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KENYA

June 27, 1991

EVENT: Earlier this month, Kenya announced a tough budget designed to stabilise its economy.

SIGNIFICANCE: This provides the firmest evidence to date of Kenya's determination, under pressure from official donors, to accelerate economic reform.

ANALYSIS: Eleven years after receiving its first structural adjustment loan, Kenya has announced far-reaching measures aimed at reversing the country's economic slowdown. Economic performance has deteriorated since the late 1970s, with the growth rate of GDP slowing from 10% between 1970-75 to 3.5% during the 1980-86 period. With population increasing at 3.7% annually, this has meant falling living standards. Although there was a partial recovery in the late 1980s, with annual GDP growth rising to 5%, this has not been sustained.

Growth slowed to 4.5% last year -- the lowest since 1985 -- and in his budget speech on June 13 Finance Minister George Saitoti predicted a further deterioration in 1991 with expansion slipping to 4%, well below the development plan target of 5.4%.

More worrying than this slowdown is the sharp deterioration in the balance of payments, which swung from a surplus of 125 million dollars in 1989 to a deficit of 60 million dollars last year. This was largely due to a falling off of capital inflows, and especially foreign investment. But it was also due to the Gulf crisis, which cost Kenya 90 million dollars in the final five months of 1990. Oil is the country's chief import -- about one fifth of the total -- and while Kenya has benefitted significantly from the sharp fall in oil prices since January 1991, its tourist industry is suffering from the negative effects of the Gulf crisis on travel and, more recently, the recession in the West. The country's debt-service ratio is still uncomfortably high at 28% last year -- down from 32% in 1989 -- and Kenya is hoping for more debt cancellation by western lenders.

Saitoti expects tea exports -- the country's second largest currency earner after tourism -- together with lower fuel prices and improving tourist receipts to stabilise the balance of payments in 1991. But he also has warned of little prospect of a revival in the crucial farming sector.

Three elements are central to economic strategy for the next two years:

-- curbing inflation;

-- restructuring the public sector; and

-- securing faster export growth.

Inflation. Inflation last year increased to 12.6% from 10.6% in 1989, which was way above the target rate of 7%. Saitoti blamed this on excessive credit creation, especially by a government whose borrowing from the banks rose no less than 59% during 1990 fuelling money supply growth of 20%. The budget deficit was responsible for the surge in credit growth.

Privatisation. The boldest long-term move foreshadowed in the budget was the decision to press ahead with the much-delayed privatisation programme which is central to solving the budget deficit problem. Saitoti says that almost a third of the deficit reduction target could be met if state-owned enterprises could service their own debts and pay taxes. Last year, the Treasury bailed the parastatals out to the tune of 70 million dollars. According to the finance minister, the return on investments worth almost 2 billion dollars was only 0.20%. The government's solution to this is to sell off -- or liquidate -- the bulk of the 250 firms in which the state owns shares while retaining so-called 'strategic' firms, but restructuring them to improve their efficiency and productivity.

Most privatisation sales will be by open, competitive tender to buyers both from within Kenya and abroad. Criteria for determining the buyer will depend not just on the price offered but on the quality of management, technology transfer and access to export markets. The long-term aim will be 100% divestiture from non-strategic parastatals. Management will be given autonomy in the strategic enterprises remaining under government control.

While these moves to restructure the public sector will be welcomed by donors and businessmen alike, there will be continued scepticism over the pace of reform.

Export promotion. Saitoti claims that the country's export drive is going well with volumes rising 6% annually over the last five years while exports of manufactured goods have been increasing at 17% a year, albeit from a very small base. The key to the export strategy has been a depreciating currency, with the value of the Kenya shilling falling more than 75% from 16 to the dollar five years ago to 28.4 today. Nairobi has high hopes that export expansion will be accelerated as its Export Processing Zones comes on stream. Two zones are being set up -- at Athi river and Mombasa -- with applications approved for the first three EPZ factories to be established.

KENYA: Economic Programme

Other incentive schemes include Manufacturing Under Bond (MUB), with eleven firms already participating. The regulations for this were further eased in the budget. Exports are also being fostered by tariff reform; the budget lowered last year's top rates from 100% to 70%.

CONCLUSION: Business and donor scepticism will only be allayed if decisive moves are made soon to implement the 1991 budget proposals and especially the privatisation programme.

