

**Kenya: 2003 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Kenya**

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2003 Article IV consultation with Kenya, the following documents have been released and are included in this package:

- the staff report for the 2003 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **March 3, 2003**, with the officials of Kenya on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on April 14, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff supplement of **May 1, 2003** updating information on recent developments.
- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its May 2, 2003 discussion** of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for Kenya.

The document(s) listed below have been or will be separately released.

Selected Issues Paper and Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to [publicationpolicy@imf.org](mailto:publicationpolicy@imf.org).

Copies of this report are available to the public from

International Monetary Fund • Publication Services  
700 19<sup>th</sup> Street, N.W. • Washington, D.C. 20431  
Telephone: (202) 623-7430 • Telefax: (202) 623-7201  
E-mail: [publications@imf.org](mailto:publications@imf.org) • Internet: <http://www.imf.org>

Price: \$15.00 a copy

**International Monetary Fund  
Washington, D.C.**

INTERNATIONAL MONETARY FUND

KENYA

**Staff Report for the 2003 Article IV Consultation**

Prepared by the Staff Representatives for  
the 2003 Consultation with Kenya

Approved by Anupam Basu and Liam P. Ebrill

April 14, 2003

- The 2003 Article IV consultation discussions were held in Nairobi during February 17-March 3, 2003. The mission comprised Mr. Kalinga (head), Mr. Rwegasira, Mr. Maehle, Mr. Powell, (all AFR), Mr. McIntyre (PDR), Ms. Jacobs (FAD), Mr. Itam (Resident Representative), and Ms. Vibar (Assistant-AFR). Meetings were held with Mr. Mwiraria, the Minister of Finance, Mr. Nyong'o, the Minister of Planning and National Development, Mr. Nyagah, who was replaced on March 4, 2003 by Dr. Mullei as Governor of the Central Bank of Kenya, and other senior officials. The mission also met with representatives of the donor community, and of the financial and business community.
- The discussions took place against the background of the formation of a new government under President Kibaki, which has begun to implement its election pledges to move to universal free primary education, strengthen Kenya's legal and enforcement anticorruption apparatus, and initiate a wide range of reforms aimed at promoting strong economic growth and poverty reduction.
- Kenya's relations with the Fund are described in Appendix I, and those with the World Bank in Appendix II. The last two IMF-supported programs were not completed, largely because of insufficient progress and setbacks in addressing the pervasive governance problems. An Enhanced Structural Adjustment Facility arrangement was approved in April 1996, but only the first disbursement was made and the arrangement lapsed in April 1999 without completion of any reviews. The current Poverty Reduction and Growth Facility (PRGF)-supported arrangement totaling SDR 150 million was approved in August 2000, and modified and augmented by SDR 40 million in October 2000 in light of a severe drought, but no reviews have been completed and it will expire in August 2003. The new government has indicated its intention to ask for a cancellation of the current PRGF-supported arrangement and to request a new program under the PRGF.
- Kenya has accepted the obligations of Article VIII and maintains an exchange rate system that is free of restrictions on current international transactions.
- Kenya's statistics continue to suffer deficiencies that hamper surveillance. These issues are discussed in Appendix III. A selected issues paper—focusing on medium-term revenue issues, the banking sector, and the labor market—accompanies this report.

Executive Summary .....	4
I. Introduction .....	5
II. Background and Historical Developments.....	5
A. Real Economy .....	5
B. Fiscal Developments .....	8
III. Key Constraints to Growth .....	10
A. Corruption .....	10
B. Financial System .....	10
C. The Labor Market.....	11
D. Inflation, Money Growth, Interest Rates, and the Exchange Rate.....	11
IV. Recent Economic Developments and Prospects for 2002/03 .....	13
A. Real .....	13
B. Fiscal .....	14
C. External .....	15
V. Medium-Term Outlook and Risk Assessment.....	15
A. Main Elements of the Authorities' Reform Agenda .....	15
B. Outlook for Growth and Poverty Reduction .....	16
C. Risk Assessment and External Environment .....	20
VI. Policy Discussions .....	21
A. Restructuring the Fiscal Position .....	21
B. Monetary, Exchange Rate, and International Reserve Issues .....	22
C. Competitiveness Issues .....	24
D. Financial Sector and Parastatals.....	25
E. Governance.....	26
F. External Trade .....	26
G. Statistics and Technical Assistance.....	28
H. Safeguards Assessment.....	29
I. The PRSP Process .....	29
J. External Debt.....	29
VII. Staff Appraisal.....	30
Boxes	
1. Status of Prior Actions for Negotiating a New Program .....	6
2. Pending Bills and Stalled Projects – Problems and Solutions .....	9
3. Comparison of Selected Tax Rates (East Africa Region).....	22
4. Progress on the Design of an Expenditure-Tracking System for Pro-Poor Expenditures .....	23
5. Governance Measures Taken or Announced by the new Government.....	27

Tables

1. GDP by Industry .....	7
2. Medium-Term Macroeconomic Scenario, June-July, Fiscal Year 2000/01-2007/08.....	18
3. Macroeconomic High-Case Scenario, June-July Fiscal Year 2000/01-07/08 .....	35
4. Central Government Financial Operations, High-Case Scenario, 1999/2000-2007/08....	36
5. Balance of Payments, High-Case Scenario, 1999-2008 .....	38
6. External Debt Indicators, High-Case Scenario, 2000-06.....	32
7. Monetary Survey, High-Case Scenario, December 2000-June 2008 .....	39
8. Macroeconomic Base-Case Scenario, 2000/01-2007-08.....	34
9. Central Government Financial Operations, Base-Case Scenario, 1999/2000- 2007-08 .....	40
10. Balance of Payments, Base-Case Scenario, 1999/2008.....	42
11. External Debt Indicators, Base-Case Scenario, 2000-2008 .....	43
12. Monetary Survey, Base-Case Scenario, 2000-2008 .....	44

Figures

1. Real GDP per Capita, 1962-2002 .....	7
2. GDP Volume Growth, 1963-2002 .....	7
3. Selected African Countries: Wages and Salaries in Percent of Total Central Government Expenditures, 1990-2002 .....	8
4. Kenya and Africa: General Constraints on Enterprises .....	10
5. Formal Sector Real Average Earnings, 1981-2001 .....	11
6. Kenya and United States: Treasury Bill Interest Rate Spread and the Exchange Rate, 1991-2002.....	12
7. Terms of Trade and Real and Nominal Effective Exchange Rates, January 1980-December 2002 .....	13

Appendices

I. Relations with the Fund.....	45
II. Relations with the World Bank.....	48
III. Statistical Issues .....	51
IV. Selected Social Indicators.....	55
V. Low-Case Macroeconomic Scenario, 2002/03-2007/08.....	56

## Executive Summary

- **Kenya's economic performance** in recent years has been well below its potential, reflecting primarily the persistence of pervasive governance problems and the slow pace of structural reforms. Real per capita GDP was in 2002 lower than it was a decade earlier. Real GDP growth is projected to edge up from 1.2 percent in 2001/02 (July-June) to 1.5 percent in 2002/03.
- **The new government** has placed the fight against corruption at the top of its agenda, and has embarked on a major strengthening of its anticorruption apparatus, including the tabling of key governance legislation and steps to strengthen the judiciary.
- **A tight monetary policy** over 1998-2001 and the first half of 2002 succeeded in lowering the inflation rate, the treasury bill interest rates, and the perceived country risk premium. After a significant drop in inflation to about 2 percent in the first half of 2002, however, inflation has registered a sharp increase in recent months, partly on account of a transitory tightening in the food supply situation and the surge in the retail prices of petroleum products. During 2002, moreover, broad money growth picked up, and the exchange rate of the Kenya shilling weakened vis-à-vis major currencies.
- **Expenditures** are expected to be higher than budgeted in 2002/03 because of an increase in housing allowances for teachers and the additional expenses associated with providing free universal primary education. The net financing requirement is expected to rise to 6.1 percent of GDP, compared with the 3.3 percent of GDP in the budget.
- **Budgetary management** will continue to be difficult in 2003/04, primarily on account of the need to restructure the banking system and to increase allocations for development spending and essential social services. The wage bill is crowding out other spending, and it will be a challenge to reduce wages as a share of GDP over the medium term because of the announced salary increases for teachers and members of parliament, and the consequential pressure to increase the salaries of other civil servants.
- **Fiscal sustainability** is threatened by the large domestic debt, and the government's large stock of pending bills and contingent liabilities in the financial sector. **Early resumption of program support** is needed to minimize the adverse effects of the large domestic borrowing requirement on macroeconomic stability.
- **The level of nonperforming loans** in the Kenyan banking system continues to be an area of concern. Divestiture of the government's ownership interests in the publicly owned banks is necessary in order to reduce the risk of political interference in lending decisions, improve the collection of bad loans, and enhance the enforcement of prudential and regulatory standards.

## I. INTRODUCTION

1. **At the conclusion of the last Article IV consultation** in March 2002 (SUR/02/33, 3/19/02), Directors commended Kenya for achieving a measure of macroeconomic stability during recent years in difficult circumstances. Directors, however, were concerned that the macroeconomic and financial situation remained fragile, and that investor confidence was low. They stressed the importance of implementing a comprehensive medium-term economic and structural reform program and undertaking measures to address the governance problems that had stalled progress to date. Directors stressed that it was important for Kenya to implement the prior actions needed to resume the Poverty Reduction and Growth Facility (PRGF)-supported program and to help restore confidence.<sup>1</sup>

2. **The 2003 Article IV consultation discussions** focused on an assessment of the financial outlook for the remainder of 2002/03 (July–June), with an emphasis on the budgetary implications of universal free primary education. Also, the discussions examined the adequacy of the medium-term reform agenda to decisively address Kenya’s tepid growth, its weak budgetary position and large domestic debt, and its suitability for Fund support under a new PRGF arrangement.

## II. BACKGROUND AND HISTORICAL DEVELOPMENTS

### A. Real Economy

3. **Kenya’s economic performance during the past 25 years has been well below its potential**, reflecting primarily the persistence of pervasive governance problems and the slow pace of structural reform. Specific factors contributing to low economic and employment growth and virtually no productivity growth include the following: low saving and capital formation; weak property rights and an unpredictable judicial system; a weak banking system; intermittent shortages and high costs of power; poor infrastructure; a falling primary education enrollment ratio; labor market rigidities; and a deteriorating security situation. As a result, **Kenya’s real per capita GDP was lower in 2002 than it was a decade earlier** (Figures 1 and 2), and the number of people living below the poverty line is estimated to have increased from 11.3 million, or 48.4 percent of the population, in 1990, to an estimated 17.1 million, or 55.4 percent of the population, in 2001. Moreover, in recent years, the incidence of the HIV/AIDS pandemic has risen markedly, thereby increasing the social and economic burden.

---

<sup>1</sup> A status report on the prior actions is presented in Box 1.

### Box 1. Kenya: Status of Prior Actions for Negotiating a New Program

#### Governance

Reflecting the main components of the new strategy developed by the authorities and discussed with the IMF staff, near-term actions and indicators of success that were required to allow the conclusion of the first and second reviews under the PRGF arrangement and the approval of a new program include the following:

#### Prior Action

- Passage of an appropriate version of the Corruption Control Bill.
- Passage of an appropriate version of the Public Officer Code of Ethics Bill.
- Evidence of a strengthening of the Attorney General's office to ensure timely action on all pending cases, and measures taken to ensure that the Attorney General's office will be held publicly accountable through the issuing of regular press releases for its actions and decisions relating to prosecution of corruption cases.
- Establishment of special courts to deal with corruption cases on a fast-track basis, including the appointment of reputable judges for these courts.
- A commitment to suspend all public officials whose cases are brought to trial, irrespective of their seniority or position.
- Evidence that the new institutions are working in practice, and that this is leading to the effective prosecution of significant corruption cases in the courts.

#### Status

A revised Anti-Corruption and Economic Crimes Bill has been published and is expected to be passed by parliament in April 2003.

A revised Public Officer Code of Ethics Bill is expected to be passed by parliament in April 2003.

Budgetary provisions have been made to hire more legal officers, and technical assistance is being provided by donors to strengthen operations in the Attorney General's office.

Two anticorruption courts have been established in Nairobi to speed up the prosecution of corruption cases.

Existing regulations specify that all public officials on trial for corruption will be subject to immediate suspension (this does not apply to members of parliament, cabinet ministers, and the judiciary). The new government has suspended all public officials whose cases are under serious investigation.

The new government has made clear its intention to tackle corruption, and there has already been a pickup in activity regarding investigations of corruption. The general perception is that the new institutions to fight corruption are working, with new impetus coming from the zero-tolerance policy of the new government.

#### Other issues

In addition to finalization of a full poverty reduction strategy paper that could form the basis for the new program, bringing the PRGF-supported program back on track will also require the following:

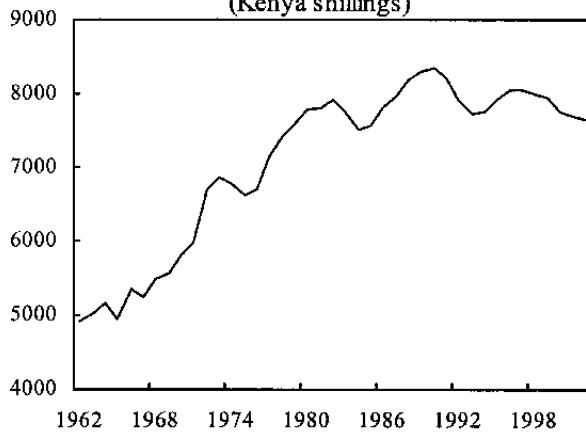
- Taking the remaining actions required under the IDA credit to bring the World Bank-supported program back on track.
- Removing the restrictive provisions of the Central Bank of Kenya (Amendment) Act.

The World Bank now expects to be able to disburse the second tranche of IDA credit after agreement on a new macroeconomic program.

The act is not being implemented as its constitutionality has been challenged in the courts.

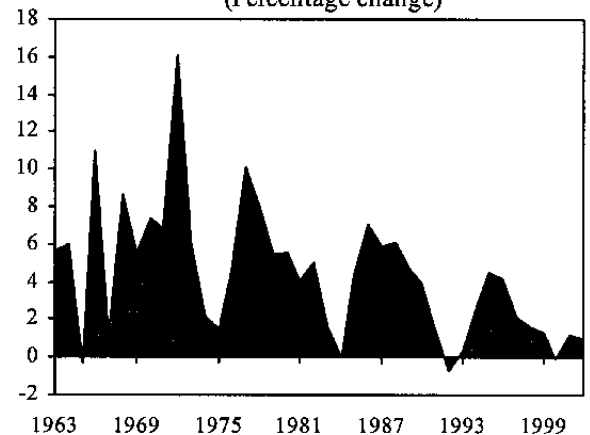
<sup>1</sup> LEG has provided comments on the draft bills and the authorities have indicated that these will be considered during the parliamentary debates.

Figure 1. Kenya: Real GDP Per Capita, 1962-2002 (Kenya shillings)



Sources: Kenyan authorities; and Fund staff estimates.

Figure 2. Kenya: GDP Volume Growth, 1963 - 2002 (Percentage change)



Sources: Kenyan authorities; and Fund staff estimates.

4. The economic growth rate has been on a declining trend over the last three decades, according to the official national accounts (Figure 2).<sup>2</sup> The annual rate of growth of real GDP, which averaged 7.5 percent during 1971–80, fell to 4.3 percent during 1981–90, and to 1.9 percent during 1991–2000. Real GDP is estimated to have increased by only 1.2 percent in 2001 and 1 percent in 2002. All major industries registered a decline in growth, which was more pronounced in agriculture, construction, and manufacturing (Table 1)—sectors that are important for the livelihoods of the poor.

	Shares of Nominal GDP in 2001	Volume Growth Rates			
		1971-80	1981-90	1991-95	1996-2000
GDP at factor cost	100.0	7.5	4.3	2.0	1.9
Agriculture, forestry, fishing, and mining	19.1	5.5	3.7	0.1	1.8
Industry	18.0	11.4	4.0	1.6	1.1
Construction	4.3	13.1	1.8	-1.0	1.0
Utilities	1.2	5.7	5.5	2.1	2.0
Manufacturing	12.5	12.2	4.8	2.5	1.4
Services	62.9	7.8	4.9	3.2	2.3

Source: Kenyan authorities.

5. Weaker growth was accompanied by a fall in savings and investment rates. The ratio of total savings to GDP declined from 20.3 percent in 1985–90 to 11.8 percent in 1996–2000 and to an estimated 9.6 percent in 2002. Similarly, the ratio of gross investment to GDP fell from 24.3 percent in 1985–90 to 18.1 percent in 1996–2000 and to an estimated 13.7 percent in 2002.

<sup>2</sup> As a result of the poor data quality, the nominal GDP and real GDP growth rates may be underestimated, particularly so for the last decade. An STA advisor is working with the authorities to improve the data. A revised set of national accounts data is expected by mid-2003.



## B. Fiscal Developments

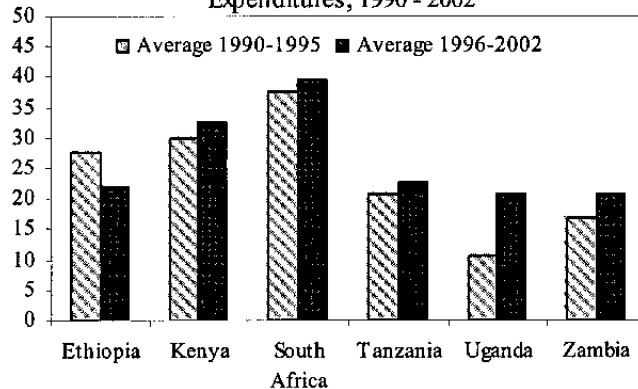
6. **The growth decline was also accompanied by a significant expansion in public sector outlays and public sector debt.** This was reflected in a sharp increases in wages and salaries and interest payments, a drain on public resources due to inefficient state enterprises, and a contraction of public outlays on social and economic services.

Wages and salaries as a share of central government expenditure rose from about 25 percent in 1990 to almost 38 percent in 1999, significantly above the level in most other African countries (Figure 3). There is a broad consensus in Kenya that the public sector, with few exceptions, is overstaffed. At the end of 2001, the public sector employed almost 40 percent of total formal sector employment. The overall expansion of the public sector

peaked in the mid-1990s when total central government expenditures rose to almost 35 percent of GDP from about the 20 percent of GDP recorded in the 1960s and early 1970s. Waste and inefficiency in the public sector reportedly increased in tandem. Inadequate spending on operations and maintenance, and the accompanying deterioration of public infrastructure, contributed to a decline in overall total factor productivity.

7. **Since the mid-1990s, central government revenues have declined steadily,** dropping from the relatively high level of 29 percent of GDP in 1995/96 to 22 percent in 2001/02. The largest contributor to the decline in revenues was the policy-induced shrinkage of receipts from corporate taxes and excise duties. The revenue decline was accompanied by significant deviations of revenue outturns from budget projections, as well as a collapse of donor support, which complicated budget management and contributed to an expansion in the stock of pending bills and stalled projects (see Box 2).<sup>3</sup> These factors also led to a significant increase in domestic financing and a corresponding rise in domestic debt and related interest payments. By end-June 2002, central government domestic debt was 22 percent of GDP, while the net present value (NPV) of external debt had declined to 30 percent of GDP from slightly above 60 percent of GDP in 1996. The government's contingent liabilities in the financial and the nonfinancial public enterprises have also risen sharply.

Figure 3. Selected African Countries: Wages and Salaries in Percent of Total Central Government Expenditures, 1990 - 2002



Source: World Economic Outlook.

<sup>3</sup> This expanding stock may also reflect a degree of corruption, and the legitimacy of a number of contracts is being reassessed by the new government.

### **Box 2. Kenya: Pending Bills and Stalled Projects—Problems and Solutions**

Expenditure control in Kenya is generally poor. Existing financial regulations have not been enforced, and the Ministry of Finance has been unable to adequately monitor expenditure. Poor financial compliance and accountability have led to the persistent accumulation of domestic arrears (pending bills). The unrealistic costing of policies has aggravated the problem of poor compliance, giving rise to many irregular within-year additions to spending. Too many capital projects have been included in the development budget, few have been completed, and overall efficiency in government capital spending has been reduced, with a remaining large stock of stalled projects. Debt service and wages, moreover, have crowded out operations and maintenance spending—especially utility payments.

The Kenyan authorities recognize that decisive actions to solve these problems are needed—by formulating more realistic budgets, curtailing and rationalizing government operations, and enforcing fiscal discipline to ensure that the budget is respected. Several attempts have been made in the past to resolve these problems, among others, to investigate the claims and to compile an inventory of stalled projects, but these efforts had limited success. The government has once again confirmed their intentions to solve these problems (and to avoid their re-occurrence). Their current efforts to get a handle on the extent and magnitude of the problems included the investigation of all pending bills, especially in light of allegations that contractors were fraudulently paid just before the December election. An inventory of stalled projects was previously completed and is currently being updated.

These actions by the authorities are encouraging, but further improvements of public expenditure management procedures will be necessary to consolidate the progress made. A more systematic treatment of the present stock of pending bills is required, including the undertaking of an audit and the formulation of a strategy for its payment and final resolution. Measures in this direction should include

- establishing a cutoff date for old pending bills;
- establishing a formal mechanism to review and report on overcommitments and pending bill information;
- undertaking a onetime comprehensive audit of the legitimacy of old pending bills, using an external auditor; and
- developing a strategy and timeframe for paying off legitimate old pending bills.

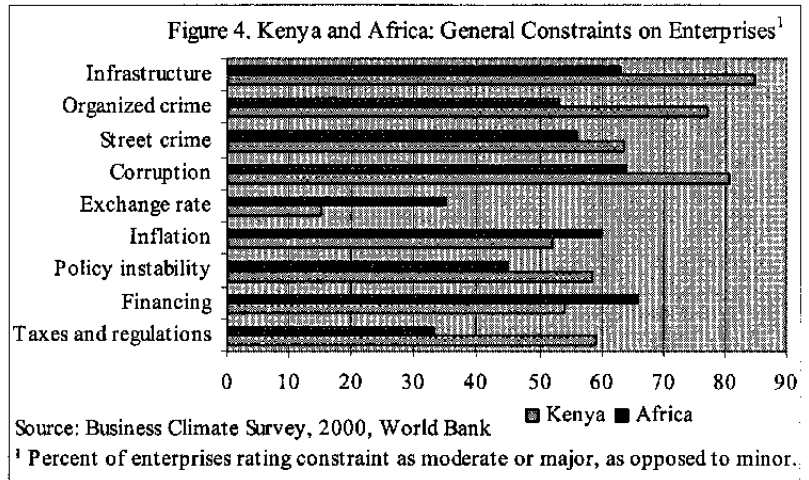
To prevent the future accumulation of arrears, control over expenditure commitments is recommended, as well as stricter control of within-year changes to the budget. The following measures could be taken to improve expenditure control:

- enforce commitment limits in addition to the present limits on exchequer releases;
- impose sanctions on financial officers who fail to control commitments or allow arrears to accumulate;
- expand the monthly expenditure returns to incorporate the commitment and expenditure information and overdue pending bills, as well as recent and prospective cash releases, and
- ensure that monthly returns are of sufficient quality and prepare quarterly reports on progress in improving budget execution procedures.

### III. KEY CONSTRAINTS TO GROWTH

#### 8. The Kenyan business community lists poor infrastructure, high crime rates, and corruption as their main constraints (Figure 4). The

telecommunications system is inefficient. Internet access is low, and Kenya's fixed-line telephone system is in a state of disrepair with long waiting times for installation and a small number of telephone main lines. The lack of progress in reforming the power sector in Kenya has led to an inefficient system for power distribution and high costs of electricity. The cost of electricity in Kenya is roughly 8 U.S. cents per kilowatt-hour, compared with about 2 and 2.7 U.S. cents, respectively, in South Africa and Egypt, Kenya's main competitors. Kenya's road system, moreover, is a serious impediment to production and export.



#### A. Corruption

9. Many of the problems associated with the inefficient use of public resources and weak investment and productivity are rooted in corruption and political interference in the functioning of government and legal institutions. Corruption is widely thought to have reached epidemic proportions in the 1990s. The problem was exacerbated by a police and court system that was largely ineffective at investigating and prosecuting corruption cases.

