya. In order to make the operations of building societies more in line with the operations of other deposit-taking institutions, in 1987 the Building Societies (Amendment) Act was passed to strengthen the capital base of the building societies, improve their supervision, and protect the deposits in these institutions. Moreover, in order to reduce further the instability stemming from the proliferation of weak depository institutions owing to the ease of market entry and lack of supervision and regulations to ensure their solvency, the Central Bank began in 1988, with the assistance of the Project Preparation Facility of the World Bank, to (i) develop action programs for restructuring weak institutions; (ii) establish an appropriate legal and regulatory framework for the financial system, particularly regarding the capabilities of the Central Bank to move in on troubled institutions; and (iii) provide some immediate systems assistance and training to the central bank staff. A revised Banking Bill will be prepared in April 1989, which among other things should enable the Central Bank to intervene in institutions prior to insolvency, to restructure, effect mergers, or liquidate as appropriate. The revised act will also limit advances to insiders and redefine exposure and capital adequacy requirements. The Central Bank will continue to strengthen its capacity to supervise the large number of depository institutions and to intervene and restructure troubled institutions. Off-site surveillance procedures (including upgrading of data flows and installing a data management and reporting system) will be improved. Regulatory and on-

site inspection procedures (primarily through the development of written procedures) will be strengthened. Action plans for viable alternatives to closing banks will be developed. The financing of the Deposit Protection Fund will be increased to ensure sufficient resources to protect depositors. The staff of the Central Bank's supervision department will be increased, as well as its in-house training and financial incentives.

23. To stimulate the development of financial markets, including long-term debt and equity markets, the Government has established the Capital Markets Development Advisory Council to identify existing impediments to the development of capital markets and to draft enabling legislation for the Capital Markets Development Authority (CMDA). By June 1989 a bill to establish the CMDA will be tabled with the intention that the CMDA will promote, develop, and regulate the corporate securities market. The Authority will promote the market through encouraging public issues and demand for securities as well as encouraging financial intermediaries to develop and participate in underwriting, securities brokerage, and related activities. It will help identify and remove impediments to securities supply, demand, and intermediation. The Authority will also propose a regulatory system to maintain investor confidence. In line with these objectives, by April 1990 the CMDA and the Government will propose measures to reduce tax disincentives to holding and issuing securities, encourage greater participation of insurance companies and other institutional investors in private securities markets, and enhance investor protection. At the same time that CMDA becomes operational in 1989, the role of the Capital Issues Committee in setting share prices in respect of domestic companies will be discontinued.

External trade and industrial policies

24. In order to accelerate industrial sector growth, the Government began in mid-1988 to implement an industrial sector adjustment program, which is being supported by IDA and other donors. The objectives of the program are to reorient industrial incentives with a view to improving the efficiency and the competitiveness of the industrial sector, increasing industrial exports, expanding industrial investment, and improving the performance of industrial public enterprises. Greater external orientation and efficiency in the sector will be attained through the reform of the trade regime. Industrial exports will be encouraged through an export promotion program as well as through a variety of other incentives. Incentives for promoting efficient investment will include strengthening administrative procedures, reducing inequalities in the tax system, and substantially reducing the scope of domestic price controls.

25. The Government will reform the protective system for domestic industry to lower and even out the structure of effective protection while making it more transparent. The authorities will attain this objective by continuing to follow a flexible exchange rate policy while

progressively introducing unrestricted licensing of imports and rationalizing and reducing tariff levels. Effective June 1988, the number of import schedules was reduced to three, with the third schedule subdivided into three categories. Under the new system, Schedule I contains primarily raw materials, intermediate inputs, and capital goods; Schedule II includes bulk import items requiring ministerial approval; Schedule IIIA comprises high-priority items insufficiently available in domestic markets; Schedule IIIB contains items that compete with domestic output and lower priority items; and, Schedule IIIC consists of other competing imports, luxury items, and goods restricted for reasons of public health and safety. In June 1988, the Government announced that items on Schedule I (accounting for 32 percent of items and 42 percent of 1986/87 imports), Schedule II (8 percent of items and 36 percent of imports) and Schedule IIIA (20 percent of items and 10 percent of imports) would be licensed without restrictions, once certain criteria (such as the accuracy of price information and other data provided in applying for import licenses) relating to technical considerations are met. In February 1989, in order to speed up the granting of import licenses and to monitor more closely the progress in the liberalization process, a modified system became operational that streamlines the import licensing process and provides timely and accurate information on import license applications, approvals of licenses, and corresponding foreign exchange allocations. The system is intended to monitor, inter alia, the speed and certainty with which import licenses are approved and to ensure that the corresponding foreign exchange is made available to the license holders.