Keywords: AF, Kenya, economy, policy, prices, aid, investment, debt, private sector, trade

THE WORLD BANK/IFC/MIGA
OFFICE MEMORANDUM

8 trans

DATE: April 22, 1991

TO: Distribution

FROM: John Nellis, CECPS

EXTN: 37482

SUBJECT: KENYA: Parastatal Reform Paper

1. This paper is a dramatic, indeed almost miraculous improvement over the sketchy and timid policy document that we received from the Kenyans just several weeks ago. It states clearly that large segments of the parastatal sector either have never met or are no longer meeting the strategic objectives for which they were created; that the way forward is to (i) divide the sector into strategic and non-strategic sub-sectors, (ii) divest the non-strategic sub-sector through privatization and liquidation, and (iii) apply stiff market proxies to the remaining strategic enterprises so as to make their behavior mimic, as much as possible, that of privately-owned firms operating in competitive markets. This is more than an advance; it is a remarkable conversion.

2. Many of the concepts and tactics presented in the paper are completely in line with Bank thinking; a first impression is that we could have written much of it. Later on one realizes that we did write parts of it; for example, the section on past performance of the sector as a whole, and parts of the sections on how to categorize firms, on how to go about the sales process, and how to improve performance in firms remaining in the state portfolio -- these come directly and in detail from Bank reviews and papers.[1] This has advantages and disadvantages: On the one hand, imitation is the sincerest form of flattery, and their use of our ideas and materials suggests they have accepted our diagnosis of their problems and our suggestions for reform. But one must admit that a less positive interpretation is conceivable; that the continuing financial crisis and donor pressure have pushed them to seize on readily available ideas in an effort to placate us. Which is it?

3. Assuming (as we must) sincerity on the part of the government, what specific comments and suggestions can be offered?

- The concept of strategic/non-strategic: this is an advance over past thinking, and it is a notion often supported by the Bank; thus, we can hardly fault it. But: the boldest African leaders (for example, the new Prime Minister of the Ivory Coast) have rejected the entire concept as "misguided," stating that there is no sector or firm which will forever be sheltered from market forces. In the Kenyan context,

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[1] In some cases the borrowing was done without sufficient editing or updating; thus, para. 3.02 refers to "the last two fiscal years" as 1984 and 1985, for a document supposedly written in 1991. Here, they have taken the text from a Bank report written in 1986.

we should **recommend a more specific and limited definition of strategic**. The document says all firms "deemed vital to national security/contingency (what does the last mean?) and those enterprises or parts of enterprises providing essential goods and services" are strategic. This is too broad and too loose; on this basis one could construct an argument on the importance or essential nature of almost any product. This definition should be sharpened to limit strategic status to (i) natural monopoly social service providers, and (ii) a few firms working in areas where private activity cannot or will not presently act.

- The concept of viable/non-viable: basically sound, but the idea of "potential viability" contains a possible pitfall -- this is the tendency for analysts to construct and governments to approve workout scenarios whereby even the poorest performer could be transformed into a productive, profitable firm, **if** one more injection of capital is made, **if** the market for its product turns up (or better yet, is made to turn up by a "slight and temporary" government intervention), **if** the enterprise's debt is forgiven so that its balance sheet is not paralyzed by interest charges, etc. It is easy and tempting to think up conditions that will make a firm viable; and while this particular paper is extraordinarily clear-headed about this issue, we must **define tightly the notion of potential viability**. The worrisome statement is in para. 5.04 which says that "potentially viable enterprises will be restructured by gradually increasing participation of the private sector." We should argue; if you've made the decision to let them go, then let them go, fully and quickly.

- A major shortcoming of the paper is that it does not spell out at least the principles by which bankruptcy and liquidation will be applied; **it should do this.**

- With regard to the specific classification of firms, the paper does not present the definitive list of which enterprises are strategic and which are not, but some hints are given. Seemingly, all firms now in receivership are classed as non-strategic; they will proceed to divestiture in the near future -- well and good. But: Kenya Airways is classed as strategic. Why? All over the world, airlines have been a prime area for enlarging the role of the private sector; i.e., in Argentina, Brazil, Panama, Mali, Pakistan, Turkey and Thailand, not to mention Britain, Canada and many other OECD countries. The point is that we should **see the list before it is cast in concrete, so that we can debate the criteria used and the decisions suggested.**

- The Kenyans should be commended on the soundness and realism of many of the tactics adopted in the paper; for example, the repeated injunction against spending state funds to restructure physically enterprises being put up for sale (this should be left to the new private owner); the notion that parts of even strategic firms could be hived off or contracted out to the private sector; and the willingness to use a range of methods to privatize.

- o With regard to <u>the social safety net for affected employees</u>, para. 6.14 puts forward the usual package of "retraining, advanced retirement benefits, relocation assistance, etc." Severance pay is needed; Bank experience is that this element often makes or breaks the implementation of a public enterprise reform program. Standard Bank practice is to participate in such programs, in terms of conceptualization and financing. We might consider **advising the Kenyans to rely on straight severance pay** rather than elaborate retraining/relocation programs which laid-off employees like less, and which are more expensive, and provide opportunities for rent-seeking.