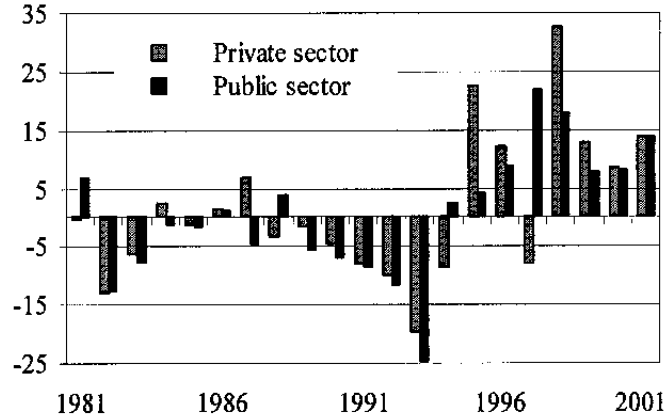
#### B. Financial System

10. The lack of financial services and access to commercial lending at affordable rates, particularly for small businesses and farmers, has been another serious constraint on growth. Kenya's banking system has been in a fragile and deteriorating state for some years. Banks have been reluctant to lend, and the spreads between deposit and lending rates have been wide, mainly because of the large share of nonperforming loans (NPLs), politically motivated directed lending, and the extreme difficulties involved in recovering through liquidation of collateral. Two-thirds of total NPLs are concentrated in the six public sector banks, which account for about 28 percent of total bank assets and deposits.

### C. The Labor Market

11. **Labor market policies and labor market rigidities appear to have hurt growth and formal sector employment**, and pushed the lower segment of the labor market into the informal sector<sup>4</sup> and unemployment. During 1995-2001, real earnings in the private and public formal sector increased at average annual rates of about 12 percent (Figure 5). The large increases in earnings can be traced partly to collective wage agreements and rapid rises in minimum wages. As a consequence of high wages, taxes, and other regulatory costs, most employment creation occurred in the informal sector. During 1995-2001, formal sector employment increased at an average annual rate of 1.2 percent, compared with 12.8 percent in the informal sector. The implications of the relative shrinkage of the formal sector include reduced external competitiveness and productivity growth, lowered growth prospects, lost fiscal revenues, and a deepening of poverty.

Figure 5. Kenya: Formal Sector Real Average Earnings, 1981-2001  
(Percentage change)



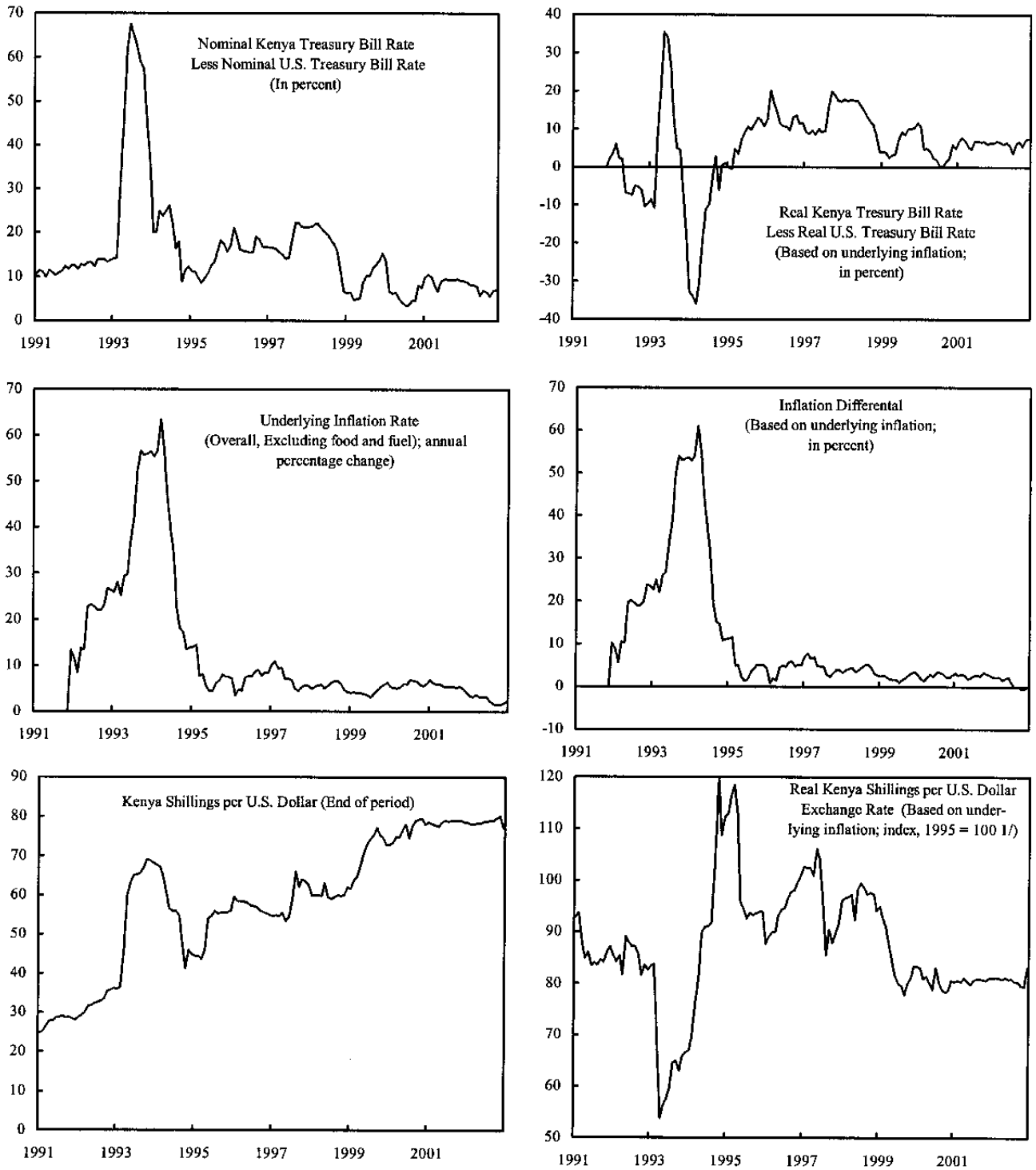
Sources: Kenyan authorities.

### D. Inflation, Money Growth, Interest Rates, and the Exchange Rate

12. During 1998-2001 and the first half of 2002, the government pursued a **tight monetary policy, which succeeded in lowering the inflation rate, the treasury bill interest rates, and the perceived country risk premium**. The inflation rate was reduced from 47 percent in 1993 to less than 2 percent in 2002. Following the significant disturbances to the financial system in the early 1990s, moreover, the nominal and real U.S. dollar exchange rates for the Kenya shilling have stabilized. Since late 2000, the exchange rate has remained at about K Sh 79 per U.S. dollar. These favorable developments resulted in a significant reduction in the perceived country risk premium, as measured by the difference between the Kenyan and U.S. short-term real treasury bill rates (Figure 6), and allowed the nominal and real treasury bill rates to come down significantly. The nominal 91-day treasury bill rate had dropped to 8.3 percent by end-December 2002 from a peak of 70 percent in 1994, and the real treasury bill rate to 4.3 percent in December 2002 from about 20 percent

<sup>4</sup> The formal sector includes wage employment, as well as self-employed and unpaid family workers; the informal sector pertains to all semiorganized, small-scale and unregulated activities. Although much informal sector production is characterized by low productivity and lack of credit access, some microenterprises and small enterprises are reported by the authorities to be as, or more, productive than formal sector firms.

Figure 6. Kenya and United States: Treasury Bill Interest Rate Spread and the Exchange Rate, 1991-2002



Sources: U.S. and Kenyan authorities; and Fund staff estimates.

1/ An increase in the index denotes an appreciation.

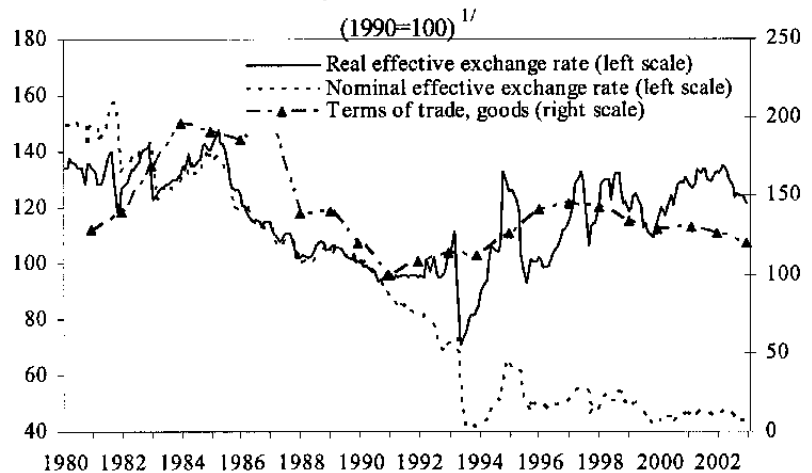
during most of 1996-98. The risk premium against the U.S. treasury bill rate dropped from an average of 13 percentage points in 1996 to 3.6 percentage points in June 2002, before increasing somewhat in the run-up to the election, in spite of the recent sharp decline in U.S. interest rates in real terms.

13. **Kenya's real effective exchange rate (REER) has shown considerable volatility in the last two decades** (Figure 7). Following a sharp depreciation of approximately 29 percent between 1981 and 1991, the REER has appreciated back toward its 1980 level. This development is broadly reflective of the changes in Kenya's terms of trade. Large

disturbances to the financial system in the early 1990s and high and volatile inflation, however, caused significant volatility around this trend in the first half of the 1990s.<sup>5</sup> Developments in the REER and the terms of trade differed significantly between December 1999 and April 2001, with the REER appreciating by 16 percent and the terms of trade remaining broadly unchanged. This development was mainly caused by the significant donor inflows, including the November 2000 Paris club rescheduling. It could also be partly reflecting an increased willingness to

hold Kenya shillings in response to the improved monetary management, lower inflation, and increased macroeconomic stability in the latter part of the 1990s. The appreciation of the REER in 2000 most likely contributed to the low economic growth over the last couple of years. Since February 2002, the REER has depreciated by about 9 percent.

Figure 7. Kenya: Terms of Trade and Real and Nominal Effective Exchange Rates, January 1980 - December 2002



Sources: MF Information Notice System and World Economic Outlook.  
↑ An increase in the terms of trade index denotes an improvement and an increase in the exchange rate indices denotes an appreciation.

#### IV. RECENT ECONOMIC DEVELOPMENTS AND PROSPECTS FOR 2002/03<sup>6</sup>

##### A. Real

14. **Real GDP grew by 1.2 percent in 2001/02, and is projected to edge up to 1.5 percent in 2002/03**, supported primarily by a strong performance of manufacturing and

<sup>5</sup> The authorities adopted a floating exchange rate system in 1993.

agricultural exports. Following a sharp contraction in 2001/02, there are indications of a rebound in private sector investment, with bank credit to the private sector picking up in recent months—between March and December 2002, it increased by 6.1 percent.

15. After a significant drop in inflation to about 2 percent in the first half of 2002, the **consumer price index (CPI) has registered a sharp increase in recent months**, partly on account of a transitory tightening of the food supplies and the surge in retail prices of petroleum products. The overall CPI increased by 10.1 percent in the 12 months to March 2003, while the overall CPI excluding food and fuel (underlying inflation) increased by 3.8 percent. At the same time, the growth of monetary aggregates has risen, reflecting a rebound in private sector credit and increased cash holdings by the public before the December 2002 elections; meanwhile, the 91-day treasury bill rate dropped to 5.8 percent by mid-March 2003 from around 10 percent a year earlier. These developments have exerted upward pressure on prices and downward pressure on the exchange rate of the Kenya shilling, which has weakened over the past year, along with the U.S. dollar, vis-à-vis other major currencies. The nominal effective exchange rate of the shilling fell by about 9.0 percent during 2002. Since the December 2002 election, however, faced with strong exchange rate appreciation pressures, the authorities increased foreign reserves by around US\$170 million, in line with their objective of increasing the reserves coverage to four months of imports. Nevertheless, the shilling has appreciated by 4.4 percent against the U.S. dollar and since the end of January 2003, by 1.6 percent against the Euro.

## B. Fiscal

16. In the first six months of 2002/03, **revenue performance was slightly weaker than projected**, largely due to lower-than-expected economic growth and, to a lesser extent, delays in the introduction of tax administration measures announced in the budget. Total revenue of the central government for the year is now expected to be KSh 212.0 billion, compared to the originally budgeted amount of KSh 218.9 billion, an underperformance of about 0.7 percent of GDP.

17. **Expenditures are expected to be substantially higher than budgeted** in 2002/03. The main cause is a KSh 5.0 billion increase in housing allowances for teachers that were not provided for in the budget, and the additional expenses associated with providing free primary education (KSh 2.8 billion). This will result in a higher deficit (on a cash basis after grants) of 5.5 percent of GDP compared to the budgeted deficit of 3.2 percent. Moreover, privatization proceeds and net foreign financing are likely to be less than budgeted. The net financing requirement, thus, is expected to rise to KSh 58.7 billion (6.1 percent of GDP compared to 3.3 percent of GDP in the budget) for 2002/03 as a whole, of which 3.4 percent

---

<sup>6</sup> A detailed background analysis of economic developments during the past 25 years is presented in the accompanying document (Kenya—Selected Issues and Statistical Appendix).

of GDP will have to be sourced during the last two months of the fiscal year. Given the limited scope for higher foreign financing most of this will have to be funded by domestic borrowing. The government has indicated its commitment to fully implement the budget as outlined in the supplementary estimates by year-end—with no additional increase in the stock of pending bills or delays in investment spending as was the practice in the past.<sup>7</sup>

### C. External

18. **The external current account deficit deteriorated further in 2002**, mainly owing to a reduction in private transfers associated with a drop in drought assistance.<sup>8</sup> It is estimated that the deficit (including official grants) widened from 3.5 percent of GDP in 2001 to 4.3 percent of GDP in 2002. Export volume growth slowed somewhat, falling from 11.6 percent in 2001 to approximately 8.3 percent in 2002. Nevertheless, some aspects of export growth in 2002 were encouraging, particularly the growth of nontraditional items, such as horticulture exports to the European Union (EU) and manufactured exports to the African regional market. Available evidence also suggests that the U.S. African Growth and Opportunity Act (AGOA) is having a positive impact, as AGOA exports increased from approximately US\$30 million in 2000 to US\$140 million in 2002, largely as a result of a significant rise in garment exports. After increasing by 7.3 percent in 2001, import volume declined by 2.1 percent in 2002.

## V. MEDIUM-TERM OUTLOOK AND RISK ASSESSMENT

### A. Main Elements of the Authorities' Reform Agenda

19. **The authorities' reform agenda is still under discussion**, which will bring together the main elements of the government's election manifesto, the **Economic Recovery Program** currently under preparation, as well as the priorities identified during the consultations for the poverty reduction strategy paper (PRSP). Meanwhile, the Ministry of Planning and National Development has prepared a paper on the strategy for economic recovery for discussion among the government, domestic stakeholders, and development partners. The paper aims to address the three challenges of reducing unemployment, increasing the utilization of productive capacity, and eliminating poverty. The planned strategy targets a growth rate of 7 percent per annum in the medium term, and focuses on job creation and the expansion of opportunities for poor farmers, micro and small enterprises, and the economically disadvantaged. It calls for the creation of an interministerial task force to alleviate the constraints facing small enterprises. The authorities are also likely to focus initially on policies to encourage tourism and agriculture and to attract investment in labor-

---

<sup>7</sup> The Supplementary Budget was tabled in parliament in late March. Staff will provide an update and assessment of the revised estimates in a Supplement to be issued prior to the Board Meeting.

<sup>8</sup> This assistance refers to amounts provided by nongovernmental organizations (NGOs).



intensive export processing. Following concerns expressed by the World Bank that the Economic Recovery Program focused too narrowly on private sector growth, it was agreed that it would be revised to cover social and environmental sustainability issues which are considered essential elements of a comprehensive growth and poverty-reduction strategy.<sup>9</sup>

20. The discussion paper argues appropriately for a **rapid restoration of public confidence** in the core functions of government, in particular efficient and impartial law enforcement and administration of justice, a competent and responsive public administration, and an evenhanded framework of economic regulation. As regards the macroeconomic framework, the objectives are to maintain low inflation and promote economic recovery, by improving public expenditure management and relying on adequate fiscal restraint to increase public savings and retire the domestic public debt. To obtain value for money, cost benchmarks and service delivery targets are expected to be established for all government ministries and other public bodies. The discussion paper calls for the creation of independent task forces to review the competitiveness policy, regulatory frameworks, and pricing structures for credit, electricity, telecommunications, and petroleum products.

### **B. Outlook for Growth and Poverty Reduction**

21. Since December 2002, **the investment climate has improved significantly, and growth may have started to pick up.** When account is taken of the deep economic decline during the 1990s, the planned public investment program, and the expected strong rebound in private investment, growth over the medium term is likely to be substantial. Much of this growth is likely to come from an expansion of the manufacturing and construction sectors. There is excess capacity in major industries, some of which can be brought onstream fairly quickly. As the economic hub of east Africa, Kenya is well positioned to increase its penetration in African markets, with exports (mainly manufactured) to these markets already accounting for 50 percent of total exports. Kenya, moreover, has a diversified economic base and is well placed to further benefit from the AGOA initiative.

---

<sup>9</sup> The World Bank program is focused on creating the conditions for growth, increasing employment, reducing the cost of doing business, good governance (including strengthening the judiciary), and improved services to the poor. The Bank currently envisages lending operations for financial sector reform, transport, urban water, energy, and education in fiscal year 2003/04, and expanding the agenda in subsequent years to include rural sector poverty and growth, agriculture, health, and governance and public sector restructuring, including privatization. The Bank's Economic and Sector Work (ESW) program addresses gaps in knowledge, particularly in the areas of poverty and rural sector growth, as well as on the sources of growth, competitiveness, tourism, and accountability and fiduciary issues which will provide the underpinnings for Poverty Reduction Support Credits (PRSCs), beginning in fiscal year 2004/05.

22. Against this background, the staff together with the authorities developed **two medium-term macroeconomic scenarios**.<sup>10</sup> Both scenarios assume a prudent monetary policy that would limit the increase in the consumer price index (CPI) to an average annual rate of 3.5 percent. The **high-case scenario** assumes implementation of a strong package of economic reforms to raise the growth rate to about 6 percent by 2006/07 (Table 2). In particular, it assumes the following:

- A strong implementation of the governance agenda results in a rapid restoration of public confidence in the core functions of government, impartial law enforcement and efficient administration of justice, and a competent and responsive public administration.
- A significant increase in public savings and strong implementation of infrastructure investment (e.g., in the transport, telecommunications, and power sectors) and privatization programs reduces the costs of doing business in Kenya, and spurs large increases in foreign direct investment and domestic private investments. The privatization of the telecommunication sector, as well as the streamlining of the regulatory framework would lay the ground for a major expansion of private investment.
- Decisive measures would be taken to substantially broaden the tax base and improve the tax system, in order to increase the revenue-to-GDP ratio from 22.2 percent in 2002/03 to 24.9 percent by 2007/08. Higher economic growth and the restructuring of the financial and corporate sectors should increase corporate profitability and formal sector employment, and thus boost income tax receipts and revenue collection.
- Far-reaching public sector reforms would facilitate a decline of the wage bill from 9.2 percent of GDP in 2002/03 to 7.2 percent by 2007/08. Expenditures would be restructured to increase the allocations for essential social and economic services, including for education, operations and maintenance, and development (Table 2).
- A speedy restoration of budget support by donors, to facilitate a rapid retirement of domestic debt. The domestic debt-to-GDP ratio is assumed to decline from 32.0 percent in 2003/04 to 9.4 percent by 2007/08.
- The banking system would be strengthened, through early actions to resolve the problems of the National Bank of Kenya. Over the medium term, the focus would be on speedy institution and enforcement of international banking supervision standards, and on ensuring that in licensing financial institutions, there is a clear separation of policymaking from policy implementation.

---

<sup>10</sup> The staff has also developed an alternative scenario (Appendix V), which illustrates the considerably weaker economic outcomes that are likely to result if the economic reforms are delayed or not implemented and donor support is not forthcoming.

Table 2. Kenya: Medium Term Macroeconomic Scenarios, June-July  
Fiscal Year 2000/01-07/08

(In percent of GDP, unless otherwise indicated)

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
<b>High case scenario</b>							
GDP volume growth (annual percentage change)	1.2	1.6	2.8	4.4	5.8	6.2	6.1
Assumed program support (in million of U.S. \$)	0	145	327	646	1050	1330	1539
Gross capital formation	14.0	14.1	15.7	18.2	20.3	21.6	22.6
Gross savings	10.1	8.6	8.4	9.7	11.5	13.4	15.0
Central government budget							
Total revenue	21.6	22.2	22.6	23.4	24.0	24.4	24.9
Total expenditure and net lending	25.0	27.7	28.0	28.1	27.8	28.6	28.9
<i>Of which:</i> wages and benefits	8.5	9.2	9.2	8.7	7.9	7.5	7.2
development expenditures	2.5	3.2	3.3	3.9	4.9	5.9	6.9
operations and maintenance	5.2	5.2	5.2	5.5	5.7	6.1	6.6
Overall balance (commitment basis) excluding grants	-3.4	-5.5	-5.4	-4.6	-3.7	-4.2	-4.0
Primary balance	-0.1	-1.9	-1.4	-0.8	0.0	-0.6	-1.0
Stock of domestic debt, net (end of period)	22.3	26.2	28.7	25.9	19.5	13.3	7.3
Balance of payments							
Current external balance, including official transfers	-3.9	-5.5	-7.4	-8.5	-8.8	-8.2	-7.6
Gross international reserve coverage							
In months of next year imports (end of period)	2.8	2.4	2.3	2.8	3.7	4.7	4.8
<b>Base case scenario</b>							
GDP volume growth (annual percentage change)	1.2	1.5	2.5	3.6	4.7	4.8	4.6
Assumed program support (in million of U.S. \$)	0	145	235	406	704	724	663
Gross capital formation	14.0	14.0	15.1	16.9	18.3	18.7	19.0
Gross savings	10.1	8.7	8.3	9.2	10.2	11.2	12.2
Central government budget							
Total revenue	21.6	22.2	22.5	22.6	22.4	22.2	22.3
Total expenditure and net lending	25.0	27.7	27.9	27.5	27.5	28.6	29.1
<i>Of which:</i> wages and benefits	8.5	9.2	9.4	9.1	8.5	8.4	8.3
development expenditures	2.5	3.2	2.8	2.6	3.4	4.0	4.4
operations and maintenance	5.3	5.3	5.3	5.3	5.3	5.4	5.5
Overall balance (commitment basis) excluding grants	-3.4	-5.5	-5.4	-5.0	-5.1	-6.4	-6.7
Primary balance	-0.1	-1.9	-1.3	-0.9	-0.8	-1.9	-2.4
Stock of domestic debt, net (end of period)	22.3	26.3	29.7	28.8	25.6	24.1	23.7
Balance of payments							
Current external balance, including official transfers	-3.9	-5.3	-6.8	-7.7	-8.1	-7.5	-6.8
Gross international reserve coverage	0.0	0.0	0.0	0.0	0.0	0.0	0.0
In months of next year imports (end of period)	2.9	2.5	2.3	2.5	3.2	3.5	3.9

Sources: Kenyan authorities; and staff estimates and projections.

<sup>1</sup> Fiscal year ending June 30.

<sup>2</sup> Despite the strong adjustment effect assumed under this scenario, donor inflows are projected to average 5.0 percent of GDP, well below the amounts received by economies in the subregion with PRGF-supported programs.

23. Under the high-case scenario, Kenya would make good progress toward achieving the Millennium Development Goal (MDG) of reducing poverty incidence to about 24 percent by 2015, from over 50 percent currently. Gross capital formation could rise from 14 percent of GDP in 2001/02 to 22.6 percent by 2007/08, and there would be good prospects for achieving a real GDP growth in excess of 6 percent a year over the medium term. The external current account deficit (excluding official grants) would widen to about 8.8 percent of GDP in 2005/06 before coming down somewhat, as imports would expand in response to the economic recovery and the increase in public spending for poverty reduction. After an initial decline to 2.3 months import cover in June 2004, gross international reserves would rise steadily to the equivalent of about 4.8 months of the following year's imports.