26. Since the issuance of the 1988-90 policy framework paper, the items contained in Schedules IIIB and IIIC have been modified, in order to better reflect the relative competitiveness of various domestic industries. As a result of this revision, 98 items have been shifted from the original IIIC to the revised IIIB, mostly in the paper, iron and steel, soap, and dairy products categories. At the same time 278 items --mostly food, textiles, metal manufactures, and leather products--have been moved from the original IIIB to the revised IIIC. Schedule IIIB, which had contained 473 items accounting for 7.1 percent of import values, now covers 293 items accounting for about 5.6 percent of import values. Schedule IIIC, which had contained 651 items accounting for 4.9 percent of import values, now covers 831 items accounting for 6.3 percent of import values. By June 1989, quantitative restrictions on items in the revised IIIB will be replaced by equivalent tariffs, and these items will be subject to unrestricted licensing. For most of IIIC, unrestricted licensing will be introduced in two stages in June 1990 and 1991. For reasons of national security and public health, a few items will be exempted from unrestricted licensing. In addition, unrestricted licensing of import items in the textile sector that are contained in IIIC, along with tariff protection, will be introduced once a comprehensive restructuring program has been implemented, with the assistance of IDA. Agreement with IDA on the scope and timing of a study to formulate the textile restructuring program will be reached by May 1989.

27. The Government is cognizant that in addition to liberalizing the system of import licensing and replacing quantitative restrictions with tariffs, there is also a need to lower and even out protection to improve efficiency and to increase export incentives relative to the domestic market. Major steps in lowering and evening out effective protection will be taken during 1991-93, once quantitative restrictions have been lifted. The Government is currently undertaking a study to examine the impact on domestic industries of reducing protection for Schedules IIIB and IIIC, with a view to developing an action program for restructuring companies severely affected by lower protection. Anti-dumping legislation will also be reviewed for adequacy.

28. In June 1988 the Government reduced the number of tariff categories from 25 to 17 to ensure that similar goods bear similar tariffs. The reduction was done primarily to tariff categories at the high end. At the same time, specific duties were reviewed, and where feasible, were converted to ad valorem rates. In June 1989 the number of base tariff categories (i.e., those excluding the tariff equivalents introduced to replace quantitative restrictions) will be further reduced to 12, resulting in a decline in the weighted average tariff for the items covered.

29. An increasing share of Kenya's future industrial growth and export receipts will have to come from manufactured exports. In line with this aim, in June 1988 the coverage of the existing export compensation scheme was widened to a larger number of items. At the same time, guidelines and procedures were initiated to expedite applications for manufacturing in bond and to ensure producers using this arrangement will have their import applications for raw materials processed within five days. Up to now ten manufacturing in bond facilities have been licensed. Moreover, the Government has acquired plots of land near Nairobi and Mombasa for export processing zones and has begun to discuss with interested donors the financing of such facilities. The export compensation scheme will be administered so as to ensure reimbursement within one month of exporting, and will be expanded to more items. In June 1989, the Government will design and start implementing a comprehensive medium-term export promotion program.

30. With a view to inducing additional foreign and domestic industrial investment, in June 1988 the Government lowered the marginal effective tax rate for companies, established a one-stop investment facility at the Investment Promotion Center, amended the Foreign Investment Protection Act to make transfers of equity and capital gains on the sale of assets more equitable, and allowed foreign exchange losses on loans used to finance fixed assets as tax deductions. Moreover, in May 1988 the prices of 20 products under the General Order were decontrolled. The remaining 20 products will be decontrolled in tandem with import liberalization. The new Restrictive Trade Practices, Monopolies, and Price Control Act, inter alia, redefines monopoly and limits the imposition of price controls to only those items produced under monopoly

or traded under restrictive conditions. Moreover, applications for price revisions of items that will continue to be price controlled and conform to the Determination of Costs Order will be processed within 90 days.

31. The Government's aim for industrial parastatals and development finance institutions is to improve their efficiency through restructuring, divestiture, and improved monitoring and supervision. With the assistance of the World Bank, the Government has initiated studies to redefine the role of the development banks and develop a plan for their financial and organizational restructuring. The Government will also review existing data and reports to classify development finance institutions' portfolios of industrial enterprises into those that need rehabilitation or restructuring, those that can be divested, and those that should be retained. Action plans based on these studies will be prepared, and implementation will begin in June 1989. For public enterprises that will be retained in the public sector, the Government will by June 1989 clarify and streamline their monitoring system, with a view to allowing them greater flexibility while providing line ministries with timely and relevant information about their performance.

Exchange rate policy

32. To ensure Kenya's external competitiveness, support the import liberalization program, and strengthen the overall macroeconomic policy framework, the Government is determined to continue to pursue a flexible exchange rate policy. The Kenya shilling, which is pegged to a basket of currencies, was depreciated in real effective terms by almost 12 percent between end-June 1987 and end-December 1988. This flexible approach to exchange rate policy will be continued during the period 1989-91 in the light of periodic program reviews of developments in export competitiveness, progress in liberalizing the trade regime, trends in the current account and external reserves, and changes in the medium-term external outlook.

Agricultural policies

33. With the objective of promoting an acceleration of agricultural growth, the Government has since 1986 been implementing an agricultural sector adjustment program. The program aims to rationalize the role of government institutions and interventions in the agricultural sector. Under the program, the Government will concentrate its efforts in creating a more favorable environment for the private sector to take up the role of providing those agricultural services that the private sector can most efficiently provide, notably output marketing and input supply. Simultaneously, the Government will continue to strengthen provision of research and extension. Government and private efforts are geared toward increased use of fertilizers, pesticides, and animal health services, as well as greater farmer knowledge reflecting improved extension services, which will increasingly take into account the special needs of women farmers. These efforts are expected to result in

relatively high agricultural growth rate in the years ahead and lead to the attainment of the Government's objectives of (i) increasing employment in the agricultural sector, (ii) promoting agricultural exports, and (iii) assuring adequate food supplies.

