HARAMBEE

REPUBLIC OF KENYA

Sessional Paper No. 4 of 1982

ON

DEVELOPMENT PROSPECTS AND POLICIES

25 Shillings — 1982

Sessional Paper No. 4 of 1982

ON

DEVELOPMENT PROSPECTS AND POLICIES

TABLE OF CONTENTS

STRUCTURAL ADJUSTMENT PROGRAMME

Introduction

The Government of Kenya remains dedicated to the long term objectives of political equality, religious freedom, social justice, freedom from want, ignorance and disease, human dignity including freedom of conscience, equal opportunity for all citizens, and high and growing per capita income equitably distributed in a setting of growing employment and stable prices. It also remains committed to pursuing these ends through the widespread participation of all Kenyans in the development process, the use of a diversity of organizational forms and incentives, the active participation of Government in the provision of basic needs and strategic economic acitivities, and the promotion of the African tradition of mutual social responsibility.

2. These objectives and principles will not be subordinated to shorter term crisis management needs. It is true that the international economic situation coupled with drought has created serious balance of payments, debt and budgetary problems, but the solutions sought for these problems must not place in jeopardy our long term objectives and principles. Those are overriding and the discussion of development prospects and policies in this paper places shorter term concerns in that longer term context.

3. The Government is, however, facing a serious financial crisis and must take both immediate and longer term measures to cope with the problem. The crisis itself is a symptom of two sets of underlying causes. The first of these sets is international in character. Very drastic changes have occurred in the international economic setting since 1973 when oil prices started their dramatic rise. As a result, our access to export markets has been limited and the terms on which we can buy and sell abroad have deteriorated. Economic growth has been retarded, Government revenues have become harder to raise, foreign aid has become more difficult to obtain, and Government has had to resort increasingly to external commercial financing at high interest rates. Increases in debt service have further curtailed Government's ability to finance growing expenditures by ministries.

4. In many ways, however, the second set of causes is of even greater concern because it is largely internal in nature and inhibits Government's ability to attain the national objectives summarized

above. The proliferation of Government activities, particularly through investments in commercial enterprises and duplications of administrative structures, has diverted scarce management talent away from the essential functions of Government and caused Government expenditures to grow at unjustified and financially unmanageable rates. As a consequence, management inefficiencies have become common place and expenditures have outrun the services provided by Government and indeed its revenues.

5. These internal causes of the current financial situation are the subject of a separate and intensive study, the results of which will lead to specific recommendations on the structure and management of Government activities. These recommendations will be incorporated in the Fifth Development Plan. This paper focusses on the international economic situation and the policies adopted by Government to restructure national economic activity in order to make the most of the difficult opportunities open to us within the new constraints which now characterize the international setting.

The International Setting

6. Kenya is very much a part of the world economy. Exports of goods and services in 1981 amounted to nearly 28 per cent of gross domestic product at market prices and imports of goods and serivces amounted to nearly 39 per cent. Clearly, our economic development depends in many ways on costs, prices and market opportunities in other countries and on our ability to compete effectively in those foreign markets. When the international economic situation deteriorates it is inevitable that development in Kenya will be adversely affected.

7. The world-wide inflation, stimulated since 1973 by successive increases in the price of crude oil, has pushed up the cost of our imports, raised the cost of living and, except for the years of the coffee boom in 1977 and 1978, reduced the purchasing power of our major exports. But the efforts of the advanced nations to cope with that inflation are having even more serious consequences. High interest rates have reduced international economic growth and increased unemployment without, as yet, bringing inflation under control. Economic stagnation has prompted many of these countries

to resort to more stringent measures to protect their own industry and agriculture from the spreading vicissitudes of international recession. Meanwhile, rising military expenditures in the wealthier nations are making their task of controlling inflation more difficult and, together with economic stagnation, are squeezing financial provisions for foreign aid.

8. In the depressing international circumstances, Kenya's development is affected in many ways. Our export opportunities, already weakened by slack demand in neighbouring countries, are struck a double blow by falling demand and rising protectionism in the industrialized nations. As the prices we must pay for imports continue to rise more rapidly than the prices we realize on exports, the purchasing power generated by our exports continues to diminish. As a result, an increasing share of the imports required for development have had to be financed by external borrowing. Given the limited availability of foreign aid on concessional terms for balance of payments support, more loans have had to be arranged at high interest rates and with shorter repayment periods. Rising debts service has put additional pressure on our balance of payments and, as a result, imports have had to be further constrained.

9. As the prices we must pay for imports continue to rise more rapidly than the prices we realize on exports, the purchasing power generated by exports continues to diminish. Our terms of trade—the ratio of export prices to improve prices—have fallen by 27.5 per cent since 1976 due largely to weakness in coffee and tea prices since the coffee boom of 1977 and the rising cost of oil. Because our exports buy fewer imports, the rate of domestic economic growth has been constrained, an effect which has been exacerbated recently by drought conditions.

10. Retardation of economic growth has necessarily meant that Government revenues have grown more slowly than otherwise would have been the case. As a consequence, more borrowing, external and internal, has been required in order to finance the basic needs and development priorities of our rapidly growing population. The credit requirements of Government, together with constraints on imports and slack export demand, have

restricted economic growth in the private sector in particular, compounding an already difficult problem.

11. The international economic situation with which we must contend will not quickly change. Inflation will abate with more stable oil prices, but recovery of the global economy is likely to be slow. We must, therefore, cope as effectively as we can with the adverse economic environment and at the same time continue with the structural adjustment programme formulated in the 1979/83 Development Plan. That programme is designed to promote more efficient, export-oriented, domestic resources-based production, comprehensive rural development, and an expanded role for the private sector. It is, therefore, a programme that contributes directly to the resolution of our balance of payments and budget difficulties while at the same time providing a firm basis for more rapid, sustained and widespread economic development in the future.

12. This paper outlines the nation's economic situation and describes the economic policies, procedures and guidelines which the Government is pursuing in order to improve that situation. Because many of our current problems were anticipated earlier, most of the measures discussed in this paper have already been introduced. How these measures fit together and mutually support each other, as components of a comprehensive programme has, however, not been fully articulated. This paper is intended to fill that gap.

13. It should be noted that the economic situation is under constant surveillance and policies are subject to modification as circumstances and further analysis may suggest. In addition, the administrative machinery and management systems of Government are also under review in order to ensure effective response to any new conditions which may arise. Greater detail on specific policies and management systems will be given by relevant ministries during the course of implementing the comprehensive programme.

The Economic Situation

14. The nation's production of goods and services has been growing much more slowly in recent years than the rates of growth called for in the Development Plan. Indeed, gross domestic product has been growing more slowly than the revised targets set forth in

Sessional Paper No. 4 of 1980 entitled Economic Prospects and Policies. Moreover, present projections show lower rates of growth also for the remaining years of the present Plan period. The current projections compare with the earlier ones as follows:

REAL RATES OF GDP GROWTH (%)

	1979	1980	1981	1982	1983	Average
Plan	4·5	7·0	6·5	6·7	6·9	6·3
Revised (1980) ..	3·5	5·8	5·9	5·9	6·0	5·4
Revised (1982) ..	4·2	3·0	4·8	4·5	4·8	4·3

15. The lower rates of growth recently achieved and now expected for the next two years reflect the prolonged international recession and the drought conditions of the last two years. As a result, production on the average over this five-year period will grow at about 4.3 per cent per year. This compares with an average rate of growth of 5.8 per cent per annum achieved between 1964 and 1978. Moreover, given the rapid growth of population, production per capita will be very little higher in 1983 than it was in 1978.

16. However, the total goods and services available to the nation for both development and consumption do not depend solely on domestic production. Indeed, some of that production is sold abroad and is not available for use at home at all. On the other hand, goods and services produced in other countries are imported, and these increase the goods and services available for domestic use. Hence, the goods and services available for use in Kenya in any year will exceed our own production if our imports of goods and services exceed our exports of goods and services.

17. The extent to which we have used external goods and services to augment our own production over the last three years is shown below:

K£ *Million*

	1979	1980	1981 (estimated)	Average Growth (per cent)
Gross Domestic Product (at market prices) ..	2,277	2,626	3,023	10·9
Excess of Imports over Exports ..	207	444	424	
Total Goods and Services available for Domestic Use	2,484	3,070	3,447	12·9
Import Surplus as % of GDP	9·1	16·9	14·0	

While production (in current prices) has been growing at an average annual rate of 10.9 per cent over the last three years, our use of goods and services has grown at 12.9 per cent per annum, simply because we have been importing more from other countries than we have sold to them. These import surpluses have enabled us to maintain a higher rate of development and higher living standards than would otherwise have been possible.