24. The base-case scenario assumes a more modest pace of reforms and a more gradual increase in donor assistance, with consequent lower capital formation outcomes. It assumes in particular the following:

- a slower implementation of the governance agenda;
- a moderate increase in foreign direct investment and domestic private investments;
- limited progress in reforming the tax system and tax collections, resulting in essentially no increase in revenues as a share of GDP;
- a more modest decline of the wage bill to 8.3 percent of GDP by 2007/08;
- a slower restructuring of the budget with expenditures on operations and maintenance assumed to only increase to 5.5 percent of GDP by 2007/08 and the development expenditures-to-GDP ratio to 4.4 percent; and
- a slower return of donor support, resulting in only a modest decline in the domestic debt-to-GDP ratio to 25.9 percent by 2007/08.

25. In the base case, real GDP growth peaks at 4.8 percent in 2006/07, or 2.8 percent per capita, which would not be sufficient to achieve the MDGs, although poverty incidence could still be reduced to about 35 to 40 percent.<sup>11</sup> The domestic debt would decline only slightly, and the reserves coverage would increase over the medium term to only 3.9 months of imports.

---

<sup>11</sup> Allocations for certain key public expenditures and for operations and maintenance, such as health, water and sanitation, as well as for environment protection, might be insufficient to achieve the required reduction in poverty.

### C. Risk Assessment and External Environment

26. **The projected economic recovery is fragile.** The uncertain world economic outlook and the continued difficult budget and financing situation, as well as potential delays in implementing key reforms, could produce a less favorable outcome than assumed in the base-case scenario (see Appendix Table 14).

27. **The crisis in the Middle East poses** a major threat to the projected recovery. It has already resulted in a marked increase in the prices of petroleum products and contributed to a pickup in inflation. In the event that (i) oil import prices average about US\$40 per barrel over the next six months before returning to the World Economic Outlook (WEO) baseline of US\$31 per barrel, (ii) export market growth drops by 1.8 percent from the baseline this year, and (iii) tourist arrivals fall by about 20 percent, the current account deficit would widen by US\$140 million, or 1.1 percent of GDP in 2003. This scenario could result in a further expansion in the fiscal deficit as revenues from petroleum taxes would likely fall. The higher deficit could fuel inflationary pressure and have a significant dampening effect on the projected recovery.

28. **Over the medium term, it will be difficult to reduce the wage bill,** because of the announced salary increases for teachers (spread out over ten years) and members of parliament. The increases in teachers' salaries may also build up pressure for increases in the salaries of other civil servants. Furthermore, retrenchment efforts in recent years have had limited success in reducing the total wage bill.

29. **Budgetary management will continue to be difficult in 2002/03 and 2003/04.** Because donor support for the authorities' reform program will resume only gradually, some new expenditure programs will be initiated, and time will be required to significantly restructure the budget, the domestic financing requirement is likely to rise substantially during the remainder of 2002/03 and stay high during 2003/04. The much-needed restructuring of the banking system, in addition, would likely involve the substitution of some contingent liabilities by government bonds. As a consequence, domestic debt will continue to rise in the near term, and there could be considerable upward pressure on interest rates.

30. **To minimize the adverse effects** of the large domestic borrowing requirement on macroeconomic stability, the staff discussed with the donor community the prospects for an early disbursement—before the end of the 2002/03 fiscal year—of some aid commitments. Indications are that budgetary assistance amounting to about US\$145 million (about 1.1 percent of GDP) could be disbursed by end-June 2003, in the event of satisfactory progress toward a new Fund-supported program. This would still leave a domestic financing requirement of about 5.0 percent of GDP.

31. **The expectations of the Kenyan public are high,** and the authorities stressed the importance of showing early results, especially regarding governance and institution reforms. Many of the fiscal, labor market, and financial sector reforms that are essential to achieve high GDP and employment growth will be politically challenging and require time to prepare properly. In the discussions, senior officials pointed out that the cabinet system of government had so far been operating smoothly and that the ruling coalition possessed both the cohesion and determination to implement the needed reforms on a sustained basis.

## VI. POLICY DISCUSSIONS

32. The discussions focused on the factors underlying the weak economic performance in recent years and the steps the authorities are taking to address the underlying structural problems. As indicated earlier, widespread governance failures contributed to Kenya's poor economic performance. Corruption was primarily responsible for the emergence and persistence of the pending bills problem, the rise in government spending on unproductive activities, the eventual withdrawal of donor budgetary support, and the consequent decline in public investment spending. It also contributed to the marked deterioration in the asset quality of public banks and the decline in private investment. Accordingly, the actions (Box 5) that the authorities have begun to implement to address corruption represent important initial steps to rebuild the economy. The government recognizes that these actions will, however, need to be reinforced by a multi-faceted reform agenda that is credible and backed by adequate donor support.

33. The discussions also focused on the structural measures needed to address Kenya's major macroeconomic vulnerabilities. These include (i) the high domestic debt burden and the large outstanding contingent liabilities of the government; (ii) a weak financial system; (iii) a sizable parastatal sector, with a significant potential for bailout; (iv) the large shares of public outlays absorbed by wages and salaries and interest payments; and (v) labor market rigidities. In this connection, the staff agreed with the authorities that the full PRSP should present a coherent medium-term reform agenda aimed at: (i) reducing Kenya's total public debt as a proportion of GDP; (ii) strengthening expenditure management, reorienting expenditure toward PRSP priorities, and improving the productivity of public outlays; (iii) divesting government from commercial activities, including ownership of commercial banks; (iv) enhancing the supervisory framework for financial institutions and the prudential supervision of these bodies to international levels at an early date; and (v) improving the flexibility of labor markets. These actions will also help to safeguard Kenya's external competitiveness and ensure that increased capital inflows are used efficiently.

### A. Restructuring the Fiscal Position

34. Fiscal restructuring, including tax and public expenditure reforms, will be key to the achievement of the high-growth scenario. There is a **need to restore fiscal sustainability** over the medium term starting with early steps to address the contingent liabilities of the financial sector in the near future. The Kenyan authorities agreed with this view, but stressed that external donor support and rapid economic growth would be important for reducing the domestic debt burden and to establish fiscal sustainability.<sup>12</sup>

35. The staff argued that it was **necessary to reconsider the current tax regime in Kenya**, noting that (i) the regime in Kenya was complex, and contained many exemptions; (ii) tax rates were relatively high, especially for excise taxes, direct taxes, and withholding taxes on foreign remittances (see Box 3); (iii) the tax base was narrow; (iv) weak policing and enforcement of tax laws and regulations had led to lower revenue collection; (v) the tax compliance rate was low

---

<sup>12</sup> See SM/02/72 (3/1/02), Section VII, "Fiscal Sustainability and Fiscal Risk in Kenya."

and tax arrears were prevalent; and (vi) tariff reforms might have a revenue-reducing effect. The authorities recognized that tax measures might be needed to maintain revenues constant as a share of GDP.

<b>Box 3. Selected Tax Rate Comparisons (East African Region)</b>			
Type of Tax/Duty	Kenya	Uganda	Tanzania
Excise duties on beer	60 percent heavy beer, 90 percent light beer	60 percent	Common Market for Eastern and Southern Africa COMESA), (US\$.22/liter), Non-COMESA (US\$.17/liter)
Excise duties on cigarettes:	135 percent; cigars 30 percent	122 percent	T Sh 14,000 per 1,000,000
Value-added tax (VAT) rate	18 percent (some items 16 percent or 2 percent)	17 percent	20 percent
Raw materials import tariff	5 percent	7 percent	5 percent
Personal income tax	0-30 percent (five brackets)	0-30 percent (four brackets)	0-30 percent (four brackets)
Corporate income tax	32.5 percent (40 percent for foreign branches)	30 percent	30 percent
Withholding tax on foreign remittances	15 percent on interest, 10 percent on dividends, and 20 percent on management fees and royalties	15 percent	...

36. **The Kenyan representatives indicated that they recognized the urgent need to restructure public expenditure** to free resources for poverty reduction. They have therefore initiated work on the identification of policy options, including actions to reduce the wage bill and other benefits. As part of this undertaking, the authorities intend to redesign the mechanisms for setting public sector wages to align them more closely with productivity gains and the availability of resources over time. They also plan to review all existing wage agreements and contracts. The Department of Personnel Management (DPM) is reviewing the role of the government and individual government departments, with a view to focusing government resources on core activities. The authorities will be discussing the implications of this work for the civil service restructuring plans with the staff of the World Bank. The government has also started work on the design of a system to track pro-poor expenditures (see Box 4). The authorities noted, however, that a restructuring of the public sector was not something that could be carried out very quickly, as political commitment needed to be transformed into action plans and timetables.

### **B. Monetary, Exchange Rate, and International Reserve Issues**

37. **The monetary authorities' principal objective is to keep inflation low while providing a stable environment for the financial markets;**<sup>13</sup> the June 2002 Monetary Policy Statement

<sup>13</sup> Mandated by the Central Bank Act.

specified the monetary policy objective principally as one of containing inflation below 5 percent. The CBK indicated that it would continue to use the current monetary policy framework to achieve its policy objectives with broad money (M3X) as the intermediate target and reserve money as the operational target. Open market (REPO and reverse REPO) operations

**Box 4. Kenya: Progress on the Design of an Expenditure-Tracking System for Pro-Poor Expenditures**

During the last two years, the government has been monitoring a set of core poverty programs, as requested by the World Bank, on a quarterly basis. These expenditures were chosen on the basis of ten criteria determining social expenditures as part of the PRSP consultative process. These expenditures, however, represent only a very narrow-based listing of poverty-related expenditure, and the government has in recent months intensified its efforts to expand this listing. As part of the medium-term expenditure framework (MTEF) budget process, spending ministries were requested to provide the Ministry of Planning with an updated list—based on a set of criteria for selecting poverty programs. The criteria include the following:

- measures to increase the income of the poor (such as access roads, agricultural services, access to credit and financial services);
- measures that will improve the quality of life of Kenyans (health care, access to clean water, primary education, and the environment);
- measures to improve security and governance (the protection of human rights, administration of law and justice, reduction of wastage/accountability, security of people and property); and
- measures that will improve equity and equality (equal opportunity, empowerment, and capability).

The government has undertaken a comprehensive assessment of its public expenditure management system's capacity to track these pro-poor expenditures, and, it will, with technical assistance from the Fund, the World Bank, and other bilateral donors, design an action plan to strengthen it.

are the main instruments used by the CBK, and interest rates on treasury bills will remain fully market determined. The authorities argued that with the effective use of existing monetary instruments the CBK was successful in achieving low inflation rates.

38. **Staff welcomed the disinflation that had been achieved, but raised concerns about the relaxation of monetary policy during the latter part of 2002.** During that period broad money growth picked up significantly, leading to a decline in treasury bill rates, and a substantial weakening of the Kenya shilling vis-à-vis major currencies. Staff argued that this relaxation of monetary policy could risk reversing the recent hard won gain of reducing inflation below 5 percent. The staff noted that inflation had indeed registered a marked increase in recent months. To consolidate the progress made in reducing inflation, the staff suggested developing a reserve money program aimed at keeping underlying inflation over the medium term under the 5 percent ceiling set out in the Monetary Policy Statement.

39. The staff suggested that, over time, **an increase in the foreign reserve coverage to around 5 months of projected imports might be needed** to provide a cushion against temporary external shocks and delays in aid disbursements. However, because of the expected large government domestic borrowing requirement for the remainder of 2002/03 and for



2003/04, the reserve build up may have to be backloaded so as not to unduly constrain credit to the private sector within the target range of reserve money growth.

40. **Staff also noted the need for greater exchange rate flexibility than has been the case in the recent past.** The authorities attributed the stability of the shilling vis-à-vis the U.S. dollar over the last two years to the stance of monetary and fiscal policies, and the weak demand for imports. The staff noted, however, that the remarkable stability of the shilling against the U.S. dollar during 2001 and 2002 suggests that the CBK effectively was shadowing the U.S. dollar. The staff explained the danger of pursuing an unannounced peg for a longer period and stressed the importance of allowing the exchange rate to be fully determined by the market to prevent a misalignment from emerging. In this regard, the greater flexibility of the shilling against the U.S. dollar since the election was welcomed. The authorities noted that they will continue to pursue a flexible exchange rate regime, which they believe to be appropriate for Kenya.

### C. Competitiveness Issues

41. **The staff discussed with the authorities and representatives of the private sector actions that could be taken to enhance Kenya's competitiveness.** While Kenya's diversification into nontraditional exports is an indicator of increased competitiveness, the recent slowness in its overall export growth does indicate that there are some valid concerns about international competitiveness. Although data on price determinants of competitiveness in Kenya are scarce, some evidence<sup>14</sup> suggests that price factors did have a negative impact on international competitiveness. Information gathered from businesses, however, indicates that nonprice constraints tend to play a more important role in inhibiting business performance in Kenya than specific concerns about the level of the exchange rate.<sup>15</sup> For example, policies aimed at enhancing labor market flexibility and containing upward pressures on wages would help to safeguard competitiveness and increase employment opportunities.<sup>16</sup> In this regard, efforts to ensure that civil service wage increases are based on improvements in productivity and that a greater degree of wage restraint is exercised in the public sector could help to contain wage pressure in other sectors. Given these considerations, efforts to improve competitiveness will have to focus on price and nonprice factors. As regards the former, the authorities will need to allow greater exchange rate flexibility to ensure that producers face the appropriate structure of economic incentives. The nonprice factors would be addressed through structural reforms (discussed below).

---

<sup>14</sup> See SM/02/72. It was concluded that the incentive for producers to move into the export sector diminished over the 1990s, particularly in the second half.

<sup>15</sup> The greater importance of nonprice constraints on business performance was also cited in SM/02/72 (3/1/02).

<sup>16</sup> Labor market issues are discussed in the Selected Issues note accompanying this staff report.

#### D. Financial Sector and Parastatals

42. Discussions on the financial sector and parastatals focused on the significant contingent liabilities which could lead to a call on the government budget in the near future.<sup>17</sup> The very high level of NPLs in the banking system, especially in the public sector banks, has contributed to wide interest rate spreads between lending and deposit rates, which continues to be a matter of serious concern. The authorities noted that the poor condition of many Kenyan banks was the result of past government interference in lending decisions and poor governance. A key objective of the new government is to divest itself from the banking system through privatization, although some banks may need to be restructured to facilitate privatization. In line with recent advice from MAE technical assistance missions, the staff argued for bringing banking supervision up to international standards and better enforcement of already existing prudential regulations. It has been agreed that an FSAP mission will take place in mid-2003.

43. The authorities noted that they **would not be in favor of bringing into force the restrictive provisions of the Central Bank of Kenya (Amendment) Act 2000** (the so-called Donde Act), which would place controls on the spread between commercial bank lending and deposit interest rates. The act is not being implemented as its constitutionality has been challenged in the courts. The staff argued that the problem of the spread between lending and deposit rates should be addressed by taking measures to reduce cost pressures in the sector, improving borrower accountability through strengthened commercial courts, making strong efforts to recover the NPLs, and enhancing competition. The government is, nonetheless, very concerned about commercial bank interest rate spreads and public perceptions of malpractice on the part of banks.

44. **The privatization program is expected to play a central role in improving the provision of key infrastructure services.** In this regard, the government plans to first establish a policy framework for privatization that will be presented to parliament in the near future. This will be followed by a listing of the public enterprises for eventual privatization that would involve sale in the domestic market as well as strategic partnerships with foreign investors.

45. Meanwhile, **the government is developing plans, in consultation with the World Bank, for enhancing private sector participation in a number of key parastatals,** including Kenya Ports Authority, Kenya Railways, and Kenya Telcom. It is also considering a strategy for divesting its remaining holding in the Kenya Commercial Bank (KCB). It will be important to establish quickly the extent of potential liabilities of the central government associated with the required rationalization of the parastatal sector. In order to be sure that all contingent liabilities have been assessed, staff have also suggested that the authorities undertake a comprehensive audit of the National Social Security Fund, which had invested heavily in land and property, thereby weakening the balance sheet.

---

<sup>17</sup> Fiscal costs of restructuring the banking sector could be equivalent to about 2 percent of GDP.

### E. Governance

46. **The new government has placed its anticorruption strategy at the top of its agenda** and has embarked on a major strengthening of Kenya's governance and anticorruption institutions (see Box 5). It has proposed a constitutional amendment to permit the establishment of a fully independent anticorruption agency with investigative and prosecutorial powers, and has gazetted new versions of the Anti-Corruption and Economic Crimes Bill and the Public Service Ethics Bill. While it may be difficult to obtain adequate parliamentary support for a constitutional amendment separately from the wider constitutional review process under way, the government remains committed to establishing an anticorruption authority with independent powers to prosecute, and it is expected that the new constitution will provide for this. The other two governance bills are expected to be passed by parliament by April 2003. Additional steps are under way to strengthen the judiciary, with the assistance of the World Bank and other donors. These actions, if followed by appropriately firm application and enforcement of the rules and regulations, should result in a significant reduction in the wastage of public resources.

### F. External Trade

47. At present, **Kenya's trade regime is moderately restrictive**—it is rated 6 on the IMF's 10-point trade restrictiveness index, with 10 being the most restrictive. External tariffs range from 0 percent–35 percent, with eight bands; the simple average tariff is 17.2 percent. The budget for fiscal year 2002/03, announced measures to stimulate exports, particularly manufacturing exports, including the exemption of duty for all capital equipment.<sup>18</sup> There is some confusion, however, about the implementation of the policy, with some exporters claiming that they have not benefited from duty exemption. More generally, the private sector contends that the budgetary measures have not been implemented fully, and that relatively high duty rates are still charged on some imported raw materials and intermediate imports.<sup>19</sup> The budget also provided for increased protection for selected industries. For example, the most-favored-nation (MFN) duty on imported steel was raised from 20 percent to 35 percent to protect the local industry from increased foreign competition.<sup>20</sup> In addition, Kenya continues the pursuit of a discriminatory policy on wheat and sugar imports from the Common Market for Eastern and Southern Africa (COMESA) trading partners, which is designed to protect local producers from

---

<sup>18</sup> A review of the effective operation of the existing duty drawback scheme for exporters is needed.

<sup>19</sup> Some intermediate inputs for manufacturing are classified in the trade regime as finished goods and thus attract the highest rate of duty of 35 percent.

<sup>20</sup> No time limit has been placed on the increased protection for the steel industry. Some private sector actors are concerned that the increased duty will force them to purchase higher-cost locally produced steel and thus increase their overall costs.

### **Box 5. Governance Measures Taken or Announced by the New Government**

The following measures have been taken or announced by the government:

- The government has publicly placed the fight against corruption and the completion of the constitutional review process at the top of its agenda.
- The government has established a Ministry of Justice and Constitutional Affairs, which is spearheading government efforts in the governance area.
- The government has established a Department of Governance and Ethics in the Office of the President, primarily to oversee the implementation of the proposed Public Officers' Ethics Bill after it is enacted and to provide guidance to public servants on possible conflict of interest and ethical matters in the execution of their duties. This department is headed by the former head of Transparency International (Kenya), who is experienced in such matters and is widely respected.
- The government is seeking to make provision for the establishment of an anticorruption agency in the new constitution that is under consideration. This agency will have the powers to conduct investigations into alleged corruption cases and undertake prosecution where necessary independently of the Attorney General.
- The government has published revised versions of the Anti-Corruption and Economic Crimes Bill and the Public Officers' Ethics Bill. These are expected to be considered in parliament during April.
- The government has formed an Economic Reform Implementation and Coordination Task Force to oversee the fulfillment of the prior actions for negotiating a new PRGF arrangement and the outstanding measures under the current IDA credit.
- All sales of public assets, including housing, have been suspended because of concerns about corruption. The government plans to establish a policy framework for privatization—to be approved by parliament—providing a transparent process to determine which public assets are to be sold and how privatization should be undertaken. A draft bill is to be presented to parliament shortly.
- All payments of pending bills have been suspended, pending a thorough audit of the outstanding stock, because of concerns about corruption.
- Task forces have been established by the government—Minister for Finance and Minister for Roads, Public Works and Housing—to review of all contracts relating to jobs undertaken for the government and for which payments are pending.
- A High Court Judge who while under investigation by the Anti-Corruption Police Unit was presiding over the Goldenberg case has been charged in court for involvement in corrupt activities.
- All senior public officials under serious investigation for corruption have now been suspended.
- Seminars and workshops on corruption prevention for civil servants, including at the local level, are being continued.
- With the assistance of the World Bank and other donor agencies, the government is developing an action program to strengthen the judiciary.
- A new Chief Justice has been appointed.

what are described as “unfair trading” practices. These are viewed as temporary measures, pending the resolution of these trade frictions through consultations or the COMESA dispute settlement mechanism.<sup>21</sup>

48. Taken together, the **budgetary measures can be said to represent a slight policy reversal** of the strategy of trade liberalization to which Kenya has indicated its commitment. The mission urged the authorities to review the recent protective measures in the context of their efforts to develop a medium-term trade strategy conducive to promoting strong economic growth. The authorities have indicated that an important policy issue they are considering is how to ensure that exporters do not pay duty on imported inputs. It is felt that this can best be done either by zero rating these imports or managing an efficient duty drawback scheme.<sup>22</sup>

49. **Kenya is a member of COMESA and the East African Community (EAC)**, and both regional groups plan to establish customs unions by 2004.<sup>23</sup> The authorities indicated that they saw no inconsistency between the two regional arrangements, as it is expected that the EAC will move toward a tariff structure for the customs union based on the agreed COMESA common external tariff system. They expected the EAC to move to the COMESA common external tariff at a faster pace than other COMESA members. The authorities described the EAC as an “inner grouping” of COMESA that would go on a “fast track” to achieve the COMESA customs union.

#### G. Statistics and Technical Assistance

50. **Kenya’s macroeconomic statistics have deteriorated over the past decade, and weaknesses in key statistics hamper economic analysis and surveillance.** The staff expressed concerns about (i) the problems with monitoring budgetary data, in particular domestic arrears and pending bills; (ii) the timeliness of trade data; and (iii) the accuracy of national accounts data. The authorities indicated that they are taking actions, with donor assistance, to improve the quality and timeliness of these data. Kenya is participating in the General Data Dissemination System project for Anglophone Africa, and metadata and detailed plans for improving the data over the short and medium term have been posted on the Fund’s Data Standards Bulletin Board. They are also preparing a statistical master plan and a new statistical act that would improve the independence of the Central Bureau of Statistics (CBS). The CBS commenced in early 2002 compilation and publication on a timely basis of a new national CPI (covering 12 urban areas). A peripatetic STA advisor, moreover, is assisting the authorities in improving their national

---

<sup>21</sup> At this stage, there is no set deadline for the removal of the discriminatory measures.

<sup>22</sup> In many developing countries duty drawback schemes are plagued by extensive delays, frequently exceeding one year, in reimbursing importers for duty paid on imported inputs. In these circumstances, it is probably more efficient to zero rate vital imported inputs.

<sup>23</sup> It is expected that the EAC Protocol will be signed by December 2003. The tariff structures in the three EAC members are quite different, with Kenya having a range of 0-35 percent (with eight bands), Tanzania a range of 0-25 percent (with four bands), and Uganda a range of 0-15 percent (with three bands).

accounts statistics. A revised set of national accounts data is expected to be released in mid-2003.

51. Representatives from the East Africa Regional Technical Assistance Center (AFRITAC) discussed with the Ministry of Finance officials in December 2002 the need for technical assistance in public expenditure management and the general budgeting framework, and for linking the macroeconomic framework to the budget. Fund staff conducted a joint mission with the World Bank in March 2003, with the participation of some bilateral donors, to assess the public expenditure management system in Kenya. AFRITAC is also providing assistance in the areas of secondary government securities market, foreign exchange reserves management, payment systems, and banking supervision.

#### **H. Safeguards Assessment**

52. A Stage-Two safeguards assessment was issued for Kenya in January 2001, and since then a number of measures have been taken by the CBK to deal with the issues raised by the report. Key outstanding issues discussed with the staff relate to (i) the establishment of an appropriately structured audit committee of the Central Bank of Kenya Board, and the need for a timetable to regularize an obligation of K Sh 36.9 billion payable by the government to the central bank on which interest has not been charged, so as to bring the CBK's accounts fully into line with International Accounting Standards. The staff of the CBK noted that an audit committee was expected to be established by April 2003, and that negotiations were under way with the treasury to determine the financial terms for the loan. Staff will continue to monitor safeguards issues and any outstanding issues would be incorporated, as needed, in a new PRGF-supported arrangement.

#### **I. The PRSP Process**

53. The authorities conducted a comprehensive PRSP consultative process in 2000. While a PRSP document was published by the previous government in September 2001, it did not include the associated government Action Plan (GAP) that was to set out the specific policies that the government intended to follow to achieve the goals of the PRSP. The new government has indicated that it intends to build on the earlier PRSP consultative process and to establish a new reform agenda. The policies identified as part of the economic recovery plan will complement the earlier work undertaken to complete the full PRSP.