34. The Government's general objectives in the area of output pricing and marketing will be to continue to provide price incentives to producers; expedite payments to farmers by marketing boards; promote the development of marketing channels; decrease any general consumer food subsidies implicit in the domestic price structure; and provide for food security. Specific measures for the different agricultural products will be as follows:

(a) For grains (maize, wheat, and rice), the Government will continue to announce around February of each year floor producer prices, taking into account import and export parity prices as well as domestic costs of production. The implicit subsidy of maize meal will be phased out in mid-1989. With the objective of reducing the fiscal burden of public sector grain marketing operations and increasing the number of participants in the system, the Government has defined more clearly the roles of participants in the system, begun implementing an organizational and financial restructuring of the NCPB, and developed an efficient system of monitoring the availability and distribution of food grains. A detailed five-year timetable for implementing the cereal sector reform has been formulated and the support of the EEC for this reform during the next three years has been secured. The plan calls for management reorganization, financial restructuring, market development, and institutional support. Budgetary allocations to the NCPB have already been limited to requirements for maintaining food security and stabilizing markets; cooperatives and private traders have been licensed to trade in maize; the target stock of maize to meet security requirements has been set; and a significant number of NCPB's buying centers has been closed and its redundant staff dismissed. A computerized system for monitoring stocks and shortages in each district has been introduced; grain distribution has been improved; and work has started to seek ways to reduce the NCPB's large stocks. Since July 1988, the Kenya Grain Growers Cooperative Union, other cooperatives, and small maize traders licensed by the NCPB have been allowed to buy up to 20 percent of the marketed maize directly from the farmers. These alternative marketing channels will be further developed and the NCPB will eventually become the holder of strategic reserves and buyer of last resort. The Government is also developing a comprehensive food security plan.

(b) For the major export crops, coffee and tea, the current system of flexible producer pricing based on export auctions will be continued. A pilot effort to improve the timeliness of coffee payments to farmers was initiated, and the new system is currently being tested with a view to replication. In 1987 the subsidization of domestic tea consumers was sharply reduced and, beginning in 1988, consumer tea prices are no longer subsidized.

(c) In order to reduce the cost of production and processing, the Government has started a series of studies of the sugar industry, as a consequence of which the South Nyanza Sugar Company (SONY) has made considerable progress in organizational restructuring and improvements in its financial and management procedures. A financial restructuring plan for SONY was approved in November 1988 and implementation will start with the 1989/90 budget, which will contain the needed authority to carry out debt liquidation.

(d) The overdue payments of the Cotton Lint and Seed Marketing Board have been cleared and in mid-1988 the Parliament approved the Cotton Act, which eliminated the legal monopoly of the Cotton Board. The Government is reviewing its policy toward the cotton subsector. A new cotton pricing system based on auctioning, which fully takes into account variety and quality differentials, will come into effect in 1989.

(e) The Government is deregulating milk marketing in areas where Kenya Cooperative Creameries (KCC) does not operate and it is also expediting payments by the KCC.

35. In the area of input pricing, the Government's general objectives are to liberalize the import system, improve distribution incentives, assure the supply of seeds, phase out subsidies for livestock services while upgrading the quality of these services, and promote the development of input distribution channels. Since 1986 the Government has increased the number of distributors and end users receiving fertilizer allocations, improved and streamlined the system for allocating import licenses for fertilizers, and increased the retail margins to provide adequate incentives for distribution of fertilizers to rural smallholder areas. As a consequence of these measures, the availability of fertilizer at the farm level is estimated to have increased by about 40 percent since 1984. The Government will continue in the near future to regulate fertilizer pricing and marketing in view of the importance of donor-provided fertilizers in the fertilizer supply. This will be done, however, in a manner that will relax constraints on private fertilizer trade. In November 1987 a revised pricing system was introduced based on benchmark international prices and adequate marketing margins; it provides a common basis for pricing both donor-provided and commercially procured fertilizer. The Government has also prepared a fertilizer policy paper, which provides a framework for the long-term development of marketing and pricing arrangements. The paper includes measures for further liberalizing the allocation system, and introducing guidelines for the use of donor-financed fertilizer. The Government will fully implement these improved policies and procedures in 1989. User charges for seed certification have been raised and retail margins will be increased during 1989. Fees for livestock dipping and artificial insemination services have been sharply increased; since 1988, clinical veterinary services have no longer been free and prices for veterinary drugs have been set at full retail levels.

36. The Government is increasing funding for agricultural extension, especially transportation, training, and other nonwage expenditure in order to disseminate improved agricultural technologies more effectively. Overall allocation to the agricultural sector has been increased in real terms during the last two years. The 1988/89 budget and the draft Forward Budget for the next three years provide increased funding for the high priority programs in extension, research, and animal health services, while reducing the allocation to parastatals. A study of manpower requirements in the Ministries of Agriculture and Livestock Development has been completed. The study's recommendations focus on containing the high proportion of personnel costs and in ensuring enough funds to cover nonwage operating costs. The action plan recommended by the study will be implemented beginning with the 1989/90 budget. The Government has already restructured the Kenya Agricultural Research Institute to provide it with adequate authority and methods for managing priorities in the national agricultural research program, with particular emphasis on adaptive research and regional programs.