18. Unfortunately, these import surpluses must be financed either by drawing down our foreign exchange reserves or from external sources. As our reserves were equal to only 1.7 months of imports at the end of 1981, there is little scope for additional financing from this source. External borrowing, largely in the form of public and publicly guaranteed debt, has been the main source of balance of payments financing. That debt has grown rapidly in recent years as is shown below:

OUTSTANDING PUBLIC AND PUBLICLY GUARANTEED EXTERNAL DEBT*

K£ *Million*

	1979	1980	1981
Central Government ..	491·0	500·4	649·9
Central Bank (I.M.F.) ..	52·3	73·6	103·4
Guaranteed Debt	275·0**	312·5**	415·1
TOTAL	818·3	886·5	1,168·4
G.D.P. at market prices ..	2,277	2,626	3,023
Debt as % of G.D.P.	35·9	33·8	38·6

*Including revaluation of debt.

**Approximate.

These levels are not yet dangerously high, but the degree to which we have relied on external borrowing can not be maintained for long. Hence, the nation will not be able to continue augmentation of its own production with an excess of imports over exports to the extent recorded in the recent past. The import surpluses of the last three years must be reduced, and the nation's use of goods and services tailored more closely to our ability to produce.

19. As every family knows, borrowing entails repayment with interest. Hence, for the nation to finance the same excess of imports over exports in the future, the gross amounts borrowed must be higher because repayments and interest are a first claim on the nation's financial resources. The sum of repayments and interest—debt service—on public and publicly guaranteed external debt has been rising rapidly as shown below.

	1979	1980	1981
Debt Service (K£m)	48·8	95·1	148·3
Export Receipts (K£m) ..	600·1	734·8	750·0*
GDP at Market Prices (K£m)	2,277	2,626	3,023
Debt Service as % of:			
Export Receipts	8·1	12·9	19·8
GDP at Market Prices ..	2·1	3·6	4·9

*Provisional

Debt service was three times greater (in current prices) in 1981 than it was in 1979. This increase is only partly attributable to new amounts borrowed (since outstanding debt increased by only 42.7 per cent over this period). The increase also reflects higher rates of interest and shorter repayment periods, and a shift in the composition of new borrowing toward commercial lenders.

20. The slower pace of economic growth and rising debt service charges have had a serious impact on the ability of Government to finance the basic services provided by ministries. In the first place, the Government's revenue-raising efforts have been less effective in a climate of slower economic growth. In the second place, rising debt service charges on both internal and external debt of the Central Government (excluding Central Bank and guaranteed debt) have taken a rising share of Government revenues, leaving a smaller share available for ministries. Finally, spending by ministries has

continued to grow at a pace reflecting public needs and the momentum generated in the past by higher rates of economic growth. As a consequence, the budget deficit has grown even more rapidly than expenditures, requiring, in turn, more internal and external borrowing to cover the gap. This can become a vicious circle unless dealt with quickly and effectively.

21. The data given below demonstrate the severity of the budget problem:

K£ Million

	78/79	79/80	80/81	Percentage Increase 78/79–80/81
Current Revenues (including grants)	523·9	630·1	721·1	37·6
Less: Consolidated Fund Services	73·7	87·9	132·0	79·1
of which				
Internal Debt Service ..	(34·2)	(36·8)	(51·2)	49·7
External Debt Service	(31·2)	(41·9)	(70·7)	126·6
Revenues Available to Ministries	450·2	542·2	589·1	30·8
Less: Expenditures by Ministries	623·9	693·4	830·1	33·0
Overall Deficit	173·7	151·2	241·0	38·7
Domestically Financed ..	(112·4)	(76·5)	(114·2)	1·6
Externally Financed ..	(61·3)	(74·7)	(126·8)	106·9

During this period, over which G.D.P. at market prices increased by 32.8 per cent, current revenues including grants increased by 37.6 per cent. But because consolidated fund services, composed of debt service on loans contracted earlier, increased by 79.1 per cent, revenues available to ministries could increase by only 30.8 per cent. However, expenditures by ministries increased by 33.0 per cent. Hence, more deficit financing was required. The deficit in fact increased by 38.7 per cent. Finally, as domestic savings were not adequate, most of the borrowing had to be arranged externally. External financing increased by 106.9 per cent.

22. As the data below show, revenues from domestic sources amounted to 24.8 per cent of G.D.P. in F.Y. 1980/81 while the share of G.D.P. at market prices absorbed by Government has

risen to 34.1 per cent as compared to 32.2 per cent in F.Y. 1978/79. This has resulted in a squeeze on the private sector effected through the financing of the deficit which in F.Y. 1980/81 amounted to 9.3 per cent of G.D.P. at market prices. In that fiscal year, domestic credit from the banking system to Government increased by 71.5 per cent in order to provide partial financing for this deficit. When the Government resorts to the domestic credit markets on a large scale, the credit available to the private sector dries up. During F.Y. 1980/81, for example, credit to the private sector increased by only 9.5 per cent. The result is that economic activity slows and Government revenues become even harder to raise.

	78/79	79/80	80/81
Current Revenue as % of G.D.P. at market prices	23·6	24·9	24·8
Total Government Expenditure as % of G.D.P. at market prices	32·2	31·9	34·1
Deficits as % of G.D.P. at market prices	8·6	7·0	9·3

23. The situation described here is not uncommon. Most oil-importing developing nations face chronic balance of payments problems, rising debt service costs, and slower economic growth. These problems are even more severe for African nations than for other developing countries. Indeed, the World Bank, in its *World Development Report 1981*, forecasts virtually nil growth in per capita income for oil-importing countries in Sub-Saharan Africa for the entire decade of the 1980's. The Government is convinced that such dire projections are not appropriate to Kenya and that both its past record and present policies provide a sound basis for more rapid growth.

24. The record between 1970 and 1979 can be summarized from World Bank data. Of the 35 oil-importing countries on which data are available, only four had an average annual growth rate of gross domestic product greater than Kenya's 6.5 per cent. Only one country exceeded Kenya's growth rate of agricultural production of 5.4 per cent. Industrial growth in Kenya averaged 10.2 per cent, a rate exceeded in only three countries. Consumption in Kenya grew at 6.9 per cent, only four countries doing better. Moreover, while Kenya had the second highest rate of growth of population, per capita income grew at 2.7 per cent per annum over the period from

1970 to 1979, a rate exceeded in only five countries and those had a combined population significantly smaller than Kenya's population.

25. The policies discussed below are intended to cope with the immediately pressing financial and foreign exchange problems described above and to provide a firm setting for renewed economic growth. Those policies of long-term significance are described first as they are fundamental to the path of future development. These stress rejuvenation of the private sector through the structural adjustment of industry, trade, agriculture, and the pattern of energy use. Monetary and fiscal policies are then shown to support the long-term structural adjustment programme while at the same time serving to redress our urgent balance of payments and budgetary problems. Finally, procedures being established to improve the monitoring and management of the implementation of Government projects and programmes are discussed.

Policies for Renewed Growth in the Private Sector

26. Since Independence it has been the policy of Government to promote the private sector as a major vehicle for development. On the whole this policy has worked well, but it had become clear during the preparation of the 1978-83 Development Plan that some of the features of that policy had run their course. In industry, the potential for import substitution was nearing its limits. Future industrial growth would have to be more export oriented. Unfortunately, the system of industrial protection designed to promote import substitution had not put a premium on efficiency in production which is essential in the world of export competition. In agriculture, opportunities to increase production by opening up new land were diminishing. Future growth would have to depend increasingly on the more intensive use of existing land through improved yields, more efficient land use, and the intensification of small farm and pastoral production. In both sectors, structural and incentive adjustments were required. These were outlined in the Development Plan and were more fully described in Sessional Paper No. 4 of 1980 and in the recent Food Policy Paper.

27. Adjustments as extensive as those required take substantial time to complete. Significant progress has been made in both sectors but much remains to be done before the fruits of these efforts will be fully realized in the form of renewed and more equitable growth.

Structural Adjustment in Industry and Trade

28. The manufacturing sector in Kenya has grown since Independence at an average annual rate of 9.5 per cent and now accounts for approximately 15 per cent of gross domestic product. That growth has been predicated on a strategy of import substitution, whereby domestic production facilities are created to serve the domestic market, thus eliminating the need to import the products now produced locally. So long as domestic production is efficient and internationally competitive, this strategy is perfectly sound.

29. Unfortunately, infant industries are not usually efficient and internationally competitive. They require special protection from international competitive forces until they achieve the vigour to compete on equal terms in the market place. In Kenya, such special protection has taken various forms including exclusive monopoly status, letters of no objection whereby competitive imports must be approved by the local producer, bans on imports, quotas, duty drawbacks, high tariffs, and Government participation.