#### **J. External Debt**

54. **Kenya's external debt appears to be sustainable by the standards of the Initiative for Heavily Indebted Poor Countries (HIPC) Initiative.** In 2002, the net present value (NPV) of debt-to-exports ratio was estimated at about 116 percent; the debt-service ratio was approximately 12 percent and is projected to fall further in the medium term. Bilateral agreements have been concluded with all Paris Club creditors in the context of the November

2000 rescheduling.<sup>24</sup> During the discussions, the authorities indicated that Kenya had reached a tentative agreement with its commercial creditors in the London Club.

55. **Kenya generally has a good external debt-servicing record.** Nonetheless, medium-term macroeconomic projections indicate that, in the absence of a new rescheduling request to its Paris Club creditors, Kenya will need initially to curtail its poverty reduction outlays or borrow locally to service its external debt obligations. In these circumstances, the authorities are considering approaching the Paris Club for a further rescheduling in the second half of 2003,<sup>25</sup> following agreement on a new program with the IMF. In this regard, the staff, in collaboration with the World Bank and the authorities, will in May 2003 conduct another debt sustainability analysis (DSA) (using end-2002 external debt data) to analyze the implications for total public debt sustainability of an external debt restructuring on both Naples and Houston terms.

## VII. STAFF APPRAISAL

56. **Kenya's economic performance in recent years has been well below its potential, reflecting primarily the persistence of pervasive governance problems and the slow pace of structural reforms.** Specific factors that have contributed to low economic and employment growth include corruption, low saving and capital formation, a weak banking system, poor infrastructure, weak property rights and an unpredictable judicial system. The implementation of the structural reform components of past Fund/Bank-supported programs has been disappointing, particularly the delay in the privatization of the public utilities. As a result of these factors, Kenya's real per capita GDP was in 2002 lower than it had been a decade earlier.

57. **The challenge facing the new government** is to pursue a comprehensive economic reform program without interruption, so as to begin demonstrating tangible results that will encourage further investment and harness increasing support from the international donor community. In order to further encourage investor confidence, sustained progress will be needed in implementing key structural reforms. In the staff's view, a comprehensive medium-term reform strategy would need to include (i) firm enforcement of planned governance legislation; (ii) strengthened public expenditure management and a reorientation of expenditures towards PRSP priorities; (iii) divestiture of the government from ownership of commercial banks; (iv) strengthened banking supervision; (v) privatization of key parastatals, including Kenya Telkom; and (vi) a medium-term fiscal strategy that allows for domestic debt to be reduced as a share of GDP.

---

<sup>24</sup> The November 2000 agreement (detailed in Box 2 of SM/02/60, 2/19/02) resulted in the rescheduling of US\$300 million of Paris Club debt, and approximately US\$40 million is expected to be rescheduled as a result of the London Club agreement.

<sup>25</sup> Preliminary estimates indicate that with a three-year Paris Club deal (2003-05) based on pre-cutoff date debt falling due, Kenya could potentially reschedule up to about US\$200 million, resources that could be directed to additional poverty spending.

58. **The new government should be commended for placing the anticorruption strategy at the top of its policy agenda.** Corruption has been primarily responsible for the rise in unproductive public outlays, the growing stock of pending bills, the marked deterioration in the asset quality of financial institutions, and the rise in informal activities, which have negatively affected public revenues. The government has already embarked on a major strengthening of its anticorruption apparatus, including the tabling of key governance legislation, and has taken steps to strengthen the judiciary. These actions, if followed by appropriately firm application and enforcement of the rules and regulations, should significantly reduce the wastage of public resources, improve the incentives for enterprises, and contribute to increased economic growth.

59. **The finalization of a full PRSP and the development of a new three-year reform program that is supported by the IMF and the donor community should facilitate the mobilization of urgently needed donor budget support.** The government's discussion paper on its Economic Recovery Program is an encouraging start to addressing the outstanding reform agenda. It will be particularly important, however, that the authorities' full PRSP set out a clear timetable for implementing key policy actions that the government intends to take to address poverty issues and raise growth in the medium term.

60. **The need to fund the teachers' salary increases and the move to universal free primary education, which is essential for tackling poverty, could complicate the management of macroeconomic policies in 2003/04 and beyond.** The necessary restructuring of the banking system, moreover, will likely involve the substitution of some nonperforming assets by government bonds. Increased budgetary allocations will also be required to expand the delivery of social services and enhance the productivity of the agricultural sector—key elements of the poverty reduction strategy. To implement successfully the above initiatives will require increased donor assistance, including a new rescheduling of Kenya's external debt under the Paris Club.

61. **The government has recognized the urgent need to restructure public expenditures and has begun to develop policy options, including modalities for rationalizing the structure of salaries, wages, and other benefits, to reduce the wage bill as a share of GDP over the medium term.** Measures to address these issues will need to form a key component of the authorities' new reform program. In the near term, however, these problems will impart a high degree of inflexibility to the budget and will greatly complicate the management of fiscal policy, as the benefits of the remedial measures are expected to be realized after a time lag. Moreover, in order to maintain the credibility of the PRSP process and to reduce poverty in Kenya, budget execution should begin to reflect the priorities identified in the PRSP process, and the public expenditure review that is currently under way. Achievement of the needed restructuring of expenditure will also require that the fiscal implications of new major initiatives be fully costed and funding implications worked out before they are included in the budget. In the meantime, close monitoring and control of expenditure will be essential to minimize deviations of budget outcomes from intentions. Finally, the government should also urgently deal with the problem of stalled projects and pending bills and prevent their recurrence.

62. **Over the medium term, fiscal policies should also aim at strengthening macroeconomic stability by lowering domestic public debt and supporting a prudent monetary policy.** To strengthen the public finances, the Kenya Revenue Authority (KRA)



should at least keep the revenue-to-GDP ratio at the level of recent years; over the longer run, there is some scope for streamlining the tax system, broadening the tax base, and removing disincentives to economic activity, while increasing the revenue-to-GDP ratio.

63. **Monetary policy should continue to aim at keeping inflation low while providing a stable environment for financial markets.** To this end, the authorities should avoid central bank financing of the government, preserve the CBK's independence in conducting monetary policy, and continue to allow bank interest rates to be market determined. Concerns about the wide spread between bank lending and deposit rates should be addressed by tackling the underlying problems in the banking system. In particular, there is an urgent need to establish a clear plan to deal with the nonperforming loans, including through enhanced loan recovery efforts. In addition, divestiture of the government's ownership interests in the publicly owned banks is necessary in order to reduce the risk of political interference in lending decisions, as well as to improve the collection of bad loans and the enforcement of prudential and regulatory standards.

64. **In the period ahead it will be necessary to allow greater exchange rate flexibility than has been the case in the past two years.** While the exchange rate does not appear to have been a major impediment to export expansion, there is a need to closely monitor exchange rate developments as a continuation of the recent appreciation would likely be distortionary, with adverse implications for export and output growth. Over the medium term, action will be needed to raise productivity and reduce production costs to offset any appreciation pressures and safeguard competitiveness. In this regard, improvements in the governance regime and public expenditure on upgrading infrastructure should help to reduce operating costs. These measures will need to be complemented by policies aimed at increasing labor market flexibility, improving the efficiency of the financial institutions and expanding financial services, streamlining the current tax regime, and reforming the trade regime so as to lower protection rates.

65. **Kenya's economy faces considerable risks.** First, the past mixed record of performance and the uncertainties regarding the timetable for completing the constitutional review, which will have a major impact on the governance framework, may continue to undermine the confidence of some potential investors. Second, the level of nonperforming loans in the banking system and the contingent government liabilities in the financial and parastatal sectors represent a serious risk to financial stability. Third, with a new coalition government in power, it will be important for the coalition to remain united in supporting the difficult decisions that will be required for restructuring the public finances. Finally, the geopolitical uncertainties in the region and the conflict in the Middle East mean that the external environment remains highly uncertain. **It will thus be important to maintain financial discipline in the immediate period ahead and to resist any pressures for implementing expansionary policies that would undermine the sustainability of the fiscal position over the medium term.**

66. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Table 3. Kenya: Macroeconomic High Case Scenario, June-July Fiscal Year 2000/01-07/08

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
(Annual percentage change, unless otherwise indicated)								
National accounts and prices								
Nominal GDP (Market prices, in billions of Kenya shillings)	846	910	953	1,020	1,114	1,236	1,372	1,523
GDP volume (factor cost)	0.5	1.2	1.6	2.8	4.4	5.8	6.2	6.0
GDP volume (factor cost) per capita	-1.6	-0.7	-0.2	1.2	2.8	4.3	4.8	4.5
Consumer price index (annual average)	10.0	2.3	4.1	2.5	3.4	3.4	3.4	3.4
Consumer price index (end of period)	4.6	2.8	3.7	2.3	3.5	3.5	3.5	3.5
Export volume, goods and services	7.8	5.8	5.0	3.8	2.8	5.8	9.8	11.0
Import volume, goods and services	7.7	-1.0	4.7	11.0	11.3	10.7	9.5	8.6
Terms of trade, goods								
(- deterioration; based on c.i.f. imports)	-1.6	-3.8	-2.7	1.6	3.1	1.8	0.5	0.0
Ksh per US \$ exchange rate (end of period)	79.0	78.8	76.8	1/				
Nominal effective exchange rate (- depreciation; end of period)	8.3	-5.9	-8.3	2/	...	...	...	...
Real effective exchange rate (- depreciation; end of period)	10.4	-4.4	-8.6	2/	...	...	...	...
Money and credit								
Net domestic assets (end of period)	-6.2	6.7	10.6	8.2	1.8	-1.7	-5.6	-9.7
Net credit to the government (end of period)	-17.5	38.0	33.7	8.1	-6.3	-35.5	-57.4	-131.2
Credit to the rest of the economy (end of period)	-4.9	20.5	-6.3	14.9	12.2	35.5	18.4	7.7
M3 (broad money, excluding foreign currency deposits, end of period)	-1.3	8.5	7.2	9.0	10.2	11.7	10.9	10.2
M3X (M3 plus foreign currency deposits, end of period)	2.1	6.7	7.5	7.3	8.6	10.2	9.6	9.2
M4X (M3X plus nonbank holdings of government paper)	8.2	-0.9	13.9	13.6	10.2	10.7	8.6	5.7
Reserve money (end of period)	-8.5	10.9	10.7	10.6	11.9	13.6	13.1	12.7
Interest rate (90-day treasury bill; end of period)	12.4	7.5	5.8	1/	...	...	...	...
(In percent of GDP)								
Investment and saving								
Investment	14.9	14.0	14.1	15.7	18.2	20.3	21.6	22.6
Central government	3.6	2.5	3.2	3.3	3.9	4.9	5.9	6.9
Other	11.4	11.5	10.9	12.4	14.3	15.4	15.6	15.7
Gross national saving	11.8	10.1	8.6	8.4	9.7	11.5	13.4	15.0
Central government	1.9	0.6	-0.9	-0.1	1.3	3.4	4.1	3.6
Other	9.8	9.6	9.5	8.5	8.4	8.1	9.3	11.4
Central government budget								
Total revenue	22.6	21.6	22.2	22.6	23.4	24.0	24.4	24.9
Total expenditure and net lending	27.4	25.0	27.7	28.0	28.1	27.8	28.6	28.9
Overall balance (commitment basis) excluding grants	-4.8	-3.4	-5.5	-5.4	-4.7	-3.8	-4.2	-4.0
Total grants	2.8	1.2	0.9	0.9	0.9	1.2	1.4	1.3
Overall balance (commitment basis) including grants	-2.0	-2.2	-4.6	-4.5	-3.7	-2.6	-2.8	-2.7
Balance of payments								
Current external balance, excluding official transfers	-4.0	-4.2	-5.5	-7.4	-8.5	-8.8	-8.2	-7.6
Gross international reserve coverage								
in months of next year imports (end of period)	3.1	2.8	2.4	2.3	2.8	3.7	4.7	4.8
Central government debt (end of period)								
Domestic debt, net (end of period)	53.6	52.2	53.7	54.3	49.7	42.0	34.9	28.2
NPV of external debt (end of period)	19.4	22.3	26.2	28.7	25.9	19.5	13.3	7.3
NPV of external debt (end of period)	34.1	29.9	27.6	25.5	23.8	22.5	21.6	20.9

Sources: Kenyan authorities; and staff estimates and projections.

1/ March 20, 2003.

2/ 12-month period ended December 2002.

Table 4. Kenya: Central Government Financial Operations, High Case Scenario, 1999/2000-2007/08 1/

	1999/00	2000/01	2001/02		2002/03	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
	Actual	Actual	Revised Budget	Actual	Budget July	IMF Projections	FY Proj.				
(In millions of Kenya shillings)											
Revenue	178,024	191,160	209,618	196,613	218,928	211,638	230,415	260,845	297,000	334,893	378,851
Income tax	54,402	55,828	58,373	55,862	67,529	66,308	71,115	79,635	90,442	103,065	117,256
Import duty (net)	28,605	28,726	23,151	21,584	19,895	19,895	22,700	27,488	32,770	36,355	41,266
Excise duty	28,493	28,318	36,197	32,077	42,671	35,739	38,322	42,357	47,483	53,193	59,568
Value-added tax	40,945	50,298	55,445	50,871	57,184	56,240	61,572	70,102	80,028	90,239	102,012
Investment income	305	2,478	2,346	767	2,123	1,762	1,886	2,260	2,707	3,204	3,757
Other	25,274	25,512	34,106	35,452	29,526	31,694	34,820	39,002	43,570	48,837	54,992
Expenditure and net lending	176,732	231,769	244,031	227,823	266,562	263,698	285,940	312,926	343,443	392,618	439,943
Recurrent expenditure	157,851	198,941	208,410	202,870	222,211	228,468	241,531	257,228	269,871	296,814	318,996
Interest payments	30,703	26,824	30,513	27,139	38,341	32,995	34,659	36,225	34,635	30,459	25,428
Domestic interest	22,068	19,021	22,614	19,543	29,882	26,802	28,525	29,861	27,983	23,420	17,895
Foreign interest due	8,635	7,803	7,899	7,597	8,459	6,192	6,134	6,363	6,652	7,038	7,533
Wages and benefits (civil service)	65,861	68,119	77,674	77,674	82,028	87,351	93,794	96,470	97,199	102,721	109,397
Civil service reform	443	6,095	1,770	1,665	1,600	1,300	2,600	1,906	2,040	2,229	2,472
Pensions, etc.	5,145	6,136	9,768	8,995	12,921	13,727	15,139	15,290	16,360	19,718	19,718
Other	44,777	57,252	69,949	69,179	70,028	72,793	76,592	86,620	98,273	120,968	136,406
Of which: Operations and Maintenance	40,341	44,357	47,727	47,727	51,625	50,000	53,516	60,791	70,800	84,069	100,729
Defense and NSIS 2/	12,564	16,571	17,236	16,448	17,293	21,109	20,158	20,869	22,434	24,078	25,574
Pending bills 3/	-1,642	1,972	1,500	1,770	0	0	0	0	0	0	0
Drought relief expenditures	0	15,972	0	0	0	0	0	0	0	0	0
Development and net lending	18,881	32,828	35,621	24,953	44,351	32,430	34,710	44,574	61,801	82,299	106,620
Domestically financed	4,253	5,685	10,278	5,908	10,509	11,088	14,546	20,591	28,058	45,939	67,270
Foreign financed	13,097	15,341	20,890	20,345	32,260	19,760	19,381	23,252	32,805	35,494	38,514
Net lending	1,531	2,805	953	1,862	1,582	1,582	783	731	937	867	836
Pending bills 3/	0	3,191	3,500	-3,162	0	0	0	0	0	0	0
Drought relief expenditures	0	5,806	0	0	0	0	0	0	0	0	0
Free primary education spending	0	0	0	0	0	2,800	9,700	11,125	11,771	13,505	14,328
Balance (commitment basis, excluding grants)	1,292	-40,609	-34,413	-31,210	-47,634	-52,060	-55,526	-52,082	-46,443	-57,725	-61,092
Grants	4,247	24,080	5,797	11,265	15,866	8,159	9,615	10,525	14,859	18,840	20,478
Food relief grants	0	12,444	0	0	0	0	0	0	0	...	...
Project grants	4,247	5,681	4,771	10,315	15,866	8,159	9,615	10,525	14,859	18,840	20,478
Program grants	0	5,955	1,026	950	0	0	0	0	0	0	0
Balance (commitment basis, including grants)	5,539	-16,529	-28,616	-19,945	-31,768	-43,900	-45,910	-41,557	-31,584	-38,885	-40,614
Adjustments to cash basis	-3,789	1,512	292	-8,404	0	-6,810	-3,250	-3,250	-3,250	0	0
Balance (cash basis, including grants)	1,750	-15,017	-28,324	-28,349	-31,768	-50,710	-49,160	-44,807	-34,834	-38,885	-40,614
Financing	-534	14,817	28,441	29,871	31,771	39,502	24,622	-2,384	-39,733	-52,894	-62,486
Net foreign financing	-18,974	12,601	-5,061	-10,853	-4,331	-7,272	-4,369	1,271	5,868	4,632	6,893
Project loans	8,850	14,042	17,915	10,031	16,394	11,600	9,765	12,727	17,946	16,654	18,036
Program loans	0	4,045	0	122	0	0	0	0	0	0	0
Commercial borrowing	0	0	0	2,063	0	1,812	3,441	2,254	1,837	1,785	1,734
Repayments due	-31,018	-27,887	-23,142	-27,672	-17,556	-18,651	-15,550	-13,709	-13,915	-13,807	-12,877
Change in arrears	3,194	496	-6,091	-193	-3,169	-4,120	-2,025	0	0	0	0
Rescheduling		21,905	6,257	4,795	0	2,087	0	0	0	0	0
Privatization proceeds	5,660	0	955	955	3,500	0	1,250	1,500	1,500	1,500	1,500
Bank restructuring costs	0	0	0	0	0	0	-16,000	0	0	0	0
Net domestic financing	12,780	2,216	32,547	39,769	32,602	46,774	43,741	-5,156	-47,100	-59,026	-70,879
Of which: excluding bank restructuring costs expenditure arrears securitization	12,780	2,216	32,547	39,769	32,602	46,774	27,741	-5,156	-47,100	-59,026	-70,879
	3,472	3,538	3,088	2,788	0	4,481	3,250	3,250	3,250	0	0
Financing gap (stat. discrepancy for outturns)	-1,216	200	-117	1,521	3	11,209	24,538	47,191	74,567	91,779	103,101
Memorandum items:											
Nominal GDP	769,054	845,625	909,869	909,869	984,176	953,199	1,020,222	1,114,341	1,236,022	1,371,654	1,523,136
Primary budget balance	32,453	11,807	2,189	-1,210	6,573	-17,715	-14,501	-8,582	-199	-8,426	-15,186
Stock of domestic debt, net (end of period)	163,405	164,203	196,750	202,775	235,377	249,549	293,290	288,134	241,034	182,008	111,129

Table 4. Kenya: Central Government Financial Operations, High Case Scenario, 1999/2000-2007/08 1/ (concluded)

	1999/00	2000/01	2001/02		2002/03		2003/04	2004/05	2005/06	2006/07	2007/08
			Revised Budget	Actual	Budget July	IMF Projections	FY	Program 4/			
(In percent of GDP, unless otherwise indicated)											
Revenue	23.1	22.6	23.0	21.6	22.2	22.2	22.6	23.4	24.0	24.4	24.9
Income tax	7.1	6.6	6.4	6.1	6.9	7.0	7.0	7.1	7.3	7.5	7.7
Import duty (net)	3.7	3.4	2.5	2.4	2.0	2.1	2.2	2.5	2.7	2.7	2.7
Excise duty	3.7	3.3	4.0	3.5	4.3	3.7	3.8	3.8	3.8	3.9	3.9
Value-added tax	5.3	5.9	6.1	5.6	5.8	5.9	6.0	6.3	6.5	6.6	6.7
Investment income	0.0	0.3	0.3	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other	3.3	3.0	3.7	3.9	3.0	3.3	3.4	3.5	3.5	3.6	3.6
Expenditure and net lending	23.0	27.4	26.8	25.0	27.1	27.7	28.0	28.1	27.8	28.6	28.9
Recurrent expenditure	20.5	23.5	22.9	22.3	22.6	24.0	23.7	23.1	21.8	21.6	20.9
Interest payments	4.0	3.2	3.4	3.0	3.9	3.5	3.4	3.3	2.8	2.2	1.7
Domestic interest	2.9	2.2	2.5	2.1	3.0	2.8	2.8	2.7	2.3	1.7	1.2
Foreign interest due	1.1	0.9	0.9	0.8	0.9	0.6	0.6	0.6	0.5	0.5	0.5
Wages and benefits (civil service)	8.6	8.1	8.5	8.5	8.3	9.2	9.2	8.7	7.9	7.5	7.2
Civil service reform	0.1	0.7	0.2	0.2	0.2	0.1	0.3	0.2	0.2	0.2	0.2
Pensions, etc.	0.7	0.7	1.1	1.0	1.3	1.4	1.3	1.4	1.2	1.2	1.3
Other	5.8	6.8	7.7	7.6	7.1	7.6	7.5	7.8	8.0	8.8	9.0
Of which: Operations and Maintenance	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.5	5.7	6.1	6.6
Defense and NSIS 2/	1.6	2.0	1.9	1.8	1.8	2.2	2.0	1.9	1.8	1.8	1.7
Pending bills 3/	-0.2	0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Drought relief expenditures	0.0	1.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development and net lending	2.5	3.9	3.9	2.7	4.5	3.4	3.4	4.0	5.0	6.0	7.0
Domestically financed	0.6	0.7	1.1	0.6	1.1	1.2	1.4	1.8	2.3	3.3	4.4
Foreign financed	1.7	1.8	2.3	2.2	3.3	2.1	1.9	2.1	2.7	2.6	2.5
Net lending	0.2	0.3	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Pending bills 3/	0.0	0.4	0.4	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Drought relief expenditures	0.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Free primary education spending	0.0	0.0	0.0	0.0	0.0	0.3	1.0	1.0	1.0	1.0	0.9
Balance (commitment basis)	0.2	-4.8	-3.8	-3.4	-4.8	-5.5	-5.4	-4.7	-3.8	-4.2	-4.0
Grants	0.6	2.8	0.6	1.2	1.6	0.9	0.9	0.9	1.2	1.4	1.3
Food relief grants	...	1.5	...	...	...	...	...	...	...	...	...
Project grants	0.6	0.7	0.5	1.1	1.6	0.9	0.9	0.9	1.2	1.4	1.3
Program grants	0.0	0.7	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance (commitment basis, including grants)	0.7	-2.0	-3.1	-2.2	-3.2	-4.6	-4.5	-3.7	-2.6	-2.8	-2.7
Adjustments to cash basis	-0.5	0.2	0.0	-0.9	0.0	-0.7	-0.3	-0.3	-0.3	0.0	0.0
Balance (cash basis including grants)	0.2	-1.8	-3.1	-3.1	-3.2	-5.3	-4.8	-4.0	-2.8	-2.8	-2.7
Financing	-0.1	1.8	3.1	3.3	3.2	4.1	2.4	-0.2	-3.2	-3.9	-4.1
Net foreign financing	-2.5	1.5	-0.6	-1.2	-0.4	-0.8	-0.4	0.1	0.5	0.3	0.5
Project loans	1.2	1.7	2.0	1.1	1.7	1.2	1.0	1.1	1.5	1.2	1.2
Program loans	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial borrowing	0.0	0.0	0.0	0.2	0.0	0.2	0.3	0.2	0.1	0.1	0.1
Repayments due	-4.0	-3.3	-2.5	-3.0	-1.8	-2.0	-1.5	-1.2	-1.1	-1.0	-0.8
Change in arrears	0.4	0.1	-0.7	0.0	-0.3	-0.4	-0.2	0.0	0.0	0.0	0.0
Rescheduling	...	2.6	0.7	0.5	0.0	0.2	0.0	0.0	0.0	0.0	0.0
Privatization proceeds	0.7	0.0	0.1	0.1	0.4	0.0	0.1	0.1	0.1	0.1	0.1
Bank restructuring costs	0.0	0.0	0.0	0.0	0.0	0.0	-1.6	0.0	0.0	0.0	0.0
Net domestic financing	1.7	0.3	3.6	4.4	3.3	4.9	4.3	-0.5	-3.8	-4.3	-4.7
Of which: excluding bank restructuring costs	1.7	0.3	3.6	4.4	3.3	4.9	2.7	-0.5	-3.8	-4.3	-4.7
expenditure arrears securitization	0.5	0.4	0.3	0.3	0.0	0.5	0.3	0.3	0.3	0.0	0.0
Financing gap (stat. discrepancy for outturns)	-0.2	0.0	0.0	0.2	0.0	1.2	2.4	4.2	6.0	6.7	6.8
Memorandum items:											
GDP (in millions of Kenya shillings)	769,054	845,625	909,869	944,864	984,176	953,199	1,020,222	1,114,341	1,236,022	1,371,654	1,523,136
Primary budget balance	4.2	1.4	0.2	-0.1	0.7	-1.9	-1.4	-0.8	0.0	-0.6	-1.0
Stock of domestic debt, net (end of period)	21.2	19.4	22.9	22.3	23.0	26.2	28.7	25.9	19.5	13.3	7.3

Sources: Kenyan authorities, and Fund staff estimates and projections.