Infrastructure

37. Compared with most African countries, Kenya has a relatively good infrastructure. During the next three years, expenditure on infrastructure will be directed not only at increasing maintenance but also at generally meeting the growing demand stemming from the projected growth of the economy and population. Particular emphasis will be placed on improving infrastructure in secondary towns planned as centers of rapid growth in employment. In the power sector, the Kiambere hydroelectric project (144 Mw) was commissioned in 1988 and the Turkwel Gorge (106 Mw) hydroelectric project will be completed in 1991. Kenya is also developing geothermal energy, which is expected to add 280 megawatts to the national grid by the year 2005. A Power Sector Master Plan that provides for least-cost sequencing of future power projects has been completed; the plan provides a framework for donor assistance to this sector. Under the World Bank's Geothermal Development and Energy Preinvestment Project, the Government will undertake a comprehensive study of energy pricing policy, taking into account the effects of existing taxes, price controls, and government regulations, in order to develop a price structure that will enhance efficiency in the supply and distribution of energy. In the water supply sector, the Government has a target to provide water near every home by the year 2000. Currently the Government is preparing a Nairobi Water Supply III project, construction of which will begin in 1989, and is continuing to implement the rural water supply program with the support of a number of donors. In the transportation sector, the focus is on necessary resealing of existing bitumen roads and regraveling of existing gravel roads and on improving farm-to-market rural access roads. Moreover, in order to reverse the recent declining trend in the Kenya Railways' operating and financial performance, a recovery program has been initiated, which includes institutional reform, expanded training, and essential equipment and spares.

38. For the power-generating projects and Nairobi water supply, pricing policy will continue to ensure an adequate rate of return. For rural electrification and rural water supply, consumers will be expected to pay operating and maintenance costs but not necessarily capital costs since most of the capital costs are financed by grants from donors.

Population and human resource development

39. Although Kenya's fertility and population growth rates remain high, there are preliminary indications of considerable progress in the implementation of the Government's population program. There has recently been a small but significant decline in the desired family size and an increase in the proportion of married women who wish to have fewer children. The number of acceptors of all types of contraceptives has been steadily increasing and the contraceptive prevalence rate appears to have risen substantially during the past four years. This progress has been due to a number of factors, including: (i) the strengthened political support for the population program from all levels of the Government, (ii) the increased effectiveness of the National Council for Population and Development, (iii) the expanded role of nongovernment organizations in the provision of family planning services, and (iv) the development of a multisectoral approach involving key ministries such as Information, Education, Culture and Social Services. This blend of activities is being supported by IDA's Population III Project, which came into effect in May 1988.

40. The health and education sectors are affected by serious financial problems and imbalances in the pattern of government expenditures. The steadily rising share of personnel costs in total expenditures has led to insufficient supplies of complementary inputs and consequently to a decline in the quality of service. Moreover, government expenditures are biased toward curative care and higher education. Given the absence of a systematic and efficient policy for user charges and cost recovery, the pattern of expenditures has tended to benefit disproportionately middle-income and urban groups who are better placed to utilize these subsidized services, especially hospitals and universities.

41. The Government plans to adopt a phased approach to user charges both in the health and education sectors. In 1988 user charges were introduced at the Kenyatta National Hospital in Nairobi. In the period ahead, this approach will be followed in other government-owned hospitals. Moreover, the Ministry of Health has been developing a national health plan and reviewing its organizational structure. In the education sector, the recommendations of the Presidential Working Party on Education and Manpower Training on measures to control expenditures on education were presented to the Government in 1988 and have been accepted in a Sessional Paper. The reform program for the sector will involve increasing fees (particularly for higher education), reducing costs and improving cost-effectiveness, increasing the provision of vocational and technical training, and improving organization and

management in the sector. The implementation of the program will begin not later than with the 1989/90 budget.

Environment

42. Kenya's environmental problems stem largely from the pressures that rapid population growth exerts on the limited resources. These environmental pressures are imposing severe constraints on production in the country's agricultural and livestock sectors and contributing to the destruction of wildlife and natural habitats. Environmental problems constraining agriculture include degradation of arable land through reduced fertility and water-holding capacity, coupled with a reduction of dry season water resources, particularly for irrigation. Soil erosion is the main cause of arable land degradation. Increased upstream offtake of water and reduced replenishment of ground water are the direct consequences of changes in forestry cover. Kenya's forest lands, in both the highlands and the lower semiarid areas, are being reduced by encroachment by farmers and pastoralists, and indiscriminate harvesting. Despite widespread tree planting, the standing stock of wood is being depleted by about 1 percent annually. In view of these developments, the Government has begun a forestry and reforestation program. The program, which is being supported by IDA, aims to strengthen forest legislation, increase resources for forest protection, and promote farm and social forestry as well as peri-urban fuelwood plantations.

43. The principal conservation issues include the poor management of wildlife resources, which has resulted in a worrisome reduction in numbers, largely through poaching, and the destruction of natural forests, which has reduced natural habitats. Kenya's wildlife is a valuable and replenishable natural resource that makes an important economic contribution directly and indirectly as a tourist attraction and a source of employment. The Government is currently preparing a wildlife program aimed at strengthening management and conservation efforts.