30. These forms of protection have enabled local manufacturers to charge higher prices than those prevailing internationally and to make profits even though they operated in a relatively inefficient manner. Consumers have paid those higher prices for final products. Other manufacturers have incurred higher costs for locally produced intermediate products making them less competitive in international markets even though they themselves operate efficiently. These costs of import substitution have been willingly incurred in the expectation that improved efficiency would soon be achieved.

31. More recently it has become clear that the scope for further import substitution is limited and that future industrial growth must depend more on export markets. These facts have three important implications. First, forms of protection for inefficient industries must be modified to provide stronger incentives for improving efficiency. Second, further import substitution in the production of intermediate products must not threaten through high costs the internationally competitive position of exporting firms who must use those intermediate products in their own production processes. Third, positive incentives for exporting must be provided. These considerations were the basis for the structural adjustment programme outlined in the Development Plan.

32. That programme provides for the gradual elimination of import duty concessions and quantitative forms of industrial protection because they provide no incentives for improving efficiency. Reasonable and equivalent tariff protection will initially be arranged. The levels of protection will then gradually be reduced to stimulate efficiency. Taxes on domestic sales, whether of imported or locally produced goods, will be adjusted as required in order to sustain Government revenues. The programme also provides suitable incentives for export.

33. The programme was initiated in the Budget message presented in Parliament in June, 1980. The initial steps were the removal of bans on imports and no objection certificates, tariff increases on over 200 items to ensure reasonable protection, and the imposition of a 10 per cent tariff surcharge. At the same time export compensation was increased from 10 to 20 per cent and interest rates were raised by one percentage point.

34. Since that time, four major further steps in the implementation of the programme have been taken. First, a significant revision of price controls was introduced during 1981 as a means of promoting industrial efficiency. It is recognized that efficiency in production requires considerable flexibility in adjusting prices to reflect costs and market conditions. Hence, prices on many products produced domestically under reasonably competitive conditions or subject to effective competition from imports were freed from price controls. This action is, however, being monitored carefully to ensure that reasonable competitive conditions do exist where prices have been decontrolled and that consumers are not adversely affected. The limited resources of the Price Controller can now focus more effectively on the control of prices less subject to competitive forces. As tariffs are rationalized and brought to levels where import competition is effective with respect to other products, further adjustments in price controls will be introduced. With respect to monopolized areas of production, the Government is reviewing alternative means of more effective regulation in order to protect exporters and consumers from excessive costs.

35. Second, two adjustments of the foreign exchange rate amounting to approximately 22 per cent were introduced during 1981.

These are discussed more fully below in the section on monetary and fiscal policies but their direct effects on the structural adjustment programme are noted here. These adjustments have made imports more expensive in Kenya shillings thus providing further non-quantitative protection for domestic industry and increasing the incentive to produce locally some of the products now imported. The adjustments also serve to stimulate exports, particularly of those goods having a high domestic value added component. The simple import and re-export of a product is not stimulated (or harmed) at all, but products produced mainly with domestic materials and labour, such as coffee and tea, are given a strong stimulus.

36. Third, increases in tariffs ranging from 2 to 90 per cent were introduced on over 1,400 items in the Budget message of 1981. At the same time tariffs on about 20 items, mainly important inputs for exports industries, were reduced. These actions adjusted protection further and placed selected industries in stronger competitive positions in international markets by reducing their costs of essential imported materials.

37. Finally, a new system of import licensing has been introduced with full effect from November, 1981. Two Schedules have been established and all imported items have been allocated to one or the other of these. Schedule I contains high priority imports, such as raw materials, machinery and intermediate products. They are admitted without quota, and import licences and foreign exchange approval are readily granted.

38. Schedule II has two parts, A and B, and Schedule IIA has two sections. One section contains high priority goods, such as maize, petroleum and fertilizers, which require special licensing arrangements. Otherwise they are treated similarly to goods on Schedule I, being essential for development. The second section of Schedule IIA contains imported items which are administered under foreign exchange quotas. The purpose of these quotas is balance of payments control, not protection of domestic industry.

39. Schedule IIB contains imported items for which quotas are established by specific item. The underlying purpose of these quotas is to protect domestic industries owned and operated by Kenyans.

The nature of this protection will be gradually shifted away from quotas to tariffs.

40. The new import schedules are being monitored with respect to licences issued and foreign exchange approved. The analysis of this information will be the basis for the gradual movement of items from the quota Schedule II to the quota-free Schedule I, a key element in the structural adjustment process. The pace at which items will be moved to Schedule I will depend on the availability of foreign exchange, and in part, therefore, on Kenya's access to and success in external markets.

41. Structural adjustment in the industrial sector is now at an advanced stage. It is being supported by export promotion activities of the Kenya External Trade Authority and the Export Promotion Project which finances feasibility studies for export projects. In addition, the I.C.D.C., I.D.B., D.F.C.K., and K.I.E. are promoting development, efficiency and export orientation throughout the industrial sector. Moreover increases in interest rates and import prices have tended to curtail demand for less important imports freeing needed foreign exchange for essential imports. Finally, loans arranged with the I.M.F., the World Bank, and other concessionary and commercial sources have assisted us to finance essential imports while the structural adjustment toward exports gains momentum.

42. The role of the parastatal sector in the structural adjustment programme has not yet been clearly defined. The Ndegwa Committee on Parastatals noted that the mixture of social and economic functions often assigned to parastatals had made their roles ambiguous, that the return on the substantial overall investment in parastatals was practically nil, and that their management, financial control, and reporting often left much to be desired. Structural adjustment must embrace a more constructive and profitable role for essential parastatals and the return of others to private sector operation. The Government is also screening all requests for loan guarantees in order to limit new borrowing to only the most essential needs.

43. To be successful, the structural adjustment of industry must enlist substantial support from foreign investors. Domestic savings are not sufficient to meet investment needs and in any case much of

the finance required is in the form of foreign exchange. The phased removal of quantitative restrictions on imports, the establishment of definite and comprehensive Import Schedules, the streamlining of licensing procedures, and the easing of price controls should reduce red tape, increase economic flexibility and make the Kenyan setting more attractive for investment. Moreover, improved export incentives and export promotion activities should direct more of that investment into export industries. Finally, the continuing dialogue between Government and the private sector may reveal other ways in which the flow of private foreign investment can be strengthened and provide a basis for improving the structural adjustment programme.

44. Finally, the programme will actively support the Kenyanization of the economy, particularly with respect to the ownership and management of enterprises by Kenyans, which is the most important remaining phase of the Kenyanization programme. First, existing Kenyan enterprises are provided special protection through Schedule IIB and adequate tariff protection will be established as quotas are gradually removed. Second, the possibility that Government will sell shares in selected parastatal enterprises or a holding company to Kenyans would increase Kenyanization of the economy without entailing the transfer of scarce domestic saving to foreigners. Finally, increases in interest rates on deposits amounting to five percentage points over the last two years should stimulate domestic savings and enable more Kenyans to invest in established companies and to start new businesses.

Restructuring Agriculture

45. Agriculture, including livestock, is the nation's major source of food, foreign exchange and employment. Its rapid growth means that the sector can supply the food required by a growing population, produce more for export abroad and provide productive work for the expanding labour force. If agriculture grows more slowly than the population, an increasing share of its resources must be directed to food production, a declining share to production for export, and both taken together will provide fewer jobs for those seeking work. The rapid growth of agricultural production is the nation's highest development priority.

46. Rapid growth has been achieved in the past through the expansion of acreage under crops and increases in yields per acre. The area devoted to crops has been increased through the conversion of pastures and some forest land to crops, irrigation and drainage schemes, and the fuller utilization of previously idle land. Yields have increased through the transfer of land from largeholders to smallholders, new and improved varieties of seed and crops. irrigation, the more extended use of fertilizers, insecticides and pesticides, better land management, and improved access to markets.

47. It has become apparent in recent years that the easy and less costly ways of expanding the area under cultivation were nearing exhaustion. Future increases in agricultural and livestock production would depend to a larger extent on increasing yields. Structural adjustment in agriculture, as outlined in the Development Plan and more recently with respect to food production in the Food Policy Paper, is intended to achieve increases in output largely through the achievement of higher yields. The Development Plan projected agricultural output to grow at 4.7 per cent per annum on the average. Of the annual increase in output, 27 per cent was expected to result from increases in the area under cultivation. Improvements in yields would account for 73 per cent of the annual increase in output.