1/ Fiscal year ending June 30.

2/ In 2002/03 an amount of KSh 2.0 billion was received for UN peacekeeping duties.

3/ The fiscal accounts are on a cash basis (with the exception of foreign interest due). Adding accumulation of pending bills and subtracting cash repayment of them adjusts to a commitment basis.

Table 5. Kenya: Balance of Payments, High Case Scenario, 1999-2008  
(In millions of U.S. dollars, unless otherwise indicated)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
			Est.							
Current account:	-234	-284	-398	-497	-857	-1,150	-1,447	-1,631	-1,610	-1,846
Excluding official transfers	-233	-375	-486	-497	-857	-1,150	-1,447	-1,631	-1,610	-1,846
Exports, f.o.b.	1,755	1,773	1,881	2,017	2,392	2,480	2,630	2,979	3,468	3,937
Coffee	172	154	94	83	93	108	118	133	149	164
Tea	472	463	435	437	477	517	551	598	640	692
Oil products	138	127	177	158	202	168	152	151	157	163
Other	973	1,029	1,176	1,340	1,620	1,687	1,809	2,097	2,522	2,918
Imports, f.o.b.	-2,679	-3,033	-3,176	-3,243	-3,931	-4,211	-4,516	-4,983	-5,439	-6,072
Public	-121	-94	-91	-94	-205	-108	-116	-125	-135	-147
Private	-2,557	-2,939	-3,085	-3,149	-3,727	-4,103	-4,400	-4,858	-5,304	-5,925
Oil	-527	-850	-721	-785	-1,028	-943	-865	-947	-1,026	-1,170
Other	-2,031	-2,089	-2,364	-2,363	-2,699	-3,160	-3,535	-3,911	-4,278	-4,755
Balance on goods	-924	-1,260	-1,295	-1,225	-1,539	-1,731	-1,886	-2,003	-1,971	-2,135
Services (net)	298	245	261	251	233	153	6	-80	-118	-222
Credit	932	969	1,087	1,110	1,203	1,248	1,309	1,417	1,561	1,706
Foreign travel	301	259	308	293	293	310	329	349	373	403
Other	631	710	779	817	910	938	980	1,068	1,188	1,303
Debit	-634	-724	-825	-859	-970	-1,095	-1,303	-1,497	-1,679	-1,928
Balance on goods and services	-626	-1,015	-1,033	-974	-1,306	-1,578	-1,880	-2,084	-2,089	-2,356
Income (net)	-173	-130	-148	-123	-125	-134	-128	-113	-92	-66
Credit	32	45	43	43	43	47	64	91	125	167
Debit	-205	-175	-190	-166	-168	-181	-193	-205	-217	-233
<i>Of which: official interest payments</i>	-164	-120	-111	-82	-77	-80	-85	-93	-102	-115
Current transfers (net)	564	860	783	600	575	562	561	566	571	576
Private (net)	566	769	694	600	575	562	561	566	571	576
Official (net)	-2	91	89	0	0	0	0	0	0	0
Capital and financial account	215	276	419	535	715	684	1,158	1,066	1,167	1,354
Capital account	63	63	69	85	126	130	158	261	285	326
<i>Of which: capital transfers</i>	63	63	69	85	126	130	158	261	285	326
Financial account	152	212	350	450	590	554	1,000	806	882	1,028
Investment assets and liabilities (net)	-285	-314	-206	-96	68	158	630	391	456	572
Official, medium and long term	-305	-170	-284	-45	20	41	253	136	100	148
Inflows	205	304	168	207	252	226	446	337	299	333
Program loans	0	49	3	0	0	0	197	60	0	0
Project loans	148	224	132	137	163	158	203	230	252	286
Defense loans	0	0	0	30	33	32	21	21	21	21
Government guaranteed/parastatal	57	31	32	40	56	36	26	26	26	26
Outflows	-510	-474	-452	-253	-232	-185	-193	-201	-199	-185
Commercial banks (net)	21	-235	96	-69	0	0	0	0	0	0
Private (net)	-1	91	-19	18	48	117	377	256	366	425
Short-term (net) and net errors and omissions 1/	437	527	556	546	521	396	370	414	416	456
Overall balance	-20	-8	21	38	-142	-465	-289	-565	-442	-492
Financing items	20	8	-21	-38	142	465	289	565	442	492
Reserve assets (gross)	-8	-106	-167	-3	-12	-214	-633	-716	-957	-1,157
Use of Fund credit and loans to the Fund (net)	-60	2	-24	18	22	68	74	28	-9	-21
Change in arrears	87	-53	48	-53	-54	0	0	0	0	0
Rescheduling	0	166	122	0	40	0	0	0	0	0
Remaining gap	0	0	0	0	145	612	848	1,252	1,408	1,670
Memorandum items:										
Gross official reserves (end of period)	791	897	1,064	1,067	1,079	1,293	1,926	2,642	3,599	4,756
(in months of next year's imports) 2/	2.5	2.7	3.1	2.7	2.4	2.7	3.6	4.5	5.4	5.4
Current account balance										
(percent of GDP, excluding official transfers)	-2.2	-3.6	-4.3	-4.2	-6.6	-8.0	-8.9	-8.8	-7.6	-7.6
(percent of GDP, excluding special imports) 3/	-1.2	-1.0	-2.1	-3.1	-5.2	-6.8	-7.1	-7.2	-6.2	-6.4
Debt-service ratio after rescheduling 4/ 5/	27.3	19.1	15.6	11.3	9.1	7.4	7.2	7.0	6.2	5.7
Import volume growth, goods (percent)	-7.2	7.0	7.3	-2.1	7.9	16.9	27.4	14.0	8.0	14.5
Import volume growth, goods (percent; excluding special imports)	-5.2	3.6	7.2	1.7	4.4	20.9	25.9	14.7	8.3	15.1
Export volume growth, goods (percent)	-5.2	-4.9	11.6	8.3	8.0	4.6	5.3	12.0	15.4	12.6

Sources: Kenyan authorities; and staff estimates and projections

1/ Includes underrecorded tourism earnings.

2/ In months of projected imports of goods and nonfactor services.

3/ Includes defense-related imports, imports of maize, sugar, and airplanes, and imports related to rehabilitation of the energy sector.

4/ After November 2000 Paris Club rescheduling and assumed rescheduling, under comparable terms, by commercial and non-Paris Club bilateral creditors.

5/ In percent of exports of goods and services.

Table 6. Kenya: External Debt Indicators, High Case Scenario, 2000-2008 1/  
(In millions of U.S. dollars, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006
<b>Debt-stock indicators</b>							
Stock of external debt by creditor 2/ 3/	5,327	4,713	4,651	4,868	5,247	5,795	6,662
Multilateral creditors	3,001	2,919	2,936	3,095	3,512	4,076	4,934
IMF	128	99	81	104	92	166	194
World Bank	2,356	2,291	2,344	2,476	2,861	3,289	3,989
African Development Bank/African Development Fund	355	302	298	314	368	430	551
Other	162	228	213	201	191	191	200
Bilateral creditors	1,889	1,600	1,541	1,527	1,503	1,500	1,527
Paris Club	1,845	1,552	1,493	1,476	1,449	1,436	1,448
Non-Paris Club	44	48	48	51	54	64	79
Other creditors 4/	437	194	174	246	232	219	202
Stock of external debt by debtor 2/ 3/	5,386	4,713	4,651	4,868	5,247	5,795	6,662
Central government	4,688	4,312	4,258	4,429	4,806	5,272	6,101
Government guaranteed	511	303	311	336	349	357	367
Central bank	128	99	81	104	92	166	194
Net present value (NPV) of debt 3/ 5/							
In million of U.S dollars	3,930	3,430	3,383	3,416	3,525	3,751	4,101
In percent of exports of goods and services 6/	143	123	115	106	101	100	102
In percent of government revenue 7/	164	139	133	122	114	107	
In percent of GDP	38	30	29	26	25	23	22
Stock of arrears 8/	59	107	54	0	0	0	0
<b>Debt-service indicators</b>							
Principal payments by creditor 3/	425	373	270	246	196	190	203
Multilateral creditors	156	128	102	103	91	85	96
IMF	42	24	18	18	12	6	12
World Bank	70	63	53	51	50	48	53
AfDB/AfDF	19	19	10	11	9	9	10
Other	25	23	21	23	20	21	22
Bilateral creditors	122	151	118	106	90	92	91
Paris Club	116	149	114	102	87	89	88
Non-Paris Club	6	1	4	4	3	3	3
Other creditors 4/	147	95	51	37	14	13	17
Interest payments by creditor 3/	99	92	82	77	80	85	93
Multilateral creditors	38	49	32	32	34	38	44
IMF	1	1	1	2	2	2	2
World Bank	26	34	19	19	22	25	30
AfDB/AfDF	8	12	6	5	5	5	6
Other	4	2	6	5	5	5	6
Bilateral creditors	37	28	45	42	41	41	43
Paris Club	36	28	44	40	37	35	33
Non-Paris Club	1	0	1	3	4	7	10
Other creditors 4/	24	15	6	3	6	6	6
Debt-service ratio (in percent of current year exports)	19	16	11	9	7	7	7
Debt-service to fiscal revenue ratio 7/	22	19	14	12	9	8	7

Sources: Kenyan authorities; and staff estimates and projections.

1/ This reflects an outcome where the program is brought back on track by 2002:Q2 (foreign program financing is received).

2/ Does not include arrears.

3/ After Paris Club rescheduling in November 2000, and assuming comparable treatment by non-Paris Club and commercial creditors.

4/ Includes commercial banks' and suppliers' credit; includes stock and repayment of arrears according to the terms agreed with commercial banks.

5/ Refers to the present value of debt service calculated by using the currency-specific commercial interest reference rate (CIRR) as the discount rate.

6/ Three-year backward-looking average.

7/ Central government revenue, excluding grants.

8/ The stocks of arrears at end-2000 and end-2001 are largely composed of arrears to commercial creditors that are assumed to be cleared when Kenya reaches a rescheduling agreement with these creditors.

9/ The figures for debt service in this table differ from those presented in the balance of payments table, as the balance of payments table presents debt service before rescheduling (and rescheduling is presented as financing below the line).



Table 8. Kenya: Macroeconomic Scenario, Base Case Scenario, June-July Fiscal Year 2000/01-07/08

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
(Annual percentage change, unless otherwise indicated)								
National accounts and prices								
Nominal GDP (Market prices, in billions of Kenya shillings)	846	910	951	1,012	1,095	1,202	1,315	1,436
GDP volume (factor cost)	0.5	1.2	1.5	2.5	3.6	4.7	4.8	4.5
GDP volume (factor cost) per capita	-1.6	-0.7	-0.3	0.8	2.1	3.2	3.4	3.1
Consumer price index (annual average)	10.0	2.3	4.1	2.5	3.4	3.4	3.4	3.4
Consumer price index (end of period)	4.6	2.8	3.7	2.3	3.5	3.5	3.5	3.5
Export volume, goods and services	7.8	5.8	4.3	2.8	2.2	4.1	6.3	6.9
Import volume, goods and services	7.7	-1.0	3.5	8.9	9.8	9.1	6.7	5.1
Terms of trade, goods (- deterioration; based on c.i.f. imports)	-1.6	-3.8	-2.7	1.5	3.0	1.9	0.5	0.0
Ksh per US \$ exchange rate (end of period)	79.0	78.8	76.8	1/				
Nominal effective exchange rate (- depreciation; end of period)	8.3	-5.9	-8.3	2/	...	...	...	...
Real effective exchange rate (- depreciation; end of period)	10.4	-4.4	-8.6	2/	...	...	...	...
Money and credit								
Net domestic assets (end of period)	-6.2	6.7	10.3	8.4	5.3	2.4	4.2	2.0
Net credit to the government (end of period)	-17.5	38.0	22.8	14.6	4.9	-7.5	3.3	8.4
Credit to the rest of the economy (end of period)	3.4	-3.4	4.8	4.6	5.2	7.8	4.7	0.2
M3 (broad money, end of period)	-1.3	8.5	6.9	8.3	9.3	10.2	9.4	8.8
M3X (M3 plus foreign currency deposits, end of period)	2.1	6.7	7.2	6.7	7.8	8.8	8.2	7.8
M4X (M3X plus nonbank holdings of government paper)	5.3	8.4	10.1	7.7	6.8	6.6	7.1	7.9
Reserve money (end of period)	-8.5	10.9	10.5	9.9	11.1	12.2	11.7	11.3
Interest rate (90-day treasury bill; end of period)	12.4	7.5	5.8	1/	...	...	...	...
(In percent of GDP)								
Investment and saving								
Investment	14.9	14.0	14.0	15.1	16.9	18.3	18.7	19.0
Central government	3.6	2.5	3.2	2.8	2.6	3.4	4.0	4.4
Other	11.4	11.5	10.7	12.3	14.3	14.9	14.7	14.6
Gross national saving	11.8	10.1	8.7	8.3	9.2	10.2	11.2	12.1
Central government	1.9	0.6	-0.9	-0.6	-0.3	0.6	0.1	-1.1
Other	9.8	9.6	9.6	8.9	9.5	9.6	11.1	13.2
Central government budget								
Total revenue	22.6	21.6	22.2	22.5	22.6	22.4	22.2	22.3
Total expenditure and net lending	27.4	25.0	27.7	27.9	27.5	27.5	28.6	29.1
Overall balance (commitment basis) excluding grants	-4.8	-3.4	-5.5	-5.4	-5.0	-5.1	-6.4	-6.7
Total grants	2.8	1.2	0.9	1.0	1.0	1.2	1.4	1.4
Overall balance (commitment basis) including grants	-2.0	-2.2	-4.6	-4.5	-4.0	-3.8	-4.9	-5.3
Balance of payments								
Current external balance, excluding official transfers	-4.0	-4.2	-5.3	-6.8	-7.7	-8.1	-7.5	-6.9
Gross international reserve coverage in months of next year imports (end of period)	3.1	2.9	2.5	2.3	2.5	3.2	3.5	3.9
Central government debt (end of period)	53.6	52.2	53.9	55.1	52.3	47.7	44.8	43.1
Domestic debt, net (end of period)	19.4	22.3	26.3	29.7	28.8	25.6	24.1	23.7
NPV of external debt (end of period)	34.1	29.9	27.6	25.4	23.5	22.1	20.8	19.4

Sources: Kenyan authorities; and staff estimates and projections.

1/ March 20, 2003.

2/ 12-month period ended December 2002.



Table 9. Kenya: Central Government Financial Operations, Base Case Scenario, 1999/2000-2007/08 1/

	1999/00	2000/01	2001/02		2002/03	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
	Actual	Actual	Revised Budget	Actual	Budget July	IMF Projections	FY Proj.				
(In millions of Kenya shillings)											
Revenue	178,024	191,160	209,618	196,613	218,928	211,638	227,449	247,096	269,404	291,835	320,538
Income tax	54,402	55,828	58,373	55,862	67,529	66,308	70,562	76,785	85,114	94,043	104,138
Import duty (net)	28,605	28,726	23,151	21,584	19,895	19,895	22,014	23,629	24,115	23,422	24,209
Excise duty	28,493	28,318	36,197	32,077	42,671	35,739	38,021	41,154	45,149	50,664	55,315
Value-added tax	40,945	50,298	55,445	50,871	57,184	56,240	60,369	65,086	70,357	74,126	82,026
Investment income	305	2,478	2,346	767	2,123	1,762	1,875	2,029	2,226	2,449	2,673
Other	25,274	25,512	34,106	35,452	29,526	31,694	34,608	38,413	42,443	47,131	52,175
Expenditure and net lending	176,732	231,769	244,031	227,823	266,562	263,698	282,258	301,725	330,445	375,635	417,143
Recurrent expenditure	157,851	198,941	208,410	202,870	222,211	228,468	243,440	261,317	276,756	309,635	339,932
Interest payments	30,703	26,824	30,513	27,139	38,341	32,995	35,592	37,963	39,263	39,811	41,467
Domestic interest	22,068	19,021	22,614	19,543	29,882	26,802	29,728	32,101	33,197	33,548	34,991
Foreign interest due	8,635	7,803	7,899	7,597	8,459	6,192	5,864	5,862	6,066	6,263	6,476
Wages and benefits (civil service)	65,861	68,119	77,674	77,674	82,028	87,351	94,698	99,392	102,180	109,841	118,716
Civil service reform	443	6,095	1,770	1,665	1,600	1,300	2,600	1,903	2,024	2,191	2,404
Pensions, etc.	5,145	6,136	9,768	8,995	12,921	12,921	13,727	15,139	15,290	16,360	19,718
Other	44,777	57,252	69,949	69,179	70,028	72,793	76,032	85,393	94,866	116,605	131,307
<i>Of which: Operations and Maintenance</i>	40,420	44,444	47,820	47,820	51,726	50,000	53,193	57,806	63,861	70,950	78,471
Defense and NSIS 2/	12,564	16,571	17,236	16,448	17,293	21,109	20,791	21,528	23,133	24,828	26,320
Pending bills 3/	-1,642	1,972	1,500	1,770	0	0	0	0	0	0	0
Drought relief expenditures	0	15,972	0	0	0	0	0	0	0	0	0
Development and net lending	18,881	32,828	35,621	24,953	44,351	32,430	29,118	29,355	42,119	52,873	63,486
Domestically financed	4,253	5,685	10,278	5,908	10,509	11,088	8,950	5,269	8,372	16,509	24,132
Foreign financed	13,097	15,341	20,890	20,345	32,260	19,760	19,381	23,252	32,805	35,494	38,514
Net lending	1,531	2,805	953	1,862	1,582	1,582	787	735	941	871	839
Pending bills 3/	0	3,191	3,500	-3,162	0	0	0	0	0	0	0
Drought relief expenditures	0	5,806	0	0	0	0	0	0	0	0	0
Free primary education spending	0	0	0	0	0	2,800	9,700	11,053	11,570	13,127	13,725
Balance (commitment basis, excluding grants)	1,292	-40,609	-34,413	-31,210	-47,634	-52,060	-54,809	-54,630	-61,041	-83,800	-96,605
Grants	4,247	24,080	5,797	11,265	15,866	8,159	9,615	10,525	14,859	18,840	20,478
Food relief grants	0	12,444	0	0	0	0	0	0	0	...	...
Project grants	4,247	5,681	4,771	10,315	15,866	8,159	9,615	10,525	14,859	18,840	20,478
Program grants	0	5,955	1,026	950	0	0	0	0	0	0	0
Balance (commitment basis, including grants)	5,539	-16,529	-28,616	-19,945	-31,768	-43,900	-45,194	-44,105	-46,182	-64,960	-76,127
Adjustments to cash basis	-3,789	1,512	292	-8,404	0	-6,810	-3,250	-3,250	-3,250	0	0
Balance (cash basis, including grants)	1,750	-15,017	-28,324	-28,349	-31,768	-50,710	-48,444	-47,355	-49,432	-64,960	-76,127
Financing	-534	14,817	28,441	29,871	31,771	39,502	30,825	17,688	-560	15,038	31,717
Net foreign financing	-18,974	12,601	-5,061	-10,853	-4,331	-7,950	-4,480	1,103	5,682	4,628	6,889
Project loans	8,850	14,042	17,915	10,031	16,394	11,600	9,765	12,727	17,946	16,654	18,036
Program loans	0	4,045	0	122	0	0	0	0	0	0	0
Commercial borrowing	0	0	0	2,063	0	1,812	3,441	2,254	1,837	1,785	1,734
Repayments due	-31,018	-27,887	-23,142	-27,672	-17,556	-18,788	-15,661	-13,877	-14,101	-13,811	-12,881
Change in arrears	3,194	496	-6,091	-193	-3,169	-4,120	-2,025	0	0	0	0
Rescheduling	0	21,905	6,257	4,795	0	1,546	0	0	0	0	0
Privatization proceeds	5,660	0	955	955	3,500	0	1,250	1,500	1,500	1,500	1,500
Bank restructuring costs	0	0	0	0	0	0	-16,000	0	0	0	0
Net domestic financing	12,780	2,216	32,547	39,769	32,602	47,451	50,055	15,085	-7,741	8,909	23,328
<i>Of which: excluding bank restructuring costs expenditure arrears securitization</i>	12,780	2,216	32,547	39,769	32,602	47,451	34,055	15,085	-7,741	8,909	23,328
	3,472	3,538	3,088	2,788	0	4,481	3,250	3,250	3,250	0	0
Financing gap (stat. discrepancy for cutturns)	-1,216	200	-117	1,521	3	11,209	17,618	29,667	49,991	49,922	44,411
Memorandum items:											
Nominal GDP	769,054	845,625	909,869	909,869	984,176	951,340	1,012,085	1,095,488	1,201,823	1,315,107	1,435,843
Primary budget balance	32,453	11,807	2,189	-1,210	6,573	-17,715	-12,851	-9,391	-10,169	-25,149	-34,660
Stock of domestic debt, net (end of period)	163,405	164,203	196,750	202,775	235,377	250,226	300,281	315,366	307,625	316,534	339,862

Table 9. Kenya: Central Government Financial Operations, Base Case Scenario, 1999/2000-2007/08 1/ (concluded)