IV. Social Impact

44. Since the magnitude of prevailing economic distortions and imbalances is less in Kenya than in most other African countries that have currently embarked on adjustment programs, the structural reforms required and their potential social impact are correspondingly smaller. Moreover, many of the reforms being implemented will directly benefit lower-income groups, such as agricultural smallholders. Nevertheless, the Government recognizes that there may be adverse effects on some groups. In order to minimize possible social costs of the adjustment program, the Government's reform measures are being applied in a gradual manner and are aimed at encouraging supply responses, which can reduce the impact of price increases and subsidy reduction on consumers. Overall, the program is designed to sustain the economy's

recent growth momentum and to permit a modest increase in real per capita consumption (0.3 percent annually).

45. The potential adverse effects arise primarily from three sources: pricing policy, industrial restructuring, and budget rationalization. Since low-income urban families spend about 40 percent of their income on food, they are likely to be adversely affected by the ongoing reduction in consumer subsidies implicit in the evolution of the domestic price structure. For a number of food items, however, the margin between producer and consumer prices is partly attributable to inefficiencies in the marketing system. To the extent that these inefficiencies are reduced, the impact of lower consumer subsidies would be mitigated. Moreover, most of Kenya's poor are agricultural producers and will therefore reap the benefits of higher producer prices while being relatively unaffected by increases in urban food prices.

46. For a number of reasons, the impact of price decontrol for manufactured products on consumers is expected to be relatively moderate. First, supply response combined with consumer resistance can effectively limit the extent of price increases, as demonstrated by the recent experience with decontrol of meat prices. Second, increased availability of competing imports for many of the decontrolled items would tend to dampen possible inflationary pressures. Third, over the longer term, price decontrol is expected to promote increased capacity utilization and encourage new investment, which would further reduce pressures for price increases while generating additional employment.

47. Aided by appropriate restructuring, much of Kenya's import-substituting industry is sufficiently efficient to withstand increased import competition. Moreover, the envisaged measures in this sector would be sequenced in such a way that expansion in newly favored activities will take place before or simultaneously with contraction of activities affected by reduced incentives and protection. In particular, measures to increase the level and efficiency of investment (price decontrol, import liberalization, export promotion, capital market development) are being implemented early in the program period, while the lowering of tariff protection will take place in later years.

48. In the budgetary area, the planned measures to reduce budgetary transfers to parastatals and to limit the rate of growth of government expenditure will mean that the public sector will no longer be a major source of employment growth. While the resources thus released will permit a more rapid expansion in private sector employment, particularly in the context of sustained economic growth, there will nevertheless be the need to phase such a reduction in a manner that minimizes any adverse social impact.

V. External Financing Requirements, 1989-91

49. The adjustment policies to be pursued during the program period are expected to progressively reduce the current account deficit, excluding grants, from 7.8 percent of GDP in 1988 to 5.7 percent of GDP by 1991. During the same period, gross international reserves are targeted to increase steadily from 2.1 months of nongovernment imports to 3.0 months. Kenya's gross external financial requirements during 1989-91, consisting of the current account deficit (excluding grants), debt amortization, and necessary increases in reserves are expected to be about US$3.2 billion. In mobilizing these resources, in order to achieve a progressive decline in the debt service ratio (defined in terms of exports of goods, nonfactor services, and private transfers) from 32 percent in 1988 to 24 percent in 1991, the Government intends to restrict the contracting or guaranteeing of new nonconcessional loans to US$100 million annually.

50. Disbursements from existing grant and loan commitments are expected to be US$1.2 billion. New grants and loan commitments from official sources are expected to yield disbursements amounting to US$1.3 billion over the 1989-91 period. Adding the proposed ESAF arrangement, and projected disbursements from other private sources, total disbursements from expected new commitments are projected at US$1.8 billion. This leaves a financing gap of US$0.2 billion over the three-year period. The Government expects to fill this gap with the Financial Sector Adjustment Credit and the associated Technical Assistant Credit from IDA (together amounting to US$125 million) and by mobilizing additional finance from bilateral sources, including possible cofinancing for IDA adjustment lending.

51. For the first year of the program, 1989, Kenya's gross external financing requirement is expected to be about US$1.1 billion. Grant and loan commitments are expected to yield disbursements amounting to some US$0.9 billion, of which about one third is in the form of grants. Of the disbursements in the form of loans, around US$0.2 billion relates to program lending, mostly from IDA and associated cofinancing, and including the IDA reflow, commercial borrowing accounts for less than US$0.1 billion, while the remainder is taken up by various project loans. With the addition of the proposed ESAF arrangement, and projected disbursements from other private sources, total disbursements in 1989 are projected at US$1.0 billion. This leaves a financing gap of less than US$0.1 billion, which the Government expects to fill with the first tranche of the Financial Sector Adjustment Credit from IDA, including its cofinancing.