48. The shift to improvements in yields as the major source of future increases in agricultural output requires significant changes in both incentives and institutional arrangements many of which have been outlined in the Food Policy Paper. The Government is confident that the nation's farmers and pastoralists will respond effectively to appropriate production incentives if they have access to inputs and markets. The structural adjustment programme in agriculture is intended to establish appropriate incentives and effective means for delivering inputs and marketing outputs.

49. The prices farmers receive are the principal incentive to which farmers respond in producing for the market. These depend on prices in the market place and the costs incurred in transporting and handling produce from the farm gate to the market place. Reducing those intermediate costs for both inputs and outputs is an essential ingredient of the programme and is discussed below.

50. The prices of export crops, denominated in foreign currencies, depend mainly on international market forces over which Kenya, being in most cases a small producer, has little control. The shilling prices of these commodities, however, can be modified through adjustments of the exchange rate and it is the shilling prices to which our farmers respond. The exchange rate adjustment introduced in February 1981 had the effect of raising the shilling price of export crops by 5 per cent. The further adjustment in September 1981 increased these prices by an additional 17 per cent. The Government has therefore, introduced a strong incentive for produrers of export crops to increase yields in order to make larger profits.

51. In establishing farm prices for produce consumed in Kenya, the nation faces an important dilemma. Higher farm prices, without savings in farm to market costs, mean higher prices to consumers. In the past, when food could be produced by bringing more land under cultivation, primary consideration could be given to consumers. That situation has changed. Farmers cannot increase yields without incurring additional costs for fertilizer, insecticides, improved seeds, storage facilities and more labour for weeding and the care of crops. They also incur greater risks should the rains fail and must be compensated for doing so. In order to provide farmers with the incentives they require to increase yields, consumer prices must reflect the costs of production. The domestic terms of trade for agriculture, the ratio of prices farmers receive to the prices they must pay for inputs, must improve if yields are to increase. Indeed, to do otherwise would mean insufficient supplies of food for the growing population. In addition, unless price incentives for growing food are kept at levels comparable to the rewards for growing export crops, farmers will shift their production toward export markets.

52. The annual price review of agricultural prices is guided by considerations such as these. The prices announced in December 1981, well in advance of the planning season, provide for the following percentage increases in prices over the previous year:

Commodity	Unit	1981 Price *Sh.*	1982 Price *Sh.*	Per cent Increase
Maize	bag	95	130	36·8
Wheat	bag	160·70	195	21·3
Rice—				
Sindano	Kg.	1·30	2·00	53·8
Basmati	Kg.	1·70	2·70	58·8
Sugar-cane	tonne	150	170	13·3
Sunflower seed	Kg.	1·50	2·00	33·3
Cotton—				
Grade 1	Kg.	3·60	3·80	5·6
Grade 2	Kg.	1·75	1·85	5·7
Cashews	Kg.	3·50	5·50	57·1

These increases should contribute in a substantive way to increase in output through the achievement of higher yields.

53. The institutional changes which form part of the agricultural structural adjustment programme include renewed emphasis on small farm production, the development of gateway towns which are the conduits for inputs and outputs going to and from rural hinterland and the pastoral areas, the rejuvenation and improved efficiency of co-operatives, a greater role for the private sector, a sharper focus of marketing boards on their public functions of strategic storage and price stabilization, and improvements in credit extension and collection.

54. Kenya's system of land tenure is based on the private, individual ownership of small farms. Small farms have demonstrated higher productivity and employment intensity per hectare for most crops and are the principal means by which the benefits of agricultural production can be equitably shared among large numbers of people. Smallholder production will be encouraged wherever feasible. In particular, the programme of land registration and adjudication will be vigourously pursued to bring into the programme the remaining 36 per cent of registrable land on which work has not yet begun. In addition, the *de facto* subdivision of large farms will be given legal recognition as soon as the essential work of surveying and reorganization or disposition of central facilities can be arranged. Programmes fostering smallholder production of such cash produce as milk, coffee, tea, and sugar-cane will be

strengthened. Finally, as has been the case since the 1979/80 crop year, a much larger share of agricultural credit will be channelled to the small-farm sector.

55. The Development Plan provides for a National Land Commission to examine pressing land issues. Since the Plan was published, the Presidential Commission on Soil Conservation and Afforestation has been established and is looking into several of the issues originally allocated to the Land Commission. Remaining issues, such as, land speculation, idle land, and fragmentation, will be examined by Sectoral Planning Groups during the course of preparing the next Development Plan.

56. In order to bring inputs and the market economy into closer reach of the agricultural hinterland and the pastoral areas, the Development Plan has identified several gateway towns for special development efforts. By improving road and transport facilities to these towns and providing essential infrastructure within them, the provision of essential agricultural and livestock inputs and marketing facilities will be facilitated. Given reasonable price incentives and improved access to inputs and markets, more remote farmers and pastoralists will become engaged in production for the market and more closely linked to the monetary economy. The development of these gateway towns is being given a high priority by all ministries concerned.

57. Plans for rejuvenation of the co-operative movement and the establishment of strict standards of efficiency and integrity within it, as announced in December, 1981, are already well underway. This effort is intended to ensure that farmers who deal through co-operatives are paid promptly and fairly for their produce and receive essential inputs on time. It is part and parcel of a larger effort to establish an improved division of functions between Government, the co-operatives and the private sector in the marketing of agricultural inputs and products. Indeed, competition among various forms of marketing of both inputs and outputs will be encouraged in order to assure farmers of fair prices and efficient service. As markets, supply stores, local dairies and transport facilities are developed, opportunities for other rural activities and industries will open up and the growth of the hinterlands will be given fresh stimulation.

58. As co-operatives and private firms demonstrate their ability to manage normal marketing functions, the marketing boards will be able to focus their energies more sharply on management of strategic food reserves. They will need to be modified and strengthened in order to perform this task well. To the extent that this function must be subsidized, the subsidies will be handled as direct allocations in the Government budget and not as an additional burden imposed on consumers.

59. Arrangements for making agricultural credit readily available on reasonable terms have undergone substantial revision in recent years. The Guaranteed Minimum Return arrangement, which was directed mainly to large farmers, was abolished in 1979. It was replaced by the Seasonal Credit Scheme directed principally to small-scale farmers and co-operative societies. While substantial amounts have been loaned under the new scheme, repayment performance by borrowers has been unsatisfactory. The Seasonal Credit Scheme is being reviewed therefore to improve its overall management and the recycling of funds, but the direction of benefit will remain unchanged. The repayment experience of co-operative societies is also being reviewed to determine which societies should qualify for new loans from the A.F.C. and the Co-operative Bank and these institutions will bear more of the risk of default. Crop insurance is also being studied to provide farmers who have received credit some protection against extreme drought.

60. In the longer term, the continuing improvement of yields will depend upon a strong and practical programme of research. That programme will have close links to the farmers both directly and through the extension service in order to identify research needs and to disperse research results as quickly as their practicality has been demonstrated. New and improved biological and mechanical technologies will be required if yields are to be steadily increased in the years ahead. Research will focus on the needs of small farmers for appropriate technologies, reliable energy sources, improved and hardy varieties of seed, and optimal packages of inputs. The extension service will disseminate information on proven techniques, crop varieties and livestock breeds, and will endeavour to assist farmers to improve their management efficiency.

61. In order to make the extension service more responsive to farmers' needs, new methods of extension will be introduced. These methods revolve around more systematic training and visiting programmes. The extension services play a vital role in linking research to the needs of farmers, and continuous efforts will be made to improve its performance and efficiency. In addition, private sector programmes to increase the productivity of farmers will also be encouraged.

62. As less productive land is brought under cultivation and yields rise with increased use of fertilizer, the risk that national agricultural production will vary more sharply with changes in rainfall increases. Marginal lands and fertilizer technologies are most productive with adequate rainfall. When the rains fail, the shortfall of output may be considerable. In order to reduce this risk, farm planning and management skills must be improved so that fertilizer is properly applied to hardy and productive varieties of crops which are appropriate for given rainfall conditions. In addition, arid and semi-arid lands must be put to suitable uses with appropriate technologies.

63. Despite these precautions, variations in agricultural production are inevitable. The Food Policy Paper outlines Government plans to establish a large strategic reserve at the end of each buying season to ensure adequate food supplies throughout the year. The physical storage of food reserves will be costly in terms of the physical facilities required and the losses of food to pests and through deterioration while in storage, and we must be cognizant of the budgetary and foreign exchange constraints on establishment and maintenance of large food reserves.

64. If the increases in yields sought are secured, we shall have adequate food supplies, earn more foreign exchange through exports, provide domestic industry with essential raw materials, and create significant numbers of employment opportunities. The problem of what to produce can be easily solved because there will be more of everything. Targets in agriculture must be regarded as firm commitments.