	1999/00	2000/01	2001/02		2002/03		2003/04	2004/05	2005/06	2006/07	2007/08
			Revised Budget	Actual	Budget July	IMF Projections	FY	Program 4/			
(In percent of GDP, unless otherwise indicated)											
Revenue	23.1	22.6	23.0	21.6	22.2	22.2	22.5	22.6	22.4	22.2	22.3
Income tax	7.1	6.6	6.4	6.1	6.9	7.0	7.0	7.0	7.1	7.2	7.3
Import duty (net)	3.7	3.4	2.5	2.4	2.0	2.1	2.2	2.2	2.0	1.8	1.7
Excise duty	3.7	3.3	4.0	3.5	4.3	3.8	3.8	3.8	3.8	3.9	3.9
Value-added tax	5.3	5.9	6.1	5.6	5.8	5.9	6.0	5.9	5.9	5.6	5.7
Investment income	0.0	0.3	0.3	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other	3.3	3.0	3.7	3.9	3.0	3.3	3.4	3.5	3.5	3.6	3.6
Expenditure and net lending	23.0	27.4	26.8	25.0	27.1	27.7	27.9	27.5	27.5	28.6	29.1
Recurrent expenditure	20.5	23.5	22.9	22.3	22.6	24.0	24.1	23.9	23.0	23.5	23.7
Interest payments	4.0	3.2	3.4	3.0	3.9	3.5	3.5	3.5	3.3	3.0	2.9
Domestic interest	2.9	2.2	2.5	2.1	3.0	2.8	2.9	2.9	2.8	2.6	2.4
Foreign interest due	1.1	0.9	0.9	0.8	0.9	0.7	0.6	0.5	0.5	0.5	0.5
Wages and benefits (civil service)	8.6	8.1	8.5	8.5	8.3	9.2	9.4	9.1	8.5	8.4	8.3
Civil service reform	0.1	0.7	0.2	0.2	0.2	0.1	0.3	0.2	0.2	0.2	0.2
Pensions, etc.	0.7	0.7	1.1	1.0	1.3	1.4	1.4	1.4	1.3	1.2	1.4
Other	5.8	6.8	7.7	7.6	7.1	7.7	7.5	7.8	7.9	8.9	9.1
Of which: Operations and Maintenance	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.4	5.5
Defense and NSIS 2/	1.6	2.0	1.9	1.8	1.8	2.2	2.1	2.0	1.9	1.9	1.8
Pending bills 3/	-0.2	0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Drought relief expenditures	0.0	1.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development and net lending	2.5	3.9	3.9	2.7	4.5	3.4	2.9	2.7	3.5	4.0	4.4
Domestically financed	0.6	0.7	1.1	0.6	1.1	1.2	0.9	0.5	0.7	1.3	1.7
Foreign financed	1.7	1.8	2.3	2.2	3.3	2.1	1.9	2.1	2.7	2.7	2.7
Net lending	0.2	0.3	0.1	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Pending bills 3/	0.0	0.4	0.4	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Drought relief expenditures	0.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Free primary education spending	0.0	0.0	0.0	0.0	0.0	0.3	1.0	1.0	1.0	1.0	1.0
Balance (commitment basis)	0.2	-4.8	-3.8	-3.4	-4.8	-5.5	-5.4	-5.0	-5.1	-6.4	-6.7
Grants	0.6	2.8	0.6	1.2	1.6	0.9	1.0	1.0	1.2	1.4	1.4
Food relief grants	...	1.5	...	...	...	...	...	...	...	...	...
Project grants	0.6	0.7	0.5	1.1	1.6	0.9	1.0	1.0	1.2	1.4	1.4
Program grants	0.0	0.7	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance (commitment basis, including grants)	0.7	-2.0	-3.1	-2.2	-3.2	-4.6	-4.5	-4.0	-3.8	-4.9	-5.3
Adjustments to cash basis	-0.5	0.2	0.0	-0.9	0.0	-0.7	-0.3	-0.3	-0.3	0.0	0.0
Balance (cash basis including grants)	0.2	-1.8	-3.1	-3.1	-3.2	-5.3	-4.8	-4.3	-4.1	-4.9	-5.3
Financing	-0.1	1.8	3.1	3.3	3.2	4.2	3.0	1.6	0.0	1.1	2.2
Net foreign financing	-2.5	1.5	-0.6	-1.2	-0.4	-0.8	-0.4	0.1	0.5	0.4	0.5
Project loans	1.2	1.7	2.0	1.1	1.7	1.2	1.0	1.2	1.5	1.3	1.3
Program loans	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial borrowing	0.0	0.0	0.0	0.2	0.0	0.2	0.3	0.2	0.2	0.1	0.1
Repayments due	-4.0	-3.3	-2.5	-3.0	-1.8	-2.0	-1.5	-1.3	-1.2	-1.1	-0.9
Change in arrears	0.4	0.1	-0.7	0.0	-0.3	-0.4	-0.2	0.0	0.0	0.0	0.0
Rescheduling	...	2.6	0.7	0.5	0.0	0.2	0.0	0.0	0.0	0.0	0.0
Privatization proceeds	0.7	0.0	0.1	0.1	0.4	0.0	0.1	0.1	0.1	0.1	0.1
Bank restructuring costs	0.0	0.0	0.0	0.0	0.0	0.0	-1.6	0.0	0.0	0.0	0.0
Net domestic financing	1.7	0.3	3.6	4.4	3.3	5.0	4.9	1.4	-0.6	0.7	1.6
Of which: excluding bank restructuring costs	1.7	0.3	3.6	4.4	3.3	5.0	3.4	1.4	-0.6	0.7	1.6
expenditure arrears securitization	0.5	0.4	0.3	0.3	0.0	0.5	0.3	0.3	0.3	0.0	0.0
Financing gap (stat. discrepancy for outturns)	-0.2	0.0	0.0	0.2	0.0	1.2	1.7	2.7	4.2	3.8	3.1
Memorandum items:											
GDP (in millions of Kenya shillings)	769,054	845,625	909,869	944,864	984,176	951,340	1,012,085	1,095,488	1,201,823	1,315,107	1,435,843
Primary budget balance	4.2	1.4	0.2	-0.1	0.7	-1.9	-1.3	-0.9	-0.8	-1.9	-2.4
Stock of domestic debt, net (end of period)	21.2	19.4	22.9	22.3	23.9	26.3	29.7	28.8	25.6	24.1	23.7

Sources: Kenyan authorities; and Fund staff estimates and projections.

1/ Fiscal year ending June 30.

2/ In 2002/03 an amount of KSh 2.0 billion was received for UN peacekeeping duties.

3/ The fiscal accounts are on a cash basis (with the exception of foreign interest due). Adding accumulation of pending bills and subtracting cash repayment of them adjusts to a commitment basis.

Table 10. Kenya: Balance of Payments, Base Case Scenario, 1999-2008  
(In millions of U.S. dollars, unless otherwise indicated)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
			Est.							
Current account	-234	-284	-398	-497	-802	-1,031	-1,290	-1,453	-1,392	-1,528
Excluding official transfers	-233	-375	-486	-497	-802	-1,031	-1,290	-1,453	-1,392	-1,528
Exports, f.o.b.	1,755	1,773	1,881	2,017	2,359	2,429	2,562	2,813	3,134	3,500
Coffee	172	154	94	83	93	108	118	133	149	164
Tea	472	463	435	437	477	517	551	598	640	692
Oil products	138	127	177	158	202	168	152	151	157	163
Other	973	1,029	1,176	1,340	1,586	1,636	1,741	1,931	2,187	2,481
Imports, f.o.b.	-2,679	-3,033	-3,175	-3,243	-3,833	-4,059	-4,394	-4,764	-5,011	-5,483
Public	-121	-94	-91	-94	-205	-107	-115	-123	-133	-145
Private	-2,557	-2,939	-3,085	-3,149	-3,628	-3,951	-4,279	-4,641	-4,877	-5,338
Oil	-527	-850	-721	-785	-976	-867	-785	-817	-863	-941
Other	-2,031	-2,089	-2,364	-2,363	-2,652	-3,084	-3,494	-3,824	-4,014	-4,397
Balance on goods	-924	-1,260	-1,295	-1,225	-1,474	-1,630	-1,832	-1,951	-1,877	-1,983
Services (net)	298	245	261	251	223	170	117	64	38	-3
Credit	932	969	1,087	1,110	1,190	1,231	1,287	1,372	1,477	1,598
Foreign travel	301	259	308	293	287	304	322	342	366	395
Other	631	710	779	817	903	926	965	1,030	1,111	1,203
Debit	-634	-724	-825	-859	-967	-1,060	-1,170	-1,308	-1,439	-1,601
Balance on goods and services	-626	-1,015	-1,033	-974	-1,251	-1,459	-1,714	-1,887	-1,839	-1,986
Income (net)	-173	-130	-148	-123	-126	-133	-137	-132	-124	-118
Credit	32	45	43	43	43	46	54	68	84	101
Debit	-205	-175	-190	-166	-169	-179	-191	-200	-208	-219
Of which: official interest payments	-164	-120	-111	-82	-78	-78	-82	-89	-93	-100
Current transfers (net)	564	860	783	600	575	562	561	566	571	576
Private (net)	566	769	694	600	575	562	561	566	571	576
Official (net)	-2	91	89	0	0	0	0	0	0	0
Capital and financial account	215	276	419	535	661	660	951	1,001	1,145	1,321
Capital account	63	63	69	85	126	130	158	261	285	326
Of which: capital transfers	63	63	69	85	126	130	158	261	285	326
Financial account	152	212	350	450	535	529	794	740	860	995
Investment assets and liabilities (net)	-285	-314	-206	-96	66	123	371	219	309	451
Official, medium and long term	-305	-170	-284	-45	18	42	54	76	100	147
Inflows	205	304	168	207	252	226	250	277	299	333
Program loans	0	49	3	0	0	0	0	0	0	0
Project loans	148	224	132	137	163	158	203	230	252	286
Defense loans	0	0	0	30	33	32	21	21	21	21
Government guaranteed/parastatal	57	31	32	40	56	36	26	26	26	26
Outflows	-510	-474	-452	-253	-233	-184	-196	-201	-199	-185
Commercial banks (net)	21	-235	96	-69	0	0	0	0	0	0
Private (net)	-1	91	-19	18	48	82	317	143	209	303
Short-term (net) and net errors and omissions 1/	437	527	556	546	468	406	422	521	551	544
Overall balance	-20	-8	21	38	-142	-371	-339	-452	-247	-207
Financing items	20	8	-21	-38	142	371	339	452	247	207
Reserve assets (gross)	-8	-106	-167	-3	-12	-124	-288	-432	-336	-507
Use of Fund credit and loans to the Fund (net)	-60	2	-24	18	22	68	74	28	-9	-21
Change in arrears	87	-53	48	-53	-54	0	0	0	0	0
Rescheduling	0	166	122	0	40	0	0	0	0	0
Remaining gap	0	0	0	0	145	427	553	856	591	734
Memorandum items:										
Gross official reserves (end of period)	791	897	1,064	1,067	1,079	1,203	1,491	1,923	2,259	2,766
(in months of next year's imports) 2/	2.5	2.7	3.1	2.7	2.5	2.6	2.9	3.6	3.8	4.3
Current account balance										
(percent of GDP, excluding official transfers)	-2.2	-3.6	-4.3	-4.2	-6.2	-7.3	-8.1	-8.1	-6.9	-6.7
(percent of GDP, excluding special imports) 3/	-1.2	-1.0	-2.1	-3.1	-4.8	-6.1	-6.3	-6.5	-5.4	-5.4
Debt-service ratio after rescheduling 4/ 5/	27.3	19.1	15.6	11.3	9.3	7.5	7.4	7.2	6.5	6.0
Import volume growth, goods (percent)	-7.2	7.0	7.3	-2.1	7.4	10.3	10.2	8.4	4.3	8.6
Import volume growth, goods (percent; excluding special imports)	-5.2	3.6	7.2	1.7	3.9	13.8	7.8	8.8	4.5	9.0
Export volume growth, goods (percent)	-5.2	-4.9	11.6	8.3	6.5	3.9	4.8	8.6	10.5	10.7

Sources: Kenyan authorities; and staff estimates and projections.

1/ Includes underrecorded tourism earnings.

2/ In months of projected imports of goods and nonfactor services.

3/ Includes defense-related imports, imports of maize, sugar, and airplanes, and imports related to rehabilitation of the energy sector.

4/ After November 2000 Paris Club rescheduling and assumed rescheduling, under comparable terms, by commercial and non-Paris Club bilateral creditors.

5/ In percent of exports of goods and services.

Table 11. Kenya: External Debt Indicators, Base Case Scenario, 2000-2008 1/  
(In millions of U.S. dollars, unless otherwise indicated)

	2000	2001	2002	2003	2004	2005	2006
<b>Debt-stock indicators</b>							
Stock of external debt by creditor 2/ 3/	5,327	4,713	4,651	4,868	5,051	5,452	6,100
Multilateral creditors	3,001	2,919	2,936	3,095	3,316	3,736	4,374
IMF	128	99	81	104	92	166	194
World Bank	2,356	2,291	2,344	2,476	2,679	2,981	3,483
African Development Bank/African Development Fund	355	302	298	314	354	398	498
Other	162	228	213	201	191	191	200
Bilateral creditors	1,889	1,600	1,541	1,527	1,503	1,500	1,527
Paris Club	1,845	1,552	1,493	1,476	1,449	1,436	1,448
Non-Paris Club	44	48	48	51	54	64	79
Other creditors 4/	437	194	174	246	232	216	199
Stock of external debt by debtor 2/ 3/	5,386	4,713	4,651	4,868	5,051	5,452	6,100
Central government	4,688	4,312	4,258	4,428	4,610	4,929	5,539
Government guaranteed	511	303	311	336	349	357	367
Central bank	128	99	81	104	92	166	194
Net present value (NPV) of debt 3/ 5/							
In million of U.S. dollars	3,930	3,430	3,383	3,415	3,451	3,617	3,881
In percent of exports of goods and services 6/	143	123	115	106	100	98	100
In percent of government revenue 7/	164	139	133	123	113	105	
In percent of GDP	38	30	29	27	24	23	22
Stock of arrears 8/	59	107	54	0	0	0	0
<b>Debt-service indicators</b>							
Principal payments by creditor 3/	425	373	270	248	195	193	203
Multilateral creditors	156	128	102	103	91	85	96
IMF	42	24	18	18	12	6	12
World Bank	70	63	53	51	50	48	53
AfDB/AfDF	19	19	10	11	9	9	10
Other	25	23	21	23	20	21	22
Bilateral creditors	122	151	118	106	90	92	91
Paris Club	116	149	114	102	87	89	88
Non-Paris Club	6	1	4	4	3	3	3
Other creditors 4/	147	95	51	39	14	16	17
Interest payments by creditor 3/	99	92	82	78	78	82	89
Multilateral creditors	38	49	32	32	32	35	40
IMF	1	1	1	2	2	2	2
World Bank	26	34	19	19	21	23	26
AfDB/AfDF	8	12	6	5	5	5	5
Other	4	2	6	5	5	5	6
Bilateral creditors	37	28	45	42	41	41	43
Paris Club	36	28	44	40	37	35	33
Non-Paris Club	1	0	1	3	4	7	10
Other creditors 4/	24	15	6	4	5	6	6
Debt-service ratio (in percent of current year exports)	19	16	11	9	7	7	7
Debt-service to fiscal revenue ratio 7/	22	19	14	12	9	8	8

Sources: Kenyan authorities; and staff estimates and projections.

1/ This reflects an outcome where the program is brought back on track by 2002:Q2 (foreign program financing is received).

2/ Does not include arrears.

3/ After Paris Club rescheduling in November 2000, and assuming comparable treatment by non-Paris Club and commercial creditors.

4/ Includes commercial banks' and suppliers' credit; includes stock and repayment of arrears according to the terms agreed with commercial banks.

5/ Refers to the present value of debt service calculated by using the currency-specific commercial interest reference rate (CIRR) as the discount rate.

6/ Three-year backward-looking average.

7/ Central government revenue, excluding grants.

8/ The stocks of arrears at end-2000 and end-2001 are largely composed of arrears to commercial creditors that are assumed to be cleared when Kenya reaches a rescheduling agreement with these creditors.

9/ The figures for debt service in this table differ from those presented in the balance of payments table, as the balance of payments table presents debt service before rescheduling (and rescheduling is presented as financing below the line).

Table 12. Kenya: Monetary Survey, Base Case Scenario, 2001-2008 1/

	Dec-00	Mar-01	Jun-01	Sep-01	Dec-01	Mar-02	Jun-02	Sep-02	Dec-02	Mar-03	Jun-03	Sep-03	Dec-03	Mar-04	Jun-04	Jun-05	Jun-06	Jun-07	Jun-08
<b>Central Bank of Kenya (CBK)</b>																			
Net foreign assets	58,977	63,145	66,806	73,156	75,608	77,663	77,832	76,165	70,274	70,274	70,994	71,557	72,676	72,641	73,126	89,886	123,191	150,410	186,405
Net domestic assets	18,756	6,903	2,504	-3,365	3,517	-1,884	-951	2,424	18,179	15,615	13,949	14,867	22,852	22,540	20,260	13,833	-6,817	-20,473	-41,781
Domestic credit	14,385	479	-2,934	-7,002	1,671	-5,015	-3,205	2,235	19,774	17,265	15,660	16,644	24,703	24,472	22,280	16,305	-3,684	-16,370	-36,259
Government (net)	19,057	18,817	10,807	2,989	14,554	10,740	20,040	17,561	18,011	18,011	18,011	18,011	18,011	18,011	18,011	18,011	8,119	8,832	10,698
Commercial banks (net)	-4,672	-18,338	-13,741	-9,991	-12,883	-15,755	-23,245	-15,326	1,763	-2,242	-3,952	-3,065	-4,963	4,912	2,412	-3,421	-13,377	-27,039	-48,858
Other items (net)	4,371	6,424	5,438	3,637	1,846	3,131	2,254	189	-1,593	-1,630	-1,711	-1,777	-1,851	-1,931	-2,020	-2,472	-3,134	-4,103	-5,523
Reserve money (RM)	77,733	70,048	69,310	69,791	79,125	75,779	76,881	78,589	88,433	85,889	84,943	86,424	95,528	95,182	93,387	103,719	116,373	129,936	144,624
Currency outside banks	43,413	41,737	42,384	41,706	45,289	46,022	48,920	46,138	53,878	52,520	52,599	53,042	61,431	60,456	60,085	69,323	80,704	93,238	107,149
Bank reserves	34,320	28,311	26,926	28,085	33,836	29,757	29,961	32,251	34,575	33,369	32,343	33,381	34,097	34,746	33,301	34,395	35,670	36,698	37,475
<b>Banks</b>																			
Net foreign assets	26,381	26,422	24,390	19,528	18,373	17,777	19,208	20,826	31,876	24,774	24,526	24,281	24,038	23,798	23,560	22,631	21,740	20,883	20,060
Reserves	34,320	28,311	26,926	28,085	33,836	29,757	29,961	32,251	34,575	33,369	32,343	33,381	34,097	34,746	33,301	34,395	35,670	36,698	37,475
Credit to CBK	4,672	18,338	13,741	9,991	12,883	15,755	23,245	15,326	-1,763	2,242	3,952	3,065	-4,963	-4,912	-2,412	-3,421	-13,377	-27,039	-48,858
Net domestic assets	251,163	243,703	247,186	238,085	257,955	256,688	258,892	272,577	287,427	287,148	292,205	301,023	312,001	313,923	318,675	336,878	356,059	371,590	378,830
Domestic credit	310,849	311,107	312,365	325,735	317,953	317,231	328,364	335,102	345,251	347,690	355,879	365,736	371,869	378,585	384,525	405,033	426,600	444,600	454,404
Government (net)	37,991	37,136	37,856	73,727	74,524	77,910	74,994	84,063	90,599	94,940	98,311	102,657	106,947	111,073	115,254	121,763	121,213	124,777	134,108
Other public sector	8,058	8,542	9,877	8,919	8,027	6,938	6,630	9,671	8,016	7,181	6,862	10,009	8,297	7,432	7,102	7,351	7,608	7,874	8,150
Private sector	243,400	245,430	244,632	243,049	235,402	233,285	239,040	241,369	246,639	245,570	250,656	253,070	256,605	260,080	262,170	275,920	297,779	311,949	312,147
Other items (net)	-38,686	-67,904	-65,179	-47,651	-39,999	-60,543	-61,472	-37,824	-60,543	-63,624	-64,713	-69,818	-62,662	-62,662	-65,851	-70,541	-73,754	-75,163	-75,163
Total deposits	316,537	316,774	312,243	313,688	323,049	319,976	331,306	340,981	352,114	347,532	353,026	361,751	365,173	369,554	372,924	397,326	427,046	456,210	485,232
<b>Monetary survey</b>																			
Net foreign assets	85,359	89,567	91,196	92,684	93,984	95,440	97,040	96,892	102,156	95,048	95,520	95,838	95,714	96,449	96,686	112,518	144,930	171,293	206,466
Net domestic assets	274,655	269,004	263,487	264,760	274,410	270,611	281,236	290,374	303,859	305,041	310,137	318,981	329,873	333,563	336,328	354,100	362,740	378,015	385,698
Domestic credit	331,293	331,299	324,555	330,253	334,004	328,467	341,951	354,304	364,932	367,197	375,441	385,445	391,589	398,144	404,193	424,259	436,494	452,269	467,004
Government (net)	76,448	75,953	68,663	76,716	89,078	88,650	94,734	101,624	108,607	112,951	116,322	120,668	124,958	129,084	133,265	139,774	129,332	133,608	144,806
Rest of the economy	254,845	255,346	255,892	253,538	244,926	240,817	247,217	252,680	256,325	254,247	259,119	264,778	266,630	269,060	270,929	284,985	307,162	321,660	322,198
Other public sector	8,058	8,542	9,877	8,919	8,027	6,938	6,630	9,671	8,016	7,181	6,862	10,009	8,297	7,432	7,102	7,351	7,608	7,874	8,150
Private	246,785	246,805	246,015	244,558	236,899	233,879	240,587	243,010	248,309	247,066	252,257	256,768	258,333	261,628	263,826	277,634	299,554	313,786	314,048
Other items (net)	-36,638	-62,295	-61,068	-65,473	-39,959	-58,856	-60,713	-63,930	-61,072	-62,156	-65,303	-66,464	-61,715	-64,581	-67,866	-70,659	-73,754	-75,163	-75,163
Money and quasi money (M3)	314,476	308,791	305,529	310,649	322,325	320,948	331,633	333,873	350,733	348,597	354,680	364,351	376,625	380,539	384,045	419,579	462,485	505,903	550,469
M3 and foreign currency deposits (M3X)	360,014	358,571	354,681	357,444	368,394	366,051	378,276	387,365	406,009	400,889	405,657	414,819	426,508	430,002	433,014	466,618	507,670	549,308	592,161
Currency outside banks	43,413	41,737	42,384	41,706	45,289	46,022	46,920	46,338	53,878	52,520	52,599	53,042	61,431	60,456	60,085	69,323	80,704	93,238	107,149
Deposits	316,601	316,833	312,299	315,738	323,106	320,028	331,356	341,027	352,131	347,569	353,058	361,776	365,156	369,566	372,929	397,394	426,967	456,070	485,014
M3X and nonbank holdings of government debt (M3X)	435,470	441,147	446,588	451,356	462,127	466,430	483,886	499,332	521,198	523,710	532,650	545,367	560,646	567,436	573,868	612,798	653,301	699,571	754,558
(Annual percentage change, unless indicated otherwise)																			
<b>Memorandum items:</b>																			
M3	0.8	-0.1	-1.3	0.8	2.5	3.9	8.5	8.1	8.8	8.6	6.9	8.5	7.4	9.2	8.3	9.3	10.2	9.4	8.8
M3X	3.6	3.7	2.1	1.8	2.3	2.1	6.7	8.4	10.2	9.3	7.2	7.1	5.1	7.5	6.7	7.8	8.8	8.2	7.8
M4X	4.6	4.8	5.3	6.5	6.1	5.7	8.4	10.6	12.8	12.3	10.1	9.2	7.6	8.3	7.7	6.8	6.6	7.1	7.9
Money base	-1.6	-2.8	-8.5	0.2	1.8	8.2	10.9	12.6	11.8	13.3	10.5	10.0	8.0	10.8	9.9	11.1	12.2	11.7	11.3
Currency outside banks	1.1	8.9	10.0	9.2	4.3	10.3	10.7	11.1	19.0	14.1	12.1	14.5	14.0	15.1	14.2	15.4	16.4	15.5	14.9
Net domestic assets of the banking sector	-5.2	-5.1	-6.2	-2.7	-0.1	0.6	6.7	9.7	10.7	12.7	10.3	9.9	8.6	9.4	8.4	5.3	2.4	4.2	2.0
NDA growth (as percent of base period M3X)	-4.3	-4.2	-5.0	-2.1	-0.1	0.4	5.0	7.2	8.0	9.4	7.6	7.4	6.1	7.1	6.5	4.1	1.9	3.0	1.4
Other items net of banking sector	-17.7	-17.5	16.0	9.4	0.5	-10.2	-5.7	-7.6	-3.6	0.0	3.5	3.5	3.5	3.3	3.5	3.3	3.5	3.5	3.5
Domestic credit	-7.6	-7.7	-1.9	0.2	0.8	-0.6	5.4	7.3	9.3	11.5	9.8	8.8	7.3	8.4	7.7	5.1	2.8	4.3	2.6
Government (net)	-9.1	-9.0	-17.5	-5.9	16.5	16.7	38.0	32.5	21.9	27.4	22.8	18.7	15.1	14.3	14.6	4.9	-7.5	3.3	8.4
Rest of the economy	-7.1	-7.3	3.4	2.2	-3.9	-5.7	-3.4	-0.3	4.7	5.6	4.8	4.8	4.0	5.8	4.6	5.2	7.8	4.7	0.2
Non-bank holdings of government debt, millions of Ksh	75,457	82,576	91,905	91,912	93,733	100,380	105,610	111,981	113,189	123,621	126,992	130,548	134,058	137,434	140,855	146,180	145,631	150,264	162,394
Stock of domestic debt, millions of Ksh	151,905	158,529	160,568	170,627	182,811	189,029	200,344	213,611	223,796	236,572	243,314	251,216	259,017	266,518	274,119	283,954	274,663	283,872	307,200
Constant exchange rate, Ksh/US\$	78.95	78.95	78.95	78.95	78.95	78.95	78.95	78.95	78.95	78.95	78.95	78.95	78.95	78.95	78.95	78.95	78.95	78.95	78.95
Current exchange rate, Ksh/US\$	78.0	77.7	78.9	79.0	78.5	78.0	78.7	79.0	77.2	76.8	76.4	75.5	75.1	74.6	74.2	72.1	70.9	69.2	66.6
Multipier (M3X/RM)	4.6	5.1	5.1	5.1	4.7	4.8	4.9	4.9	4.6	4.7	4.8	4.8	4.5	4.5	4.6	4.5	4.4	4.2	4.1
Reserve cover, in months of next years imports	2.9	2.9	3.1	3.3	3.3	2.9	2.9	2.8	2.7	2.5	2.5	2.5	2.5	2.3	2.3	2.5	3.2	3.5	3.9
Sources: Central Bank of Kenya																			
Note:																			
1/ Constant Ksh/US\$ exchange rate prevailing on September 30, 2001																			

**Kenya: Relations with the Fund**

(As of February 28, 2003)

<b>I. Membership Status:</b> Joined February 3, 1964; Article VIII.				
<b>II. General Resources Account:</b>				
		<b>SDR million</b>	<b>Percent of quota</b>	
Quota		271.40	100.00	
Fund holdings of currency		258.81	95.36	
Reserve position in Fund		12.59	4.64	
<b>III. SDR Department:</b>				
		<b>SDR million</b>	<b>Percent of allocation</b>	
Net cumulative allocation		36.99	100.00	
Holdings		0.44	1.18	
<b>IV. Outstanding Purchases and Loans:</b>				
		<b>SDR million</b>	<b>Percent of quota</b>	
Enhanced Structural Adjustment Facility (ESAF) and Poverty Reduction and Growth Facility (PRGF) arrangements		64.62	23.81	
<b>V. Financial Arrangements:</b>				
	Approval	Expiration	Amount Approved	Amount Drawn
<u>Type</u>	<u>Date</u>	<u>Date</u>	<u>(SDR million)</u>	<u>(SDR million)</u>
PRGF	8/4/00	8/3/03	190.00	33.60
ESAF	4/26/96	4/25/99	149.55	24.93
ESAF	2/22/93	12/21/94	45.23	45.23
ESAF	5/15/89	3/31/93	261.40	216.17

**VI. Projected Obligations to Fund**

(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Principal	14.03	9.51	4.99	9.21	6.72
Charges/interest	<u>0.80</u>	<u>0.90</u>	<u>0.86</u>	<u>0.82</u>	<u>0.78</u>
Total	14.83	10.41	5.85	10.03	7.50

**VII. Exchange Rate Arrangement**

The currency of Kenya is the Kenya shilling. Kenya has adopted a unitary exchange rate structure where the exchange rate is determined in the interbank market. The official exchange rate, which is set at the previous day's average market rate, applies only to government and government-guaranteed external debt-service payments and to government imports for which there is a specific budget allocation. The exchange rate regime is a managed float, in which the U.S. dollar is the principal intervention currency. Kenya maintains an exchange arrangement that is free of exchange restrictions and multiple currency practices. On December 31, 2002, the exchange rate was K Sh 77.1=US\$1.