Kenya: Summary and Time Frame for Macroeconomic and Structural Adjustment Policies, 1989-91

	Objectives and targets	Strategies and measures	Timing
1. External policies			
a. Exchange rate	Ensure growth and structural improvement in balance of payments.	*Review and adjust exchange rate to expand and diversify export base and compensate for removal of quantitative import restrictions and adoption of moderate tariff structure.	From time to time.
b. Imports	Make protection transparent and smooth out the dispersion in the structure of industrial incentives.	See section 2b. below for details.	
c. Exports	Increase nontraditional exports.	See section 2b. below for details.	
d. External debt	Improve information on external debt and reduce debt service ratio.	Limit public sector external borrowing on nonconcessional terms.	Continuous.
		Establish a statistical system on private sector external debt.	End-1989.
2. Sectoral policies			
a. Agriculture	Maintain producer incentives.	*Set floor producer prices for grains (maize, wheat, rice) with appropriate reference to import parity and export parity principles.	Announce floor producer prices around February of each year.
		Continue with auction pricing for coffee and tea exports.	Continuous.
		Introduce new cotton pricing system based on auctioning.	1989.
		*Speed up payments to milk producers by Kenya Cooperative Creameries.	Continuous.
	Reduce cost of sugar production and processing.	*Undertake a study of the sugar industry with a view toward reducing cost of production and processing.	1989.
		*Implement a financial restructuring of the South Nyanza Sugar Company.	1989/90.
	Improve marketing arrangements. Reduce financial burden on the budget of grain marketing operations.	Confine budgetary allocations to the NCPB for maintaining food security and stabilizing markets.	Continuous.
		Complete the organizational and financial restructuring of NCPB, and continue to expand the role of the cooperatives and private traders in maize marketing.	1988-91.
	Provide for food security.	*Develop a food security plan.	1989.

Kenya: Summary and Time Frame for Macroeconomic and Structural Adjustment Policies, 1989-91 (continued)

	Objectives and targets	Strategies and measures	Timing
	Improve agricultural input supply.	*Prepare annual fertilizer import plan; assure minimum allocation to established importers; allow major approved end-users to import directly; increase the number of authorized importers and distributors.	July of each year.
		Implement the recommendations of the fertilizer policy paper.	1989.
		Increase retail margins for seed.	1989.
		Charge for veterinary services and set prices for veterinary drugs at full retail levels.	1989.
	Disseminate and develop improved agricultural technologies.	*Provide adequate funding for agricultural extension.	Continuous.
b. Industry	Import liberalization.	*Complete study to examine the impact on domestic industries (other than textile) of unrestrictive licensing for Schedules IIIB and IIIC.	May 1989.
		Formulate an action program to provide equivalent protection by tariffs only and draft appropriate anti-dumping legislation. In the second phase of the study, prepare action program for restructuring or liquidating companies severely affected by planned lowering of protection.	January 1989-March 1990.
		Monitor import liberalization by having in place a system which provides accurate and timely data on import license applications, approvals of licenses, and corresponding foreign exchange allocations.	1989.
		*Implement unrestricted licensing for items in Schedule IIIB.	June 1989.
		*Implement unrestricted licensing for items in Schedule IIIC (except for items restricted for reasons of health and public safety and selected items in the textile sector, for which a restructuring program will be prepared).	June 1990 and June 1991.

Kenya: Summary and Time Frame for Macroeconomic and Structural Adjustment Policies, 1989-91 (continued)

	Objectives and targets	Strategies and measures	Timing
		*Reduce the number of tariff levels to 12, mainly at the top of the range, so as to reduce the weighted average tariff for items on Schedules I, II, and IIIA.	June 1989.
		Reduce the weighted average tariff of Schedule III according to amounts to be agreed under the proposed second Industrial Sector Adjustment Credit.	June 1990-June 1993.
	Export incentives.	*Strengthen the administration of the export compensation scheme to make payments prompt and reliable.	Continuous.
		*Complete study to design a comprehensive medium-term export promotion scheme, and commence implementation.	June 1989.
		*Improve procedures and incentives for manufacturing in bond.	June 1988-June 1989.
		*Implement export processing zone, subject to donor support.	June 1989.
	Promote investment	*Establish one-stop investment center at Investment Promotion Center to streamline investment approval procedures and to issue investment guidelines.	June 1988-June 1989.
		*Establish clear criteria for issuing and renewing work permits.	June 1989.
	Reform industrial public enterprises.	*Determine enterprises in development finance institutions' portfolios to be restructured or divested. Define procedures for restructuring and divestiture, taking into account indigenization.	1989.
		*Begin implementing the agreed classification.	June 1989.
		*Clarify and streamline the monitoring of industrial public enterprises.	June 1989.
3. Fiscal policy	Adjust fiscal position.	Reduce Central Government budget deficit to sustainable foreign financing and non-inflationary domestic financing.	Continuous.
		Begin to measure public sector deficits.	1989/90.

Kenya: Summary and Time Frame for Macroeconomic and Structural Adjustment Policies, 1989-91 (continued)

Objectives and targets	Strategies and measures	Timing
Increase the effectiveness of expenditure in achieving its objectives, while lowering the level of central government expenditure in terms of GDP.	Measure the economic composition of expenditure in the annual estimates and forward budget processes, for programs (sub-votes), ministries, and the Central Government as a whole.	June 1989.
	Formulate training, recruitment, and employment policies with the objective of reducing the growth of government employment, and gradually reducing the share of the budget claimed by personnel expenditure. Reduce intake into civil service of pre-service trainees and reorient training institutions to more in-service training. Review preservice training allowance.	Beginning in 1989/90.
	Have ministries plan staffing levels as part of forward budget processes.	Start in 1989.
	Increase real nonwage operating and maintenance expenditures in priority sectors, including road maintenance, agricultural services, education, and health and water supply.	July of each year.
	Formulate a Public Sector Project List, distinguishing ongoing from new projects, with projects corresponding to budgetary subheads and costed out on the assumption that they will be implemented expeditiously. Formulate a Public Fixed Investment program embracing the capital expenditures of both the Central Government and selected nonfinancial parastatals.	Beginning in 1989/90.
	Distinguish transfers to parastatals in the budget documents as to whether they are grants or loans, to finance operating losses, capital formation, or lending to finance capital formation.	Annually.