65. The structural adjustment programme in agriculture suffered a setback in 1980 as the drought created urgent food supply problems and diverted attention and management time from implementation of the programme to the food crisis. Nevertheless, substantial progress has been made as outlined above and further progress will be made in the years ahead despite continuing budgetary and balance of payments difficulties.

Restructuring the Pattern of Energy Use

66. Energy is essential for development. The principal sources of commercial energy are oil and electricity. The non-commercial sector, which includes rural households, relies heavily on wood and charcoal. Eighty per cent of all commercial energy comes from oil and in that fact lies the nation's major energy problem. Nearly as critical, however, is the fact that needs for non-commercial energy by the rapidly growing population threaten to outstrip our ability to replenish supplies of wood as quickly as they are used up. Both problems require policies designed to restructure our pattern of energy use.

67. The rising cost of crude oil and petroleum products since 1973 has caused all oil-importing nations serious balance of payments problems. The magnitude of the problem in Kenya is indicated by the following data:

K£ Million

	1973	1974	1980	1981
Oil Imports	22·3	82·1	277·3	358·1
Oil Exports	21·2	45·6	160·9	158·0
Net Cost of Oil	1·1	36·5	116·4	200·1
Non-Oil Exports	140·2	165·7	326·7	350·9
Portion of Non-Oil Export Earnings Required to Finance Net Cost of Oil (%)	0·8	22·0	35·6	57·0
Portion of Non-Oil Export Earnings Available to Finance Non-Oil Imports (%)	99·2	78·0	64·4	43·0

While only 0.8 per cent of non-oil export earnings were required in 1973 to finance the net cost of oil imports, 57.0 per cent was required in 1981. As a consequence, in 1981 only 43.0 per cent of non-oil export earnings was available to finance non-oil imports while nearly all of those earnings were available to us in 1973. Non-oil imports in the form of raw materials, spare parts, and machinery and equipment are essential ingredients of development. The underlying reason for the drastic change in expenditures on oil is that the prices we have had to pay for oil in 1981 were approximately 13 times higher than those we paid in 1973.

68. Oil prices are now levelling off and further drastic increases are not expected over the next two years. It seems likely, however, that the high price of oil relative to other sources of energy will be maintained. This assumption underlies the several policies initiated in the Development Plan to restructure the pattern of energy use. The objectives of those policies are:

68.1. to ensure that demand reflects development priorities and the essential needs of the people.

68.2. to encourage the efficient use of energy and its conservation in every use.

68.3. to redirect demand toward less costly and renewable sources of energy; and

68.4 to develop indigenous sources of energy supply.

69. The Government cannot protect users of energy from the higher costs of procuring and producing it. Indeed, to do so would encourage consumption and less efficient use. Moreover, given the high administrative costs and the inefficiencies and inequities associated with direct rationing, it is Government policy to rely largely on the pricing mechanism to bring about a more rational use of energy.

70. Petroleum products have gone up more rapidly in price than other forms of energy, though not as rapidly as the crude oil from which those products are manufactured. Product prices in 1981 in Kenya were about 6 times product prices in 1973, while crude oil prices were about 13 times 1973 prices. This reflects the lower rate of increase in prices of complementary inputs and improvements

in efficiency at the refinery and in the distribution system, the pipeline being a major factor. That the higher prices have had an effect on petroleum consumption can be seen from the following data which relate the use of petroleum and all commercial energy sources to the growth of the monetary economy:

Year	Index of Monetary G.D.P. at constant prices	Index of oil, coal, coke and electricity consumption	Index of petroleum products consumption
1976	100	100	100
1977	109	104	103
1978	116	111	106
1979	120	113	107
1980	124	117	113
1981	130	119	107

71. Since 1976, when higher prices began to affect the users of petroleum products, consumption of these products has increased by 7 per cent while monetary gross domestic product has increased in real terms by 30 per cent. Hence, consumption of petroleum products has grown by less than one-quarter of the rate of growth of monetary gross domestic product. Total consumption of commercial energy has, however, grown nearly two-thirds as rapidly as monetary G.D.P., and consumption of non-oil commercial sources of energy has grown even more rapidly than monetary G.D.P.—in fact by over 44 per cent over this period. Significant substitution of non-oil for oil sources has already taken place.

72. The pricing mechanism is also being used effectively to encourage the more efficient use of energy sources. A cost-reflecting tariff structure for electricity was introduced in 1979 in order to shift demand from peak to off-peak hours and reduce transmission losses. The higher prices of petroleum products have discouraged non-essential journeys and, together with the reduced speed limit, have encouraged more efficient driving. The price of illuminating kerosene has not risen as rapidly as prices of most other petroleum products in order to provide this essential commodity at as favourable a price as possible.

73. Despite these efforts, preliminary studies have shown that the industrial sector could save as much as 15 per cent of the energy it now uses through more efficient plant processes. Methods for inducing appropriate changes, such as waste energy recovery and prevention, are under study. The aim is to attain lower indexes of energy intensity for each sector of the economy. This index, represented by the quantity of primary energy used per unit of product, is also a function of the type of energy used. More efficient uses of wood and charcoal in the rural areas are also under study because the potential savings in energy in those uses are substantial.

74. As already noted, there has already been a significant shift from petroleum as a source of energy to alternative sources. The search for cheaper sources of energy as substitutes for petroleum is a continuing one. The cement industry is embarking on plant modifications to substitute coal for petroleum. While both products are imported, there will be substantial savings of foreign exchange as a result of the shift to coal. Similar studies are going on in other industries and will result in further foreign exchange savings.

75. Substitution does require the availability of other options, and major efforts have been initiated in Kenya to increase non-oil sources of energy for commercial users and to develop substitutes for wood and charcoal in the rural areas.

76. A growing share of electricity is produced with hydro power. In 1976, hydro capaciy amounted to 48.5 per cent of total installed capacity. By 1980, this ratio had risen to 64.6 per cent, and with the completion of Masinga Dam, the ratio is approaching 70 per cent. When the Kiambere and Turkwel projects are completed, 225 MW will be added to the hydro-system, but the ratio will not change much because of the parallel development of geothermal power. Kenya's estimated geothermal capacity of 500 MW is beginning to come on stream with the construction of a 15 MW station commissioned in 1981. Geothermal capacity is expected to reach 30 MW in 1983 and 170 MW in 1988. On another front, the production of fuel alcohol to mix with petrol will provide a direct substitute for petroleum imports.

77. Alternative sources of energy to wood and charcoal are also being developed for rural users of energy. The Rural Electrification Programme is intended to help the development of rural industry

as well as to raise the standard of living of the people. Other efforts are also underway to widen the energy base in rural areas. These include the development of quick growing species of trees and the introduction of simple and efficient technologies for deriving usable energy from other renewable sources, such as biogas, wind and solar sources. Pilot projects are in operation for each of these sources.

78. The structural adjustment programmes described for industry, agriculture and energy are intended to maximize the productive use of the nation's resources, to diversify and stabilize exports, and to establish a sound basis for renewed, long-term growth. These basic adjustments may have to move ahead more slowly because of external pressures on our balance of payments and the effect of temporarily slower growth on budgetary revenues. Nevertheless, these structural adjustments will help also to alleviate those financial problems in the longer term. It is essential, therefore, that shorter-term financial measures to ameliorate balance of payments, monetary and fiscal problems be viewed in the context of structural adjustment and contribute to rather than disrupt those programmes.

Balance of Payments Policies

79. The balance of payments situation is indeed serious. It must be brought under control in ways which will not jeopardize the development of the nation. We cannot do without those imports, such as crude oil, machinery and raw materials, that make growth possible. We must rather seek remedies through the expansion of exports, the reduction of non-essential imports, and special external finance to cover residual deficits until export earnings improve.

80. The recent situation and projections for the next three years are summarized below:

K£ Million

	Actual	Estimated		Projected	
	1980	1981	1982	1983	1984
Current Account Balance ..	–373·4	–333·6	–290·8	–260·5	–253·7
Normal Capital Inflows ..	257·3	182·0	136·4	164·8	163·6
Overall Deficit	–116·1	–151·6	–154·4	–95·7	–90·1
Special Financing	68·6	91·0	201·0	115·7	110·1
Change in Reserves	–47·6	–60·5	46·6	20·0	20·0

Because foreign exchange reserves have been drawn down so sharply in the last two years, and further decreases cannot safely be considered, we must either restrict essential imports or seek substantial amounts of special balances of payment finance in 1982 As the projections indicate, the Government has chosen the latter course.