**VIII. Article IV Consultations**

Kenya is on the 12-month cycle for Article IV consultations. The 2001 Article IV consultation was concluded on March 15, 2002 (SM/02/60 and SM/02/72).

**IX. Technical Assistance**

Department	Purpose	Time of Delivery
MAE	Mission on banking supervision	November 1999
MAE	Mission on banking supervision and bank restructuring	February 1999
STA	Resident expert on balance of payments statistics	May-August 1999
MAE	Mission on banking supervision	July 1999
STA	Mission on government finance statistics	November-December 1999
FAD	Mission on improving expenditure management and control	February 2000
MAE	Mission on banking supervision	May 2000
STA	Mission on Balance of Payments statistics	May-July 2000
FAD	Mission on internal audit.	November 2000
FAD	Mission on tax and customs administration	January 2001

MAE	Mission on bank restructuring and review of deposit insurance system	June 2001
MAE	Mission on review of banking conditions and systemic vulnerability	January 2002
MAE	Mission on elements of a plan to deal with the NPL problem	July 2002

**X. Resident Representative**

The Fund has had a resident representative in Kenya since December 1993. Mr. Samuel Itam is the current Senior Resident Representative.



## **Kenya: Relations with the World Bank**

(as of March 24, 2003)

1. As of March 24, 2003, the World Bank had committed to Kenya about US\$3.9 billion (net of cancellations), of which US\$3.6 billion had been fully disbursed. The total undisbursed balance as of March 24, 2003 is about US\$310 million. IDA disbursements in FY02 were US\$85.4 million.

### **Agriculture**

2. The Bank's activities in the sector support the government's development strategy, which aims at realigning the policy framework and the incentive structure, redefining the role and core functions of the government in the sector, and encouraging a more competitive marketing system with increased participation by the private sector. The government's development strategy also envisages support for the core programs of research and extension. The Bank currently has three ongoing projects in the agriculture and environmental areas, including a Second National Agricultural Research Project, which would set the stage for developing a sustainable agricultural research program.

3. On environmental/natural resource management, the Bank financed the preparation of the National Environmental Action Plan. The Bank also approved in December 1995 an Arid Lands Resource Management Project, which seeks to ameliorate economic and environmental conditions in the more fragile arid areas. This is scheduled to close in June 2003, and a second phase (Arid Lands II) is expected to be approved by the Bank's Board in June 2003 for US\$60 million. The project's overall objective is to enhance food security and promote sustainable livelihoods through implementing effective systems and structures which reduce vulnerability. In addition, the Bank approved in July 1996 a Lake Victoria Environmental Management Project, which will support efforts by the Kenyan, Ugandan, and Tanzanian governments to improve management of the lake's ecosystem. Although the IDA credit has closed, the GEF component has been extended for two years to complete the regionally-oriented components and activities of the project.

### **Infrastructure development**

4. A major impediment to private sector development is inadequately maintained and inefficiently operated physical infrastructure. Public enterprise inefficiency is at the heart of many of these problems. Addressing these deficiencies requires an appropriate role for the private sector. Bank activity in this sector has aimed at financing critical infrastructure needs while putting in place policy and budgetary reforms to increase long-term sustainability through greater private sector participation.

5. The Bank has three ongoing infrastructure projects. In January 1996, the Bank approved two infrastructure projects: an Urban Transport Project (currently under suspension), which finances new and expanded road links, intersections, and public transport facilities in urban areas, and a Nairobi-Mombasa Road Rehabilitation Project, which supports rehabilitation of

Kenya's chief transport corridor. The Bank also approved an Energy Sector Reform and Power Development Project in June 1997, which is expected to increase generation capacity, reform energy pricing, and encourage private sector participation in the sector. An Emergency Infrastructure Rehabilitation Project to assist the country in coping with the damage done by the "El Niño" floods was approved by the Board in July 1998, providing US\$40 million of new support and redirecting US\$37 million of existing commitments toward rehabilitation. In addition, an emergency power supply credit for US\$72 million was approved in October 2000 to assist the government in implementing emergency measures to address the ongoing power supply crisis. Both emergency credits closed at the end of December 2001. Preparation is underway for a Transport Project which is currently planned for Board delivery in FY04.

### **Education and health**

6. In these two sectors, the Bank's emphasis has been on enhancing financing and management capacity to increase the effectiveness and sustainability of public sector expenditures. In education, the emphasis is on (i) improving the quality of primary and secondary education through curriculum reform; (ii) restructuring key sectoral institutions and policies to enhance the efficiency of service delivery; and (iii) shifting public expenditure to improve access to quality basic education, especially in rural areas. In health, the emphasis is on (i) the development of prevention programs for sexually transmitted diseases, including AIDS; (ii) a shift in resources from curative to efficient primary care, including reproductive services; and (iii) a clarification of the respective roles of the private and public sectors.

7. The Bank has three ongoing human resource operations. In April 1997, the Bank approved an Early Child Development Project, which aims at reinforcing existing institutions and improving the quality of services offered to children of preschool age. In September 2000, the Bank approved a US\$50 million HIV/AIDS Disaster Response Project to reduce the spread of HIV/AIDS, to mitigate the socio-economic impact of the disease, and to increase the access to care and support for people infected or affected by the HIV/AIDS epidemic in Kenya. In December 2000, the Bank approved a US\$50 million Decentralized Reproductive Health and HIV/AIDS Project aimed at improving mother and child health by promoting delivery of comprehensive reproductive health services. Moreover, in response to the Government's policy of universal free primary education, the Bank is rapidly preparing a quick-disbursing operation for US\$50 million which is expected to be presented to the Board in June 2003. The project will focus primarily on providing textbooks along with a small capacity building component. This will be followed up by a larger program of assistance in FY04, with a broader focus on secondary as well as primary education.

### **Public sector management**

8. A Public Sector Management Technical Assistance Credit for US\$15 million was approved in July 2001 with the principal objective of improving governance by putting in place systems and human resource capacity that are necessary conditions for achieving greater fiduciary responsibility and reducing corruption in the public service.

### **Private sector development**

9. In April 2001, the Bank approved a Regional Trade Facilitation Project (US\$25 million) aimed at poverty alleviation through private sector led growth in participating countries by improving access to financing for productive transactions and cross-border trade. The Bank is also discussing with the government a technical assistance project to support Kenya's privatization program.

### **Adjustment lending**

10. In June 1996, IDA approved a structural adjustment credit (SAC) of US\$126.8 million, including US\$36.8 million in IDA reflows. The first tranche of US\$79.8 million was released in June 1996. The second tranche of about US\$47 million, together with about US\$26.6 million in fiscal-year (FY) 1997 IDA reflows and US\$17.5 million additional reflows approved in December 1997, was not released because of the government's failure to meet fully all second tranche release conditions. The SAC was closed in June 1998, and US\$87 million was cancelled.

11. In September 1998, the Bank's Board endorsed a new Country Assistance Strategy (CAS) for Kenya which put the Bank's lending program for Kenya in the "low case," with a projected lending program of up to US\$150 million over the next three years. Subsequently, the government undertook a series of governance and public sector reforms, paving the way for the resumption of a base case lending program in August 2000.

12. With a major initiative of public sector reform under way in Kenya, on August 1, 2000, the Bank approved the Economic and Public Sector Reform Credit of US\$150 million, to be disbursed in three tranches: an effectiveness tranche, and two floating tranches. The first tranche was released in late August 2000. In November 2000, the Bank approved a supplemental credit of US\$3.4 million in IDA reflows, which has been fully disbursed. The two additional tranches of SDR 37.7 million each and another IDA reflows allocation for 2001 amounting to SDR 1.15 million were expected to be released during 2000/01 on the basis of performance relative to agreed monitorable indicators. The tranches have yet to be released. Following a request from the Government, the closing date of the EPSRC was extended for one year - from June 30, 2002 to June 30, 2003 on the basis of an agreed Action Plan. We hope to release the second tranche by the end of this fiscal year.

13. A \$2.6 million Learning Innovation Loan in support of a Development Learning Centre Project is expected to be presented to the Bank's Board in June 2003.

### **Kenya: Statistical Issues**

1. Weaknesses in key macroeconomic statistics hamper economic analysis and surveillance. Kenya's macroeconomic statistics have deteriorated significantly over the past decade, reflecting primarily managerial and organizational weaknesses, and inadequate resources at the Central Bureau of Statistics (CBS). During the 2002 Article IV consultation discussions, the staff emphasized the need to improve the timeliness and quality of these statistics, and encouraged the authorities to promptly implement the recommendations of past technical assistance missions from the STA.

2. The authorities are taking actions, with donor assistance, to improve the quality and timeliness of the data. Kenya is participating in the General Data Dissemination System project for Anglophone Africa that is funded by the Department for International Development (DFID) of the UK, and metadata and detailed plans for improving the data over the short and medium term have been posted on the Fund's Data Standards Bulletin Board. Kenya received Fund technical assistance in the context of this project, and further assessment of the need for capacity building has been undertaken by the AFRITAC East Statistical Advisor. The authorities, moreover, are preparing a statistical master plan and a new statistical act that would improve the independence of the CBS.

3. A multisector STA mission to Kenya in 1998 undertook a comprehensive review of the major statistical areas and prepared a work program providing a broad time frame for implementing the principal recommendations, which address most of the statistical problems discussed below. A peripatetic STA advisor assisted the authorities in improving the balance of payments statistics in the course of 1999 and 2000, and a peripatetic STA advisor is currently assisting the authorities in improving their national accounts statistics. A revised set of national accounts data is expected to be released in mid-2003.

4. Monetary, exchange rate, and some external data are published on a monthly and biannual basis by the Central Bank of Kenya (CBK) in its *Monthly Economic Review*. Core financial data are also made available to the Fund on a regular basis. A detailed account of various sectoral activities and the corresponding statistical data are published annually by the CBS in its *Economic Survey*.

#### **National accounts**

5. Data quality, which was previously reported as good, has deteriorated significantly because of budgetary and staff constraints at the CBS. GDP is believed to be significantly underestimated, as important and increasing parts of the economy, such as the informal sector, nonagriculture subsistence, horticulture, and self-employed professionals are not properly covered. Moreover, the constant-price base year is seriously outdated (1982). The authorities urgently need to revise their annual national accounts statistics and strengthen their institutional capacity to improve the quality of data. The latest available official national accounts data are for 2001.

### **Prices and production**

6. The CBS commenced publication in early 2002 of a new national CPI (covering 12 urban areas), with 1997=100 and weights based on the 1992-93 HBS. The index is compiled and published on a timely basis. There is no producer price index, or any short-term export and import price indices produced.

### **Government finance statistics**

7. The 1998 multisector statistics mission found several statistical problems with the cumulative year-to-date monthly and quarterly fiscal data that the Ministry of Finance (MoF) compile and report to the AFR for budget-monitoring purposes. These data, which do not conform to the Fund's government finance statistics (GFS) methodology, do not adequately facilitate economic analysis, mainly because of inappropriate classification of expenditure data. The MoF has not developed a system to adequately monitor expenditure commitments, or domestic arrears, and relies mainly on monitoring cash movements in government accounts at the CBK. The recording of external financing and expenditure directly financed from abroad also remains an area for improvement. The 1998 mission made several recommendations for improving the data, most of which have not been implemented.

8. The CBS compiles and reports to the STA aggregate annual GFS revenue and expenditure data for budgetary central government based on detailed data in the reports of the Controller and Auditor General, using a methodology established by a 1999 STA GFS mission. Lack of proper computerization prevents the CBS from compiling more detailed GFS data. Considerable differences exist between these data and the data compiled by the MoF and reported to the AFR for monitoring purposes.

### **Monetary statistics**

9. Monetary statistics are compiled from a bank reporting system and are broadly adequate for policy, analytical, and supervisory purposes. A STA technical assistance mission in January 2000 observed that the authorities had implemented virtually all recommendations of the previous STA missions, which had led to a number of improvements in Kenya's monetary statistics. However, the mission identified and made recommendations to address further problems in monetary data, in particular (a) asymmetrical interbank positions, (b) the statistical implications on the data of numerous bank closures, and (c) the coverage of international reserves. Since then, the authorities have initiated revisions to monetary statistics in line with the recommendations of the mission.

### **Balance of payments statistics**

10. The CBS compiles and reports balance of payments data in Kenya shillings annually on a regular basis to the STA, although with a considerable lag. The CBK, in addition, compiles a complete set of annual balance of payments statistics in U.S. dollars, which are reported to the AFR and used for programming and surveillance purposes. The two sets of

balance of payments data are not entirely consistent, and the staff has been strongly encouraging the authorities to reconciling the two sets. Recently, the CBK also started to compile and publish discrete quarterly balance of payments estimates.

11. The quality of the data has deteriorated. Although the overall quality of trade data may be reasonably good, data for other current account and many financial account transactions are rather weak. Following the liberalization of the exchange system in 1993-94, gaps have emerged in the coverage of balance of payments source statistics. The compilation system (other than that used for compiling customs statistics), used since 1994, relies on reports from domestic banks and may result in a substantial underrecording of current earnings, including tourism receipts, as well as a failure to capture transactions that are settled via accounts held abroad. Present estimates of direct and portfolio investment are believed to be substantially understated. The large positive errors and omissions that have emerged in the balance of payments since 1994 raise concerns as to the potential size of external obligations.

12. The MoF compiles data covering Kenya's public and publicly guaranteed external obligations to official and commercial creditors. This database does not take account of nonresident purchases of the government's domestic currency-denominated debt securities. The 2001 STA BOP mission noted that, should the results of the benchmark foreign investment survey become available; the CBS can start compiling and disseminating more comprehensive annual external debt data for Kenya.

**Kenya: Survey of Reporting of Main Statistical Indicators**  
(as of January 31, 2003)

	Exchange Rates	Central Bank Balance Sheet	International Reserves	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Central Government Balance	Exports/ Imports	Current Account Balance	External Debt	GDP/ GNP
Date of latest observation	1/30/2003	1/29/2003	1/29/2003	1/29/2003	12/2003	1/30/2003	12/2003	12/2002	5/2002	7/2001	12/2000	2001
Date received	1/30/2003	1/30/2003	1/30/2003	1/30/2003	1/24/2003	1/30/2003	1/9/2003	1/21/2003	10/2002	12/2001	3/2001	5/2002
Frequency of data <sup>1</sup>	D	D	D	D	M	W	M	M	M	A	A	A
Frequency of reporting <sup>1</sup>	D/W	D/W	D/W	D/W	M	W/M	M	M	M	A	A	A
Frequency of publication <sup>1</sup>	D	M	M	M	M	D	M	Q	M	M	A	A
Source of data <sup>2</sup>	DR	DR	DR	DR	DR	DR	DR	DR	DR	DR	DR	OP
Mode of reporting <sup>3</sup>	F	F	F	F	F	F	F	F	F/P	P/SV	P/SV	P/SV
Confidentiality <sup>4</sup>	E	R	R	R	E	E	E	R	E	E	E	E

<sup>1</sup>D = daily; W = weekly; M = Monthly, Q = quarterly; A = annually.

<sup>2</sup>DR = direct reporting from the Central Bank of Kenya or Ministry of Finance; OP = official publication.

<sup>3</sup>F = facsimile; P = mail; SV = staff visit.

<sup>4</sup>R = restricted use; E = embargoed for a specified period and then unrestricted use.

## Kenya: Social Indicators

	Kenya, Latest Single Year			Sub-Saharan Africa	Low-Income Countries 1/
	1970-75	1980-85	1994-2000		
Population					
Total population, midyear (millions)	13.7	19.9	30.1	658.9	2,459.8
Growth rate (percent annual average for period)		3.6	2.3	2.4	1.9
Urban population (percent; of population)	12.9	19.8	33.1	34.4	31.9
Total fertility rate (births per woman)	8.0	6.9	4.4	5.2	3.6
Poverty (percent of population) 2/					
National	...	...	52	...	...
Urban	...	...	49	...	...
Rural	...	...	53	...	...
Income					
GNI per capita ( <i>World Bank Atlas</i> method; U.S. dollars)		310	350	470	410
GNI per capita (constant 1995 prices; U.S. dollars) 3/		310	332	538	449
Income/consumption distribution (share of income or consumption)					
Gini index	...	...	44.5	...	...
Lowest quintile (percent of income or consumption)		...	5.0	...	...
Highest quintile (percent of income or consumption)		...	50.2	...	...
Public expenditure					
Health (percent of GDP) 4/	...	...	2.4	2.4	1.2
Education (percent of GNI)	6.3	6.4	6.5	3.6	3.4
Net primary school enrollment rate (percent of age group)					
Total	88	88	...	...	...
Female	83	86	...	...	...
Access to improved water source (percent of population)					
Total	...	27	49	55	76
Urban	...	61	87	82	88
Rural	...	21	31	41	70
Immunization rate (percent under 12 months) 5/					
Measles	...	63	79	53	57
DPT	...	70	79	46	57
Child malnutrition (percent under 5 years) 4/					
Total	...	...	22	...	...
Life expectancy at birth (years)					
Total	52	57	47	47	59
Male	51	55	47	46	58
Female	55	59	47	47	60
Mortality					
Infant (per 1,000 live births)	92	64	78	91	76
Under 5 (per 1,000 live births)	156	90	120	162	115
Adult (15-59)					
Male (per 1,000 population)	467	417	600	504	294
Female (per 1,000 population)	379	339	558	459	261
Maternal (per 100,000 live births) 5/	...	...	590	...	...
Births attended by skilled health staff (percent) 4/	...	...	44	...	...

Source: World Bank, *World Development Indicators*, 2002; and draft Kenya poverty reduction strategy paper, June 2001.

1/ Low-income countries are those that had a GNI per capita of 755 U.S. dollars or less in 2000.

2/ These data are for 1997. Poverty rates for 1994 are 43.7 percent at the national level, and 29.0 percent and 46.3 percent in urban and rural areas, respectively

3/ Gross national income (GNI) data for Kenya are from 1975, 1985, and 1999; income data for sub-Saharan Africa and low-income countries are for 1999.

4/ These data is for 1998.

5/ These data is for 1999.



Kenya: Low-Case Macroeconomic Scenario, 2002/03–2007/08  
(In percentage of GDP, unless otherwise indicated)

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Revenue	22.3	22.6	22.7	22.7	22.7	22.6
Expenditure and net lending	28.0	28.8	29.5	30.4	31.1	32.0
<i>Of which</i>						
Interest payments	3.6	4.1	4.4	4.7	5.0	5.4
Domestic interest	2.9	3.5	3.8	4.2	4.5	4.9
Foreign interest due	0.7	0.6	0.6	0.6	0.5	0.5
Wages and benefits (civil service)	9.2	9.5	9.6	9.7	9.8	9.9
Operations and Maintenance	5.3	5.3	5.3	5.3	5.3	5.3
Development and net lending	3.4	2.9	3.2	3.8	4.2	4.5
Domestically financed	1.2	0.9	0.9	0.9	1.2	1.6
Foreign financed	2.1	1.9	2.2	2.9	2.9	2.9
Balance (commitment basis)	-5.7	-6.2	-6.8	-7.8	-8.4	-9.3
Balance (cash basis including grants)	-5.5	-5.6	-6.1	-6.7	-6.9	-7.8
Primary budget balance	-2.0	-1.5	-1.7	-2.0	-1.8	-2.4
Net domestic financing	6.4	7.5	5.8	6.1	6.4	7.2
Stock of domestic debt, net (end of period) <sup>1</sup>	31.3	37.3	40.7	43.8	46.8	50.5
GDP growth	1.4	1.9	2.6	3.4	3.6	3.6
Increase in the treasury bill rate compared to the base case (percentage points)	--	1.0	2.0	2.0	2.0	2.0

Source: IMF staff estimates.

1 For the domestic debt-to-GDP ratio to stabilize at the projected 2003/04 level, the primary balance during 2003/04-2007/08 would have to be improved from the average of -2.0 percent of GDP to 1 percent of GDP.

INTERNATIONAL MONETARY FUND

KENYA

**Staff Report for the 2003 Article IV Consultation  
Supplementary Information**

Prepared by the African Department in consultation with the Policy Development  
and Review Department

Approved by Anupam Basu and Liam P. Ebrill

May 1, 2003

**Kenya: An Update on the Governance Legislation  
and the 2002/03 Supplementary Budget**

This note updates information provided in the Staff Report for the 2003 Article IV Consultation on the anticorruption legislation and the 2002/03 supplementary budget.

**Anticorruption legislation**

In mid-April 2003, parliament unanimously passed two anticorruption legislations: the Public Officer Ethics Act 2003 and the Anticorruption and Economic Crimes Act, 2003, which have now become laws. Copies of the acts were forwarded to the staff this week. Staff is currently reviewing the acts and will report its conclusions to the Board at a later date.

**Supplementary budget**

In April 2003, the Minister of Finance presented to parliament a supplementary budget for 2002/03. The budget is broadly in line with the revised fiscal projections for 2002/03 that are presented in the Staff Report for the 2003 Article IV Consultation (attached table). However, the domestic borrowing requirement envisaged under the supplementary budget is 1.2 percent of GDP higher than the staff projections only because the supplementary budget does not take account of projected donor assistance. In this regard, a number of donors have indicated their intention to begin the disbursement of budgetary assistance to Kenya as soon as discussions are concluded on a new three-year program that could be supported by the Fund under the PRGF.