Kenya: Summary and Time Frame for Macroeconomic and Structural Adjustment Policies, 1989-91 (continued)

	Objectives and targets	Strategies and measures	Timing
	Increase revenue while reducing disincentive aspects and improving administration.	Implement tax modernization, which would include computerization and other administrative improvements in the revenue-collecting departments, and improve policy formulation capabilities. (See also tax aspects of industrial sector and financial sector adjustment programs).	1989-90.
		Introduce/raise user charges for education and health.	1989-90.
		Replace most sales taxes with value-added tax.	1989/90-1991/92.
4. Public enterprises	Establish government objectives; improve financial performance; reduce transfers from Central Government.	Formulate a policy framework for public enterprises.	1989.
		Begin to monitor the flow of funds for selected nonfinancial public enteprises, and the consolidated public sector deficit.	June 1989.
		Clarify the Government's position as a creditor of public enterprises by categorizing the Government's portfolio of loans to parastatals as performing or nonperforming and strictly enforcing collection of loans.	1989.
		*Require parastatals to pay market-equivalent interest rates to Government, making any subsidies transparent.	April 1989.
5. Monetary and financial policy	Move toward greater reliance on market forces in mobilizing and allocating financial resources.	*Maintain positive real interest rates.	Continuous.
		*Raise the maximum lending rate for commercial banks to 18 percent for loans with maturities of four years or more.	April 1989.
		*Allow interest rates to be market determined.	June 1991.

Kenya: Summary and Time Frame for Macroeconomic and Structural Adjustment Policies, 1989-91 (continued)

	Objectives and targets	Strategies and measures	Timing
	Implement monetary programming and active use of indirect monetary policy instruments.	*Introduce reserve money management and active use of available monetary policy instruments through the Monetary Policy Committee.	April 1989.
		*Strengthen the tendering mechanism for treasury bills and bonds.	April 1989.
		*Improve the Central Bank's discount facility.	April 1989.
		*Refine the design of monetary policy instruments.	Continuous.
	Remove inefficiencies in the financial system.	Implement all the provisions of the amendment to the Banking Law.	1988 and 1989.
		*Prepare revised Banking Bill.	April 1989.
		*Strengthen central bank supervision of banking institutions, by developing standardized financial reporting formula, written examination and inspection procedures, and appropriate provisioning guidelines.	April 1989.
		*Increase the Central Bank's supervision staff and develop for it suitable training programs.	Continuous.
		*Prepare restructuring program for weaker banks.	April 1989-April 1990.
	Encourage development of capital market.	*Establish a Capital Markets Development Authority.	1989.
		*Remove the Capital Issues Committee's jurisdiction over pricing of domestic equities.	1989.
		*Propose measures to reduce tax disincentives to holding and issuing securities.	April 1990.
		*Begin implementing the proposed tax measures.	June 1990.
		*Implement appropriate investor protection measures.	April 1990.
		*Review investment guidelines for insurance companies to increase the portion of securities allowed in the Nairobi Stock Exchange.	April 1990.
6. Pricing policy	Strengthen market forces in the price-setting mechanism.	*Adjust consumer prices of maize, wheat flour, and rice in line with producer prices with a view to avoiding subsidies.	Around February each year.

Kenya: Summary and Timeframe for Macroeconomic and
Structural Adjustment Policies, 1989-91 (concluded)

Objectives and targets	Strategies and measures	Timing
	Start eliminating subsidies on vegetable oil.	1989.
	*Remove remaining price controls on items under the General Order, except for items produced by monopolies as defined under the Restrictive Trade Practices, Monopolies and Price Control Act, in tandem with import liberalization.	June 1989-June 1991.

*Refers to measures already incorporated in agreements with the World Bank.

Table 1. Kenya: External Financing Requirements, 1988-91

(In millions of U.S. dollars)

	1988	1989	1990	1991
Total financing requirement	1,086	1,081	1,070	1,038
Current account, excluding official transfers	655	609	580	531
Public MLT debt amortization 1/	314	282	314	360
Of which: World Bank/IDA	(88)	(97)	(109)	(113)
IMF repurchases	90	135	106	41
Change in reserves	27	55	70	106
Disbursements from existing commitments	1,086	592	379	212
Grants	274	160	60	30
Public MLT loans	850	432	319	182
Bilateral creditors	228	115	85	54
Multilateral creditors	549 2/	242	154	108
Of which: World Bank/IDA	(86)	(98)	(102)	(73)
Of which: adjustment lending	(90)	(102)	(--)	(--)
Private creditors	73	75	80	20
Other capital (net)	-38	--	--	--
Disbursements from expected new commitments	--	421	574	781
Grants	--	99	191	249
Public MLT loans (excluding IMF)	--	177	215	347
Bilateral creditors	--	117	132	144
Multilateral creditors	--	35	73	123
Of which: World Bank/IDA 3/	(--)	(17)	(49)	(91)
Private creditors	--	25	10	80
IMF - ESAF	--	112	112	112
Other capital (net)	--	33	56	73
Subtotal	1,086	1,012	954	993
Initial financing gap	--	69	116	45
Disbursements from expected IDA adjustment lending 4/	--	55	55	15
Cofinancing	--	14	16	10
Residual financing gap	--	--	45	20

Sources: Data provided by the Kenyan authorities; the World Bank; and staff estimates.