81. The nature of the special finance received in the last two years and projected for the next three years is as follows:

K£ Million

	Actual		Projected		
	1980	1981	1982	1983	1984
I.M.F., net	21·2	34·6	116·5	56·5	50·9
I.B.R.D., net	26·9	—	66·8	40·0	40·0
Other Concessionary Loans, net	—	22·0	30·8	40·0	40·0
Commercial Loans, net ..	20·5	34·4	−13·1	−20·8	−20·0
Total Special Finance ..	68·6	91·0	201·0	115·7	110·1

For 1982 a standby loan from the I.M.F. has already been arranged with K£35.8 million having been drawn under this facility in January and a further K£53.8 million in June. Negotiations with the World Bank have been completed recently for a further structural adjustment loan, and the first tranche of that loan amounting to about K£40 million is expected to be received in August or early September. Most of the other concessionary loans have been arranged for 1982 and are being drawn. It is expected that further commercial loans for special balance of payments financing will not be required during 1982. Hence, only repayments are shown.

82. Improvements in the balance of payments over the next three years are expected to follow from improvements in the international economic situation and from domestic measures that are, for the most part, already in place. Internationally, crude oil prices are expected to remain relatively stable over the next two years. This, more than any other single factor, should reduce the rate of international inflation to a more reasonable level. As inflationary pressures subside, the rate of economic growth in the industrialized nations should improve and markets for Kenya's exports should follow suit. The resumption of economic growth in Uganda and the new Preferential Trade Area Treaty should also benefit our exports. In addition, the system of coffee quotas seems to be working reasonably well and promises greater stability in coffee prices. In particular, in 1982 Kenya should be able to sell about 15,000 tonnes more of its coffee in quota markets than it was able to sell

in 1981, and at somewhat better prices. A similar system for tea may be worked out over the next two years. Finally, the outlook for lower international interest rates should improve economic activity and reduce the current high cost of borrowing.

83. Several of the domestic policies discussed in conjunction with the structural adjustment programme are beginning to have favourable effects on the balance of payments. In particular, export incentives are encouraging the private sector to explore export opportunities more vigorously and increases in tariffs and the tariff surcharge are discouraging imports and stimulating the production of domestic substitutes. The two devaluations in 1981, amounting to about 22 per cent, have reinforced these other measures by making imports even more expensive and exports even more profitable. As the private sector begins to respond to this new pattern of incentives, the balance of payments will improve.

84. In further support of these measures, Government has introduced firm controls over its own requirements for foreign exchange. Priority is being given to development projects whose foreign exchange costs are covered by foreign grants and concessionary loans. Imports of vehicles and equipment are restricted to those financed by foreign aid. Foreign travel has been restricted to essential journeys and these require approval of the Office of the President. Finally, defence imports have been limited to those for which commitments have already been made or which are required for training and supply purposes.

Other Monetary Policies

85. Since the beginning of 1980, the interest rate on deposits has been raised by five percentage points and lending rates have been raised by four percentage points. These interest rates now stand at 10 and 14 per cent respectively and can be compared with an inflation rate of about 12 per cent. Real lending rates are therefore positive and real deposit rates are only slightly negative. It is Government policy, through periodic adjustments, to maintain the structure of interest rates at levels which will encourage saving and discourage speculative borrowing.

86. When domestic interest rates are comparable to interest rates prevailing abroad, the incentive to borrow funds locally for use abroad or to borrow locally instead of bringing in funds from

abroad, both of which are harmful to our balance of payments, disappears. Second, positive real deposit rates stimulate domestic saving and a greater share of investment in Kenya can be financed domestically, reducing our need for private foreign investment. Third, positive real lending rates discourage borrowing to finance unnecessary imports and the accumulation of unneeded stocks. Such rates also help to make credit available to those who will use it most productively whether in industry or agriculture.

87. The policies discussed depend in part for their effectiveness on other related policies for controlling domestic inflation. If domestic costs of production were allowed to rise at the same rate as import prices, the favourable effects of the two devaluations described above would be quickly dissipated. Then the competitive advantages given to domestic production over imports and to exports in foreign markets would be lost. In any case, as imports amount to almost 40 per cent of G.D.P. in 1981, domestic market prices must be expected to rise as the higher import prices are reflected throughout the economy.

88. What must be done is to ensure that the domestic costs of production do not rise as rapidly as the import costs of production. This will ensure that domestic production retains its competitive advantage both at home and abroad. Rising production will also stimulate employment.

89. The wage guidelines to the Industrial Court are designed to contribute to this objective. For the last two years the guidelines have directed that increases in overal wages compensation should not exceed on the average one-half of cost of living increases. This limit has recently been raised to 75 per cent. In awarding increases, employers and the Industrial Court are instructed to favour those being paid lower wages. The guidelines will continue in their present form until our competitiveness in export markets is more firmly established. As international and domestic inflationary pressures subside, the wage guidelines will be further relaxed.

Fiscal Policy

90. Fiscal policy must also support the structural adjustment programme and at the same time reduce the budget deficit which in 1980/81 reached an all time high, amounting to 9.3 per cent of G.D.P. at market prices. Fortunately, those policies which serve to

reduce the budget deficit will also reduce pressure on the balance of payments and release more credit for investment and growth in the private sector.

91. The task, however, is a difficult one. It requires that Government revenues be maintained as a percentage of G.D.P. at market prices, while Government expenditures, as percentage of G.D.P. at market prices, are reduced. This does not mean that Government expenditures must be reduced in absolute terms, but they must grow more slowly than G.D.P. and Government revenues. The objective is to reduce the budget deficit to approximately 5 per cent of G.D.P. at market prices by the fiscal year 1983/84.

92. The forward budgets that have been projected to achieve this objective are summarized below in current prices:

K£ Million

	Actual	Estimated	Projected		Average Annual Growth
	1980/81	1981/82	1982/83	1983/84	%
Total Non-Loan Revenue* ..	721·1	841·1	904·2	1,021·5	10·4
Consolidated Fund Services ..	132·0	169·1	198·6	218·6	16·4
Disposable Revenue	589·1	671·1	705·6	802·9	9·1
Total Expenditure of Ministries—					
Recurrent ..	(555·1)	(613·3)	(614·2)	(684·6)	(5·8)
Development ..	(275·0)	(331·4)	(310·0)	(325·0)	(4·5)
Overall Deficit ..	241·0	273·3	218·6	206·7	–3·6
Financed by:					
External Sources	126·8	138·5	148·4	131·7	0·1
Domestic Non-Bank Sources ..	66·4	50·0	50·0	55·0	–4·3
Domestic Bank Credit	47·8	84·8	20·2	20·0	–14·5
Total Financing	241·0	273·3	218·6	206·7	–3·6
As % of G.D.P. at Market Prices	9·3	8·1	6·1	5·1	—

*Including Foreign Grants.

93. Revenues are expected to grow at 10.4 per cent per annum on the average. Consolidated Fund Services, mainly debt service, will, however, grow at 16.4 per cent per annum and represents a first claim on revenues. Hence, disposable revenue, that available for the financing of expenditures by ministries, will grow more slowly, namely at 9.1 per cent per annum. It follows that if the budget deficit is to be reduced, total expenditure of Ministries must grow more slowly than disposable revenue.

94. This is the most critical fiscal problem—how to contain the growth of total expenditure while at the same time continuing to supply the essential services of Government in the quantities required. To do so will require actions of two kinds. First, as essential services depend primarily on the Recurrent Budget, recurrent expenditure must be allowed to grow somewhat more rapidly than total expenditure. Hence, the main burden of slowing expenditure growth must fall on the Development Budget. Development expenditure is in fact programmed to fall in real terms over the period in order to ensure that essential services are maintained during this period of austerity. Second, the efficiency of Government in providing essential services will be improved through the fuller utilization of presently underutilized facilities and staff, improved care and maintenance of capital stock, and the reduction of duplications of functions and responsibilities.

95. As a result of these actions, the Government deficit will be reduced in absolute terms and brought into a more reasonable and sustainable relationship to G.D.P. at market prices.

96. The structure of deficit financing will also be modified. In particular, the heavy reliance on bank credit which was necessary in 1980/81 and 1981/82 will be sharply and quickly reduced. The objective is to reduce the share of new credit required by Government so that the private sector can resume more normal growth.

97. This is an austere fiscal programme. While development spending suffers the most, it is also true that economic services and the provision of basic needs will have to be more carefully and economically planned than heretofore. Within economic services, higher priority must be accorded to the maintenance of existing capital,

including roads, pipelines, railways and rolling stock, ports, buildings, and the telecommunication network. Those new projects that can be introduced must demonstrate improvements in service to the rural areas and to the target groups identified in the Plan as the focus of the strategy to alleviate poverty. In order to reduce the subsidy element in the provision of economic services, the appropriateness of charges to those who benefit from the services will continue to be reviewed and adjusted accordingly. Most recently, railway tariff rates were raised in 1981 and postal rates were increased in 1982. The adjustment in postal rates is the first since 1975.