Fiscal Operations 2001/02 - 2002/03 (In percent of GDP)  
(In percent of GDP)

	Budget 2001/02 (Actual outturn)	Original Budget (Jul 2002)	Staff Projections (Feb 2003)	Supplementary Budget (March 2003)
Revenue	21.6	22.2	22.3	22.6
Expenditure and net lending	25.0	27.1	27.7	28.3
Recurrent	22.3	22.6	24.0	24.3
Wages and Benefits	8.5	8.3	9.2	9.0
Development	2.7	4.5	3.4	3.7
Free primary education	0.0	0.0	0.3	0.3
Balance (cash basis, excluding grants)	-3.4	-4.8	-5.5	-5.7
Balance (commitment basis, including grants)	-3.1	-3.2	-5.3	-5.3
Financing	3.3	3.2	4.2	-5.3
Net domestic financing	4.4	3.3	5.0	6.0
Projected donor	0.2 <sup>1</sup>	0.0	1.2	0.0
GDP (K Sh millions)	944,864	984,176	951,340	951,340



INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL  
RELATIONS  
DEPARTMENT

Public Information Notice (PIN) No. 03/83  
FOR IMMEDIATE RELEASE  
July 9, 2003  
Corrected(\*): August 22, 2003

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Concludes 2003 Article IV Consultation with Kenya**

On May 2, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Kenya.<sup>1</sup>

### **Background**

Kenya's economic performance in recent years has been well below its potential reflecting primarily the persistence of pervasive governance problems and the slow pace of structural reforms. Specific factors that have contributed to low economic and employment growth include low saving and capital formation, a weak banking system, poor infrastructure, weak property rights and an unpredictable judicial system, and labor market rigidities. As a result, Kenya's real per capita GDP was in 2002 lower than it was a decade earlier.

Real GDP growth could edge up from 1.2 percent in 2001/02 to 1.6 percent in 2002/03, supported primarily by a strong performance of manufacturing and agricultural exports. After a significant drop in inflation to about 2 percent in the first half of 2002, the consumer price index has registered a marked increase in recent months partly on account of a transitory tightening in the food supply situation and the surge in the retail prices of petroleum products. At the same time, the growth of monetary aggregates has risen, and the 91-day treasury bill rate has

---

<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

(\*) Correction to the Executive Board Assessment

dropped to 6.1 percent by mid-March 2003 from around 10 percent a year earlier. These developments exerted downward pressure on the exchange rate of the Kenya shilling, which weakened over the past year along with the U.S. dollar vis-à-vis other major currencies. The nominal effective exchange rate of the shilling fell by about 9.0 percent during 2002.

The new government has placed its anti-corruption strategy at the top of its agenda and has embarked on a major strengthening of its governance and anti-corruption institutions. It has already embarked on a major strengthening of its anti-corruption apparatus, including the tabling of key governance legislation and has commenced steps to strengthen the judiciary.

### **Executive Board Assessment**

Directors noted that Kenya's economic performance in recent years has been well below its potential, reflecting primarily the persistence of pervasive governance problems and the slow pace of structural reforms. As a result, Kenya's real per capita GDP was lower in 2002 than it had been a decade earlier.

Directors commended the new Kenyan government for placing the anticorruption strategy at the top of its policy agenda. They noted that the government had already embarked on a major strengthening of its anticorruption apparatus, including the recent passage of key governance legislation, and that it had begun to take steps to strengthen the judiciary. Directors considered that these actions, if followed by appropriately firm enforcement of the laws and regulations, should significantly reduce the wastage of public resources, improve the incentives for enterprises, and contribute to increased economic growth and the reduction of poverty.

Directors agreed that the main challenge facing the new government is to implement a comprehensive economic program without interruption. They considered that the tangible results from such a program would help to garner broad public support behind the reforms and mobilize financial assistance from the donor community and also encourage additional investment. A comprehensive medium-term reform strategy would need to include credible actions to continue to improve governance and fiscal transparency; consolidation of the budgetary position to address the domestic debt problem and ensure fiscal sustainability; a credible strategy to reform the tax system and enhance revenue; strengthened public expenditure policy and management, involving a reorientation of expenditures towards priorities of the Poverty Reduction Strategy Paper ( PRSP); improved tracking of spending on poverty programs; a bold privatization program, including the divestiture of the government from ownership of commercial banks; and strengthened banking supervision.

Directors welcomed the authorities' intention to finalize a full PRSP in the near future, which would articulate the reform agenda to be supported by the IMF and the donor community. They stressed the need for the PRSP to set out a clear timetable, for implementing key policy actions that the government intended to take to address poverty and promote strong growth over the medium term. They also stressed the importance of aligning the PRSP to the budget and the medium-term expenditure framework.

Directors suggested that budgetary policies should over the medium term aim at fiscal consolidation to significantly reduce the reliance of the budget on domestic borrowing and to

support a prudent monetary policy. To help achieve this, Directors encouraged the authorities to pursue discipline expenditure policy and implement a credible strategy to form the tax system and measures aimed at strengthening revenue performance.

Directors stressed the urgent need to reorient public expenditures in favor of social and economic outlays, and encourage the authorities to develop policies to contain the growth of the wage bill, including changes to the public sector wage-setting arrangements and a deepening of civil service reforms. They emphasized the need for such measures to form a key component of the new program. In the near term, however, Directors recognized that present structure of expenditure would impart a high degree of inflexibility to the budget and greatly complicate the management of fiscal policy, as the benefits of the restructuring effort would be realized over time. Nevertheless, Directors emphasized the need to begin immediately the process of realigning public expenditure with PRSP priorities and the recommendations of the ongoing review of public expenditure. Achievement of the needed restructuring of expenditures will also require its close monitoring and control of expenditure to minimize deviations of budget outcomes from intentions. Directors also underscored the urgency of dealing with the problem of stalled projects and pending bills.

Directors considered that monetary policy should continue to aim at keeping inflation low while providing a stable environment for financial markets. To this end, they stressed the need for bold actions to significantly reduce the reliance of the budget on domestic financing, which would also help to preserve the independence of the Central Bank of Kenya in the conduct of monetary policy, and to ease interest rate pressures. Directors suggested that the authorities' concerns about the wide spreads between bank lending and deposit rates should be addressed by tackling the underlying structural problems in the banking system, including a clear plan to deal with the large nonperforming loans. In addition, Directors urged the government to divest itself from the ownership of banks, which tended to complicate the prudential supervision of the sector. Directors considered that a flexible exchange rate system continued to be appropriate for Kenya. They therefore encouraged the authorities to take steps to improve the functioning of the system.

Directors considered that a flexible exchange rate system continues to be appropriate for Kenya. They therefore encouraged the authorities to take steps to improve the functioning of the system. They noted that, while the exchange rate did not appear to have been a major impediment to export performance, there was a need to closely monitor exchange rate developments as a continuation of the recent appreciation could have adverse implications for export and output growth. In this context, Directors stressed the importance of actions to raise productivity and reduce production costs to safeguard competitiveness over the medium term. They pointed out that measures to improve the governance regime, upgrade infrastructure, and enhance the flexibility of the labor market were essential.

**Public Information Notices (PINs)** are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2003 Article IV Consultation with Kenya is also available.

Kenya: Selected Economic Indicators, 1997-2002

	1997	1998	1999	2000	2001	2002 Estimate 1/
(Annual percentage change, unless otherwise indicated)						
<b>National accounts and prices</b>						
GDP volume	2.4	1.8	1.4	-0.2	1.2	1.2
GDP volume per capita	0.1	-0.4	-0.7	-2.4	-0.8	-0.6
Consumer prices (annual average)	11.9	6.7	5.8	10.0	5.8	2.0
Terms of trade, goods (- deterioration)	2.0	-5.0	-1.3	-0.7	-2.6	-5.0
Exchange rate (Kenya Shillings per U.S. dollar, period average)	58.0	61.8	70.4	76.3	78.6	78.6
Real effective exchange rate (- depreciation; end of period)	-1.9	-6.6	0.1	12.0	2.9	4.3
(In percent of GDP, unless otherwise indicated)						
<b>Investment and saving</b>						
Investment	18.5	17.4	16.2	15.4	14.5	13.5
Central government	4.4	4.0	2.9	3.0	3.1	3.0
Other	14.1	13.4	13.3	12.4	11.3	10.5
Gross national saving	14.3	12.5	14.0	12.7	11.0	9.3
Central government	2.1	3.6	3.5	1.9	0.3	-1.1
Other	12.2	8.9	10.5	10.7	10.7	10.4
<b>Macroeconomic policy variables</b>						
Total central government revenue 2/	27.2	26.8	23.1	22.6	21.6	22.2
Total central government expenditure and net lending 2/	29.5	27.6	23.0	27.4	25.0	27.7
Overall central government balance (commitment basis) excluding grants 2/	-2.3	-0.7	0.2	-4.8	-3.4	-5.5
Overall central government balance (commitment basis) including grants 2/	-1.5	0.0	0.7	-2.0	-2.2	-4.6
Government domestic debt, net (end of period) 2/	20.7	20.5	21.2	19.4	22.3	26.2
Money and quasi money (M3, End year, percent change)	9.8	3.3	2.7	0.8	2.5	8.8
Interest rate (90-day treasury bill; end of period)	26.3	11.1	20.5	13.5	10.8	8.4
(In million of U.S. dollars, unless otherwise indicated)						
<b>External sector</b>						
Current external balance, excluding official transfers (in percent of GDP)	-549 -4.4	-233 -4.9	-375 -2.2	-486 -3.6	-497 -4.3	-857 -4.2
Overall balance of payments	-37	66	-20	-8	21	38
Net present value of external public debt (in percent of exports of goods and services) 3/ 4/	156	145	140	143	126	115
Scheduled external debt service, including the Fund 4/ (in percent of export of goods and services)	22.4	23.6	27.3	19.1	15.6	11.3
Gross international reserves (end of year) (in months of next year imports)	788 2.5	783 2.8	791 2.5	897 2.7	1,064 3.1	1,067 2.7

Sources: Kenyan authorities; and IMF staff estimates.

1/ Actual data for prices, exchange rates, money and interest rates.

2/ Data are on July-June fiscal-year basis.

3/ Three year backward looking average of exports.

4/ After 2000 Paris Club rescheduling and assumed rescheduling by commercial and non-Paris Club creditors.



**Statement by Ismaila Usman, Executive Director for Kenya  
May 2, 2003**

**Main Points:**

- The new administration in Kenya has not only addressed pending governance issues, especially in the areas of concern to the Board in the past, it has also shown commitment to further reforms in other areas in the medium to long term.
- An Economic Reform Programme that complements the PRSP process is being proposed, with the elements of reforms that would improve the business environment, facilitate enhanced growth and accelerate poverty reduction to meet the MDGs target.
- While many important reforms have been undertaken in recent times, my authorities acknowledge that many challenges remain, including the raised expectations of Kenyans and the ability of the government to deliver on its election promises.
- The ability of my authorities to successfully implement the outstanding economic and social reforms is constrained by scarce financial resources and limited human capacity. As a result, they would appreciate the support of the international community, including the IMF to achieve the desired macroeconomic goals.
- In this regard, the authorities are requesting for a cancellation of the current PRGF-supported arrangement and its replacement with a new programme under the PRGF, which will enable them obtain a further debt rescheduling from their creditors.

**Introduction**

Directors will recall that during the last Board discussion on Kenya in March 2002, two prior actions were considered necessary to bring the PRGF programme, approved in 2000, back on track, for the attainment of macroeconomic stability and growth. These were, the implementation of a comprehensive medium-term economic and structural program, as well as the need to address governance problems. As you are aware, Kenya has recently undergone a landmark election that has ushered in a new government, which is determined to restore good relations with its development partners, including the IMF. In this connection, officials of the government have recently held fruitful discussions with management and staff of the Fund.

The new administration has consistently shown its commitment to addressing governance and economic reform issues, as indicated by the many steps it has taken in the last few months to address the outstanding challenges. For example, there is a notable update on the measures analysed in bullet 5, box 5 of the staff report on governance issues. Both the Anti-

Corruption and Economic Crimes Bills, 2003 and the Public Officers' Ethics Bill, 2003 have been passed by Parliament and are awaiting the President's assent, while the Kenya Anti-Corruption Commission will soon be established. Moreover, the government has strengthened other anti-corruption agencies and institutions, including the judiciary. They are also proposing to table other key governance legislations before Parliament soon. On the economic front, the authorities have proposed an Economic Recovery Programme that will align with the PRSP to address the outstanding economic reform agenda.

However, the government still faces very daunting challenges in implementing some of the outstanding policies and reforms in the face of scarce resources and capacity constraints, as well as the raised expectations of the Kenyan people looking to the government to deliver on its election promises. The new government also requires time to fully understand the challenges confronting them in order to find appropriate solutions. In this regard, the authorities at this crucial period, would appreciate the understanding as well as the support of the Fund and the donor community in carrying out the identified reform programmes. As a starting point, therefore, they are requesting for the cancellation of the current PRGF and the approval of a new programme that will enable them obtain further debt rescheduling from the creditors.

## **2. Recent Developments**

In the fiscal year 2002/3, as a result of a strong performance of the manufacturing and agricultural sectors, real GDP is estimated to grow by 1.5 per cent from the level of 1.2 per cent recorded in the previous fiscal year, while a rebound is also anticipated in private sector investment because of an improvement in the investment climate. My authorities were able to pursue a tight monetary policy during the year which helped to significantly reduce the inflation rate to less than 2 per cent. In line with their objective of increasing the reserve coverage to four months of imports, the authorities increased the foreign reserves by about US\$170 million.

### **a. Fiscal programme**

The steady decline in the revenue of the government continued in the fiscal year, and was exacerbated by a further decline of donor support, leading to significant deviations of revenue outturns from budget projections and contributing to an expansion of the stock of pending bills and stalled projects. As a result of the need to provide for expenses not budgeted for, especially additional expenses for the new free primary education programme and the accompanying allowances for teachers, expenditures may be higher than budgeted for in the current fiscal year.

### **b. Monetary developments**

The tight monetary policy adopted by the authorities in 2002/03 have produced favourable developments, which include stability in the nominal and real US dollar exchange rates for the Kenya shilling since 2000, resulting in a lowering of the inflation rate to less than 2 per cent, and reduction in the nominal 91 day treasury bill rate from 70 per cent in 1994 to

5.8 per cent by mid-March 2003. The perceived country risk premium against the US treasury bill rate also dropped significantly from an average of 13 percentage points to 3.6 percentage points in June 2002.

### **c. The External Sector**

Although export growth slowed down slightly in 2002, there was nonetheless appreciable growth in non-agricultural items, such as in horticulture exports to the EU and manufactured exports to African regional market. In addition, the US African Growth and Opportunity Act (AGOA) appeared to be having a positive impact, as exports under the arrangement increased from US\$30 million in 2000 to US\$140 million, largely as a result of a significant rise in garment exports. The strong exchange rate appreciation pressures faced by the Kenyan authorities necessitated the increase of the foreign exchange reserve by US\$170 million to raise the reserves coverage to 4 months of imports.

### **d. Domestic and External Debt position**

The significant decline in revenue and the collapse of external donor support contributed largely to the increase in domestic financing, the rise in the stock of pending bills, as well as in government's contingent liabilities in the financial and the non-financial public enterprises. However, the external debt is sustainable by the standards of the Heavily Indebted Poor Countries Initiative as the net present value (NPV) of debt-exports ratio was estimated at about 116 percent, while the debt to service ratio is 12 per cent, and is projected to fall further in the medium term. Kenya also has a good external debt servicing record as a result of which bilateral agreements were concluded with all Paris Club creditors in the November, 2000 rescheduling. A tentative agreement has also been reached with the commercial creditors in the London Club.

Nonetheless, the medium-term macroeconomic projections indicate that, in the absence of a new rescheduling agreement with its Paris Club creditors, Kenya will need to reduce its poverty reduction expenditures or otherwise borrow locally to service its external debt obligations. Consequently, my authorities are considering approaching the Paris Club for a further rescheduling in the second half of 2003, after agreement on a new programme with the IMF.

## **3. Reforms Undertaken**

**a. Actions taken on Pending Bills and Stalled Projects** – As part of the government's efforts to address governance issues, payment of all pending bills have been suspended, pending a thorough audit of the outstanding stock, which has been subjected to external audits. Meanwhile, government has formed a Pending Bills Action Plan Committee (PBAPC) on September 15<sup>th</sup>, 2002 to establish the stock of pending bills and their authenticity as at 31<sup>st</sup> August, 2002, with the mandate to produce an action plan for managing the pending bills and stalled projects. The next step is to form a team of technical experts to interpret and implement the external auditors' recommendations.

**b. Development of a reserve money programme and build-up of foreign reserves**– The Central Bank of Kenya (CBK) concurs with staff assessment in paragraph 38 of the report with regard to developing a reserve money programme aimed at keeping underlying inflation over the medium term under 5 per cent, while providing a stable environment for financial markets. The Bank has already formulated a reserve money programme that will reduce underlying inflation from 4.1 per cent in December 2002 to 3.8 per cent in December 2003 and to 3.5 per cent by June 2004, in line with inflation levels of Kenya’s trading partners.

However, it is important to note that the legal limit on CBK overdraft to the government as provided in the CBK Act has been observed to date. In addition, the cause of the wide spread between lending and deposit rates is being addressed, while options for addressing non-performing loans (NPLs) are being considered to include formation of a trust, and the restructuring of the Deposit Protection Fund Board to take it over. Meanwhile, the divestiture of the government in the banking sector is being worked out.

**c. Safeguards Assessment** – Since staff issued the stage-two safeguards assessment in 2001, the CBK has taken a number of measures to deal with the issues raised in the report, while an audit committee is expected to be established soon to regularise the outstanding issue of the government’s obligation to the CBK, including negotiations with the treasury to determine the financial terms for the loan

**d. Design of an expenditure-tracking system for pro-poor expenditures** – At the request of the World Bank, the Kenyan government has, in the last two years, been monitoring on a quarterly basis, a set of core poverty programmes, the list of which has been expanding. As part of the medium-term expenditure framework (MTEF) budget process, spending ministries have been requested by the Ministry of National Planning to provide an updated list of poverty-related expenditures, based on a set of criteria for selecting poverty programmes.

**e. Other governance measures undertaken** – include, the establishment of a Ministry of Justice and Constitutional Affairs, as well as a Department of Governance and Ethics in the Office of the President to oversee the implementation of the proposed Public Officers’ Ethics Bill. The government suspended the sales of public assets and plans to establish, in consultation with the World Bank a policy framework that would private sector participation in the privatisation programme, as well as provide a transparent framework for privatisation, for which a draft bill will be sent subsequently for the approval of parliament; a new Chief Justice has been appointed and all senior public officials under serious investigation for corruption have been suspended, while seminars and workshops on corruption prevention for civil servants are continuing.

#### **4. The Economic Recovery Strategy**

The paper on the proposed Economic Recovery Strategy takes cognisance of work done in the PRSP, the PRSP-GAP, the KIPPRA research work, and in consultation with development partners. Its objectives will be a macro-economic framework that creates growth, employment, low inflation, poverty reduction, sectoral targets and institutional reforms that

are consistent with the overall macro target. The approach of the strategy will be to identify the importance and linkage of the sectors in the economy, including their constraints and challenges. The key focal areas are governance, public and social sectors reform, infrastructure development, and promotion of exports and investment. It also proposes to address issues related to widening the tax base, as well as its enforcement and policing.

Several workshops have been organised by the Ministry of Planning and National Development for the discussion of the paper among government officials, domestic stakeholders, development partners and non-government organisations. A task force has also been put in place to finalise an Action Plan and Implementation Framework, which will be forwarded to the Cabinet for approval and shared with the development partners. The programme is expected to be funded through the 2003-4 and 2004-5 MTEF and the MTEF sector ceilings to reflect the growth-oriented priorities, especially on infrastructure. The process is expected to be completed by August 2003.

## **5. Medium-Term Economic Outlook**

**a. Prospects** - The significantly improved investment climate in Kenya and the attendant rebound in private investment, as well as an expansion of the manufacturing and construction sectors are expected to drive the substantial growth that is estimated for the economy over the medium term, while As the economic hub of East Africa and with a diversified economic base, Kenya is well positioned to further benefit from the AGOA initiative and also increase its penetration in African markets, with exports (mainly manufactured) to these markets currently accounting for 50 per cent of total exports. The high case scenario developed in the staff report indicates that Kenya will make good progress toward achieving the Millennium Development Goal (MDG) of reducing poverty incidence to about 24 per cent by 2015, from the current level of over 50 per cent.

My authorities agree with the staff appraisal that the actual expenditures for 2002/3 and in the medium term are expected to be higher than the budgeted levels, because of increases in teachers' basic salary and house allowance, as well as the additional expenses associated with providing the election promise of free primary education, which is essential for tackling poverty. They agree that this could complicate the management of macro-economic policies in the medium term in the absence of increased donor assistance and a rescheduling of Kenya's external debt under the Paris Club.

**b. Reforms Proposed – On the tax regime**, my authorities have abolished a number of tax exceptions under the tax law and they have pledged to continue with efforts to rationalise the tax regime, taking into account, issues related to harmonisation and reduction of exceptions that are in line with the EAC tax harmonisation programme. They hope to put in place a dynamic tax system that can attract investment, create enabling environment for business, and support savings and investment growth. In addition, they would like to point to a number of positive updates on the tax data provided in box 3 of the staff report. The tax rates on excise duty on beer and cigarettes, the import tariff on raw materials, the personal income tax bracket and corporate income tax have been reduced, while the VAT was raised from 16 per cent to 18 per cent. Furthermore, measures are being proposed to widen the tax base, address

issues of tax arrears, and improve tax administration and information technology to assist in this endeavour.

**c. To enhance Kenya's competitiveness**, the government is taking measures to rationalise the external tariff towards a more competitive trade regime, promote the productive sectors and therefore spur growth both for local investors and exporters. In this regard, duties on capital goods equipment, and machinery and plant have been reduced to 0 per cent in the budget for 2002/03, and on those items readily recognisable as raw materials. Similarly, duties on all intermediate goods were lowered to 15 per cent. The Minister of Finance will also review the tariff policy during the 2003/04 budget preparation in order to address the problem of manufacturers who may not have benefited from the tariff codes. As a member of COMESA and the East African Cooperation (EAC), Kenya is committed to work with her partners to resolve any inconsistencies and any outstanding issues towards creation of a viable customs union.

## **6. Outstanding Challenges**

My authorities acknowledge the enormous challenges confronting them, which include, among others: the difficulty to reduce the wage bill, inspite of retrenchment efforts in recent years, and in view of the likely pressure for increases in the salary of civil servants arising from the recent increase in teachers' salaries; the adverse impact of the large domestic borrowing on the macroeconomy; the difficulty in budgetary management because of anticipated gradual resumption of donor support for the reform programme; the need for a comprehensive reform of the tax regime; and the high expectations of the Kenyan people in the important areas of high GDP and employment growth, improved governance, and institution reforms, especially in the labour market and the financial sector.

The government has pledged its commitment to tackle these problems head-on with utmost the current spirit of transparency and accountability, but only as much as resources and human capacity at their disposal can afford,. Nonetheless, they welcome the outcome of the Fund staff's discussion with donors, which indicated prospects of an early donor assistance and budgetary disbursement by end-June 2003.

My authorities recognise the urgent need to restructure public expenditure to free resources for poverty reduction. As a result, they have initiated actions to review the wage bill and other benefits and they propose to redesign the mechanisms for setting public sector wages to align them more closely with productivity gains and the availability of resources over time. They also intend to review all existing wage agreements and contracts, as well as focus government resources only on core activities.

On the need to pursue a flexible exchange rate regime, my authorities would like to note that the shilling has continued to be determined by forces of demand and supply since the liberalisation of the exchange and payment systems in 1993. The CBK intervention has been limited to rare cases when the movement of the rate is considered inconsistent with economic fundamentals and driven by speculative tendencies. The CBK purchases foreign exchange from the interbank market solely to meet official external financial obligations, which should

be considered as part of normal demand for foreign currency. The Bank agrees on the need to build foreign exchange reserves to around five months of projected imports as this is also in line with the CBK Act which provides the Bank necessary flexibility in this regard.

With regard to statistics, my authorities are taking actions, with donor assistance to improve the quality and timeliness of data in the relevant areas. Detailed plans for improving the data over the short and medium term have been posted on the Fund's Data Standards Bulletin Board, while a statistical master plan and a new statistical act that would improve the independence of the Central Bureau of Statistics are being prepared.

## **7. Conclusion**

The new government in Kenya has shown in many ways strong determination and commitment to implementation of governance reforms, including the fight against corruption, which constituted one of the main challenges that derailed the last IMF programme. The proposed Economic Reform Strategy, which complements the draft PRSP, and which contains far-reaching medium term reforms to improve the business climate and accelerate the growth process and poverty reduction is a further testimony of the positive and welcome wind of change that is now blowing through Kenya for which the authorities deserve the support of the international community, including the IMF. On this score, my authorities would appreciate a new programme under the PRGF with the Fund to send a positive signal that would facilitate their obtaining appropriate rescheduling agreement with their creditors and renewed donor support for the medium term economic programme. They hope they can count on the understanding and support of the IMF Executive Board in this regard.