1/ MLT, medium- and long-term.
2/ Includes US$176 million in disbursements under stand-by and SAF arrangements as well as the compensatory window of the compensatory and contingency financing facility.
3/ Project lending only.
4/ Financial sector adjustment credit and associated technical assistance credit.

Table 2. Kenya: Key Indicators, 1985-91

	1985	1986	1987	1988	1989	1990	1991
	Actual			Est.	Projections		
GDP at market prices (growth rate)	4.1	5.8	5.0	4.9	5.1	5.2	5.4
GDY growth rate 1/	0.6	8.2	2.0	5.7	4.9	4.8	5.6
GDP/per capita growth rate	0.2	1.9	1.1	1.1	1.3	1.4	1.6
GDY/per capita growth rate 1/	3.2	4.2	-1.8	1.9	1.1	1.0	1.8
Consumption/per capita growth rate	-0.9	--	2.4	1.6	0.1	0.3	0.5
Inflation rate (end period) 2/	10.5	4.3	6.6	10.4	8.0	7.5	5.5
Real effective exchange rate depreciation (end period)	-12.5	-4.8	-14.0	-2.6	...	...	...
Total domestic credit (growth rate) 3/	21.9	28.2	10.2	13.7	8.0	8.5	6.9
Net credit to Government (growth rate) 3/	32.3	59.5	0.1	12.8	5.6	3.9	--
Credit to other sectors (growth rate) 3/	17.6	13.9	16.7	14.2	9.3	11.0	10.2
Broad money (growth rate) 3/	21.8	21.5	4.0	17.0	12.3	11.0	10.7
Debt service (in U.S. dollars)	477	573	608	644	658	665	649
Debt service/Exports 4/	28.0	28.7	33.2	31.7	29.3	27.3	24.0
Debt service/GDP	8.0	8.0	7.6	7.6	7.6	7.6	6.9
Gross investment/GDP	20.7	22.4	25.0	24.3	24.3	24.7	24.8
Domestic savings/GDP	19.6	22.5	19.9	19.2	20.1	20.9	21.8
National savings/GDP	17.2	19.8	17.0	16.5	17.3	18.1	19.1
Marginal national savings rate	0.4	0.4	-0.1	0.1	0.3	0.3	0.4
Public investment/GDP 5/	7.0	8.1	7.6	7.6	7.5	7.4	7.3
Government savings/GDP	-0.2	-0.7	-0.2	0.7	0.7	1.1	1.5
Private investment/GDP	10.9	11.9	12.6	13.2	13.3	13.8	14.0
Private savings/GDP	17.5	20.5	17.2	15.9	16.6	17.0	17.6
Public/Private investment ratio	64.0	68.2	60.5	57.4	56.2	53.6	51.9
Government revenue/GDP 3/	22.6	22.5	23.2	23.8	24.1	24.3	24.5
Grants/GDP 3/	1.0	1.3	2.1	2.4	2.5	2.6	2.5
Government expenditure/GDP 3/	29.7	31.9	29.6	30.7	30.8	30.6	30.2
Deficit/GDP 3/ 6/	5.4	7.6	4.0	4.5	4.2	3.7	3.2
Deficit/GDP 3/ 6/ 7/	6.4	8.9	6.1	6.9	6.7	6.3	5.7
Export growth rate 8/	-3.5	4.1	-17.5	6.8	7.8	7.2	9.4
Exports/GDP 8/	26.3	27.1	25.8	22.3	23.9	25.7	26.7
Import growth rate 8/	-4.3	1.4	1.3	4.5	3.1	4.7	6.0
Imports/GDP 8/	-25.6	-26.9	-28.9	-27.4	-28.1	-29.5	-29.7
Current account (in millions of U.S. dollars) 7/	-200	-221	-642	-655	-609	-580	-531
Current account/GDP 7/	-3.3	-3.1	-8.0	-7.8	-7.0	-6.6	-5.7
Current account (in millions of U.S. dollars) 9/	-90	-72	-483	-380	-350	-329	-251
Current account/GDP 9/	-1.5	-1.0	-6.0	-4.5	-4.0	-3.7	-2.7
Gross official reserves (months of nongovernment imports)	3.4	3.7	2.1	2.1	2.3	2.6	3.0

Sources: Data provided by the Kenyan authorities; and staff estimates.

1/ GDP at constant prices adjusted by gains and losses from changes in terms of trade.
2/ Nairobi consumer price index.
3/ Year beginning July 1.
4/ Ratio of public debt to exports of goods, all services, and private transfer receipts.
5/ Public includes central government, municipalities, councils, and parastatals.
6/ Figures do not add up because of adjustment to cash basis.
7/ Excludes grants.
8/ Exports and imports defined as including nonfactor services. Growth rates in terms of SDRs.
9/ Includes grants.