98. The provision of basic needs is essential to the alleviation of poverty but here, too, priorities must be rearranged. The rehabilitation of existing water schemes must take precedence over new projects; preventive and rural medicine must be given a higher priority relative to curative facilities in the urban centres; and the funds that can be provided for housing must be directed increasingly to lower income requirements so that more people can be helped at a lower total cost. As with economic services, charges to the beneficiaries of basic needs services must be kept under review. If charges can be increased to those who now benefit, similar services can be extended to others within the same total cost to Government and the tax-payers. Finally, the provision of more health and education services by voluntary associations and others in the private sector will expand the numbers of people served without increasing the burden on Government. The needs are there and all who can assist to meet them will be given the opportunity to do so.

Improving Implementation

99. As noted, the objective of spending limited funds efficiently and effectively is being vigorously pursued. Improvements in the management and implementation of Government activities are neccessary if the essential services of Government are to be provided in reasonable amounts and at reasonable cost. The measures being introduced are focussed on the planning and budgeting of development projects, the control of expenditures, the claiming of foreign aid, the early identification of implementation problems and the prompt introduction of remedial actions when these are necessary.

Realistic Budgeting

100. Given the austerity of the forward budgets summarized above, it is essential that Ministries plan their expenditures with even more care than usual. Procedures are thus being introduced in the Forward and Annual budgeting processes to ensure that:

100.1. financial ceilings are strictly adhered to;

100.2. foreign aid is drawn, to the extent it is available, as a supplement to domestic revenues;

100.3. foreign exchange requirements of projects are minimized;

100.4. specialized manpower and skills necessary to implement projects are clearly identified;

100.5. future operational funding and staffing requirements of projects are properly planned.

101. In addition, Ministries have been instructed in planning their expenditures to give first priority to improving the degree to which existing facilities and staff are efficiently utilized. Hence, in budgetary decision-making, provision must first be made for the operation, maintenance, rehabilitation and full utilization of existing facilities. Second priority will be given to the completion of on-going projects. Only after adequate provision has been made for the accomplishment of these two tasks will new projects be entertained. In all of these development efforts, concessionary sources of aid must be identified and utilized to the maximum extent. All projects requiring substantial amounts of local finance will be rigourously scrutinized and pruned or postponed if possible.

102. New projects, hereafter, will be subjected to even more careful and rigourous evaluation than has been the case in the past. A project evaluation handbook is being prepared containing specific guidelines for the presentation of investment proposals and the calculation of economic and financial rates of return. Sponsoring agencies will be required to prepare all proposals according to handbook guidelines. Beginning in the 1982/83 financial year, no projects will be considered for inclusion in the Development Budget unless they are proposed in the prescribed fashion.

103. In addition to these evaluation guidelines, procedures are being introduced which require that realistic forward implementation schedules be set out for all development projects, including Government equity, loan and loan-guarantee investments in major parastatals and public companies. Beginning in the 1982/83 financial year, projects will not be considered for inclusion in the Forward Development Budget unless implementation processes have been realistically scheduled and specific implementation objectives established.

104. Finally, the Office of the President is reviewing the management and implementation capacity of all operating Ministries. Where institutional weaknesses are identified, remedial measures will be initiated to overcome them. The intention is to achieve improvements in organization, management methods, and staff productivity as quickly as possible.

Expenditure Control

105. The Government accounting system monitors and controls public expenditure. Several improvements in this system have been recently introduced. A report of expenditures on each project is now required as part of the procedure for drawing funds from the Exchequer. In addition, cumulative financial histories of all projects are being compiled. A monthly flash expenditure reporting system has also been introduced which sets out revenue, recurrent expenditure and development expenditure figures by ministry. These various sources of information will improve financial control and the regular review of project implementation. In addition, procedures are being developed to ensure that financial commitments are consistent with budgetary allocations.

106. Finally, because of the sharp rise in debt service—interest and repayments—the Government is formulating an overall borrowing plan covering Government and Government-guaranteed debt. Borrowing plans of Government and loan-guarantee plans of municipalities and parastatals will be reviewed annually as part of the budgetary process.

Claiming Foreign Aid

107. The current Development Budget contains over K£150 million in donor financing of individual projects. However, during the past five years, actual receipts of budgeted donor contributions have varied between 60 and 90 per cent of budgeted receipts. Shortfalls in aid receipts stem from two principal factors. First, aided projects may encounter implementation delays. Second, there may be delays in the claiming of aid which is due.

108. The consequences of delays in the claiming and reimbursement of foreign aid are particularly severe. Local funds are tied up at the expense of other development programmes, and needed foreign exchange receipts are deferred. In addition, Government borrowing rises to underwrite shortfalls in external receipts. In these circumstances, steps must be taken to remove the backlog of outstanding claims and to ensure more rapid reimbursement in the future.

109. A crash programme was launched in 1980/81 to obtain all outstanding claims from Ministries, forward them to donors and receive reimbursement. This programme had considerable success in that 82 per cent of budgeted receipts were received for the 1980/81 financial year. Since then, procedures have been introduced requiring ministries to keep claims fully up to date. Under these procedures, when ministries request funds from the exchequer for projects, they must report both the amounts claimable from donors and actual amounts claimed. Where backlogs of outstanding claims are excessive, drawings of more development funds by the ministry concerned are deferred until proper claims for foreign aid reimbursement have been prepared. In addition, discussions are being held with donors to reduce the stringency of reimbursement requirements and to speed up the reimbursement of documented claims.

Identifying Bottlenecks and Taking Remedial Action

110. Even with more effective project evaluation, implementation scheduling, and expenditure control, unforeseen implementation problems and bottlenecks will continue to arise. Such problems must be identified quickly and corrected without delay. The financial reporting procedures outlined above will assist in the

identification of problems. Regular implementation report procedures are also being introduced for all development projects. In addition to financial information on drawings, expenditures and claims for aid, these reports will identify for each project:

110.1 any departures from the implementation schedule prepared during the budget process, together with reasons; and

110.2 current bottlenecks, actions taken on problems identified in previous reports, and problems which cannot be resolved by operating ministries acting alone.

111. Summary implementation reports will be prepared for each ministry, highlighting progress and problems. The determination and introduction of remedial measures will normally be the responsibility of each operating ministry. However, when problems become critical to development progress, the Office of the President will initiate action to ensure that effective remedial steps are taken without delay.

District Participation

112. Several measures have been specified in recent Development Plans to strengthen the role and involvement of Districts in project selection, planning and implementation. These include the creation of District Development Committees, the formulation of District Development Plans, and the expansion of local project funding through the Rural Development Fund. These actions have been taken and relevant training programmes for District Officers have been established. These decentralized administrations will be further strengthened through improvements in budgeting, accounting and monitoring methods at the district level.

113. District Development Committees already have a responsibility to monitor all on-going development activities within their borders. Monitoring systems have been initiated at the district level which will be fully co-ordinated with the ministries' scheduling and monitoring procedures outlined earlier. Through these procedures, district components of major national development programmes will be identified and monitored. Separate Estimates will be established for the district components of those national programmes which are of immediate concern to district administrations. In

addition, all project implementation reports which originate from sectoral officers in district administration will be copied to the secretary of the relevant District Development Committee, where a project registry will be maintained. Finally, project financial and accounting data will be made available to these committees on a regular basis.

114. The measures outlined in this section entail a major tightening of the administration and management of government programmes. Their intent is:

114.1 to ensure that Government resources are allocated only to activities which have been thoroughly evaluated and realistically scheduled;

114.2 to strengthen capacity to identify implementation problems and take corrective actions;

114.3 to identify organizational and staffing weaknesses and ensure that these are corrected;

114.4 to tighten financial management and ensure that overall resource and borrowing constaints are not exceeded;

114.5 to ensure that foreign aid is claimed and reimbursed rapidly; and

114.6. to strengthen the role of decentralized personnel in improving programme management and implementation.

These measures should improve the efficiency of resource use and the pace of economic development.

CONCLUSION

115. This Sessional Paper has discussed policies for coping with chronic financial and balance of payments problems in ways which will support rather than jeopardize the nation's structural adjustment programmes in trade, industry, agriculture and energy. The structural adjustment programmes are intended to provide the basis for renewed and redirected growth as monetary and fiscal problems are reduced to more easily manageable proportions. The discussion of structural adjustment programmes described the longer-term setting within which monetary and fiscal policy decisions have been taken. Hence, while the time perspective of the paper is in the structural sense long term, in the monetary and fiscal

sense, the paper addresses the fiscal years 1982/83 and 1983/84 and the calendar years 1982 to 1984. There are two reasons for this focus.

116. First, Government has authorized the preparation of a new Plan which will cover the fiscal years 1983/84 to 1987/88 and the calendar years 1984 to 1988 inclusive. During the course of preparing the new Plan, intensive reviews of all policies, economic sectors and district development priorities will be undertaken. To attempt to deal with a longer period than the intervening years to Plan publication would require the compression of much plan preparation work into a period of a few months.

117. Second, the years covered, together with 1981, are considered to be the most critical in the management of budgetary and balance of payments affairs. The outlook for the international economic situation is improving somewhat and Kenya's economic prospects should improve accordingly. The low point of economic growth in Europe and Japan appears to have been 1981, when average growth was about nil. Growth in the U.S., on the other hand, is expected to reach its low point in 1982. Prospects for 1983 with some notable exceptions are considerably brighter worldwide. Coffee prices in 1982 are expected to be about 10 per cent higher than in 1981 and tea prices should be up a little. Together with lower prices for crude oil in 1982, Kenya's terms of trade should begin improving in 1982 after declining for four consecutive years. With some revival in Ugandan and world markets, demand for Kenya's exports should be somewhat stronger in 1982 and perhaps considerably stronger in 1983. The domestic economy should also be helped by declining international inflation rates, already apparent, and lower international interest rates expected in 1983. While the demands for careful budgetary, monetary and balance of payments management will clearly extend beyond the time horizon of this paper, the remaining critical years are the two immediately ahead.

118. For similar reasons, this paper has not attempted to cover comprehensively all aspects of economic development. Rather, it has focussed on those issues regarded as most pressing in the two years immediately ahead. The larger task will be addressed in the

next Development Plan. Some implications of the policies discussed in this paper for employment, which is clearly a pressing and growing problem, must, however, be noted.

119. The creation of productive work opportunities is most closely related to the growth in economic activity. When this falls to the low levels of recent years, new jobs are created more slowly and many new aspirants for jobs find none. Policies which are directed to the enhancement of economic growth are by definition also intended to create employment opportunities. The structural adjustment programmes outlined in this paper will stimulate both growth and employment.

120. The need to contain Government expenditure in the years immediately ahead inevitably means that public sector employment opportunities will grow more slowly than in the recent past. But this is not the whole picture. As Government requirements for domestic credit diminish, more credit can be made available to the private sector. Private sector activity should increase more rapidly than it otherwise could and employment opportunities in the private sector should also expand. The necessary firm control of Government expenditure does mean that a larger proportion of school leavers must find work in the private sector than has been the case in the past.

121. A thorough review of employment problems and prospects was recently initiated by Government. The results of this review will be tabled in Parliament as a separate Sessional Paper. The topic deserves much more detailed treatment than the few paragraphs in this paper.

122. This paper has focussed primarily on Government policy and Government's role in overcoming those of our current economic difficulties that stem primarily from changing international circumstances. It is important that Government take the lead in these matters, but the problems are national in scope and the response to them must involve all sectors of the economy. This means that farmers, pastoralists, employees, managers, owners, civil servants, KANU officials, and Members of Parliament must strive to understand the nature of the problems we all confront. Leaders have a vital responsibility to spread that understanding widely among the

people and to stimulate their co-operation and productivity. Effective Government policies are essential to the resolution of the problems outlined in this paper, but in the final analysis it is farmers who produce food and export crops, workers who produce industrial products for both domestic use and export markets, managers who organize efficient operations, and civil servants who provide services in the public interest.

123. It should be noted in conclusion that there is another largely internal set of underlying causes of our present financial situation with which this paper has not dealt. A thorough analysis of these internal causes and of requisite changes in the structure, functions and priorities of Government at all levels will be incorporated in the next Development Plan. It is clear, however, that in order to cope successfully with both internal and external causes enhanced productivity and dedication to the national interest will be required of all citizens. Those are critical ingredients of the national recipe for surmounting current problems. The tradition of mutual social responsibility and the Nyayo philosophy of peace, love and unity will guide us toward the objectives we seek—greater well being for all families and renewed development vigour for the nation.

APPENDIX

PROJECTIONS OF G.P.D. AT CONSTANT (1981) PRICES

	1980	80/81	1981	81/82	1982	82/83	1983	83/84	1984	84/85	1985	85/86	1986	86/87	1987	87/88	1988
	K£m	%	K£m	%	K£m	%	K£m	%	K£m	%	K£m	%	K£m	%	K£m	%	K£m
Traditional Economy	147·1	3·5	152·2	3·5	157·4	3·5	162·9	3·5	168·6	3·5	174·5	3·5	180·6	3·5	186·9	3·5	193·4
Monetary Economy—Agriculture	745·5	6·2	791·7	5·8	838·0	5·0	879·9	4·5	919·5	4·5	960·9	4·5	1,004·1	4·5	1049·3	5·0	1,101·8
Forestry	15·8	7·0	16·9	6·5	18·0	6·0	19·1	5·0	20·1	5·0	21·1	5·0	22·2	5·0	23·3	5·0	24·5
Fishing	5·1	15·7	5·9	5·0	6·2	10·0	6·8	7·0	7·3	5·0	7·7	5·0	8·1	5·0	8·5	5·0	8·9
Mining and Quarrying	6·3	–17·5	5·2	—1·0	5·1	1·0	5·2	2·5	5·3	3·0	5·5	3·0	5·7	3·0	5·9	3·0	6·1
Manufacturing	326·1	5·0	342·4	6·0	362·9	6·0	384·7	6·0	407·8	6·0	432·3	6·5	460·4	7·0	492·6	7·0	527·1
Building and Construction	102·5	—1·9	100·6	2·0	102·6	4·0	106·7	5·0	112·0	4·6	117·1	4·6	122·5	5·0	128·6	5·0	135·0
Electricity and Water	38·5	6·2	40·9	6·5	43·6	6·5	46·4	6·0	49·2	6·0	52·2	6·0	55·3	6·0	58·6	6·0	62·1
Trade, Restaurants & Hotels	280·9	0·3	281·8	1·5	286·0	2·0	291·7	3·0	300·5	4·0	312·5	4·0	325·0	4·0	338·0	4·0	351·5
Transport, Storage & Communications	141·3	1·5	143·4	3·5	148·4	4·0	154·3	5·0	162·0	5·0	170·1	5·0	178·6	5·0	187·5	5·0	196·9
Fin. Ins. R/E & Business Services	136·1	4·5	142·3	5·0	149·4	5·0	156·9	6·0	166·3	6·0	176·3	6·0	186·9	7·0	200·0	7·0	214·0
Ownership of Dwellings	116·4	13·8	132·5	4·9	139·0	6·0	147·3	6·0	156·1	6·0	165·5	6·0	175·4	6·0	185·9	6·0	197·1
Other Services	52·6	6·8	56·2	7·0	60·1	7·0	64·3	7·0	68·8	6·5	73·3	6·5	78·1	7·0	83·6	7·0	89·5

PROJECTS OF G.D.P. AT CONSTANT (1981) PRICES—(*Contd.*)

	1980	80/81	1981	81/82	1982	82/83	1983	83/84	1984	84/85	1985	85/86	1986	86/87	1987	87/88	1988
	K£m	%	K£m	%	K£m	%	K£m	%	K£m	%	K£m	%	K£m	%	K£m	%	K£m
Less Imputed Bank Service Charges	—53·0	4·5	—55·4	5·0	—58·2	5·0	—61·1	6·0	—64·8	6·0	—68·7	6·0	—72·8	6·0	—77·2	6·0	—81·8
TOTAL	1,914·2	4·8	2,004·4	4·8	2,101·1	4·8	2,202·2	4·9	2,310·1	5·0	2,425·8	5·1	2,549·5	5·3	2,684·6	5·5	2,832·7
Private Households	29·6	8·4	32·1	10·0	35·3	12·0	39·5	8·0	42·7	8·0	46·1	8·0	49·8	10·0	54·8	10·0	60·3
Producers of Government Services	372·1	5·3	391·8	4·7	410·2	4·6	429·1	4·5	448·4	4·6	469·0	4·7	491·1	5·0	515·7	5·1	542·0
TOTAL MONETARY ECONOMY	2,315·9	4·9	2,428·3	4·9	2,546·6	4·9	2,670·8	4·9	2,801·2	5·0	2,940·9	5·1	3,090·4	5·3	3,255·1	5·5	3,435·0
TOTAL G.D.P. (at Factor Cost)	2,463·0	4·8	2,580·4	4·8	2,704·0	4·8	2,833·7	4·8	2,969·8	4·9	3,115·4	5·0	3,271·0	5·2	3,442·0	5·4	3,628·4