- o Finally, para. 6.03 on the <u>autonomy and accountability of enterprises</u> needs **much more specificity**; i.e., precisely what decisions will be placed in managerial hands, and what principles will guide the autonomy measures.

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REPORT AND RECOMMENDATION

OF THE

PRESIDENT OF THE

INTERNATIONAL DEVELOPMENT ASSOCIATION

TO THE

EXECUTIVE DIRECTORS

ON A

PROPOSED CREDIT OF SDR 73.6 MILLION

AND A PROPOSED

AFRICAN FACILITY CREDIT

OF SDR 7.2 MILLION

TO THE

REPUBLIC OF KENYA

FOR AN

INDUSTRIAL SECTOR ADJUSTMENT PROGRAM

May 24, 1988

Industry and Energy Operations Division
Eastern Africa Department, Africa Region

CURRENCY EQUIVALENTS

Currency Unit = Kenyan Shilling

US$1.0 = KSh 17.0 = SDR 0.72 (April, 1988)

ABBREVIATIONS AND ACRONYMS

DFI	Development Finance Institutions
ECS	Export Compensation Scheme
EPR	Effective Protection Rate
EPZ	Export Processing Zone
FIPA	Foreign Investment Protection Act
ICB	International Competitive Bidding
IDB	Industrial Development Bank of Kenya
IPE	Industrial Public Enterprise
KIE	Kenya Industrial Estates
MIB	Manufacturing-in-bond
NBFI	Near-bank Financial Institutions
NSE	Nairobi Stock Exchange
PFP	Policy Framework Paper
SAF	Structural Adjustment Facility
SAL	Structural Adjustment Loan
SOE	Statements of Expenditures

GOVERNMENT OF KENYA FISCAL YEAR

July 1 - June 30

KENYA - INDUSTRIAL SECTOR ADJUSTMENT CREDIT PRESIDENT'S REPORT

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KENYA

INDUSTRIAL SECTOR ADJUSTMENT CREDIT

CREDIT SUMMARY

Borrower:	Government of Kenya
Executing Agency:	Ministry of Finance
Credit Amount:	IDA: SDR 73.6 million (US$102 m) African Facility: SDR 7.2 million (US$10 m)
Terms:	Standard IDA and African Facility terms. IDA Credit has a 35 year maturity.
Description and Allocation of Credit:	The proposed Credits would support the first phase (1988-90) of the Government's medium-term adjustment program for the industrial sector. These reforms are intended to stimulate investment, promote export production and improve the efficiency of the sector. The program includes reforms in the areas of trade liberalization, tariffs, price controls, export promotion, corporate taxation, financial sector policies and industrial public enterprises. The key elements of the reform program include: (i) rationalization of the import licensing system and liberalizing imports of raw materials, intermediate and capital goods and some consumer goods; (ii) reduced dispersion in tariff rates; (iii) decontrolling prices of about 20 products and streamlining approval procedures for goods remaining under price control; (iv) improved incentives for export promotion, including manufacturing-in-bond, export finance, and a new import duty compensation scheme; (v) streamlining of investment procedures; (vi) improved tax incentives for investment; (vii) the development of an action program for restructuring the industrial development finance institutions and their portfolios; and (viii) limited financial sector reforms to activate the capital and money markets. The proceeds of the Credits would finance general imports based on a negative list.
Benefits and Risks:	The Credits will support the Government's efforts to make the industrial sector more outward-oriented and competitive. Because Kenya's industrial sector is already relatively efficient, the primary benefits will

come from increased investment and a greater export orientation, rather than from a reallocation of resources. The Credits will also help strengthen several institutions supporting the industrial sector (the development finance institutions, capital markets) and provide the foundation for more flexible management of the money supply in the wake of Kenya's periodic "boom and bust" cycles. The main risks to the Credits are possible internal resistance to the policy reforms and the Government's institutional capability to implement and monitor the reform program. These risks are mitigated by the Government's strong commitment to the program, the choice of the Ministry of Finance as the primary implementing agency and close supervision of the Credit by IDA staff.

Estimated Disbursements: The proceeds of the IDA Credit would be disbursed in two tranches: SDR 37.5 million (US$52 million equiv-equivalent), including US$1 million equivalent for technical assistance, after effectiveness; and SDR 36.1 million (US$50 million) after implementation of specific reforms as described in the Government's Letter of Industrial Policy and an overall review of the implementation of the macroeconomic and sectoral reform programs. The African Facility Credit will be disbursed with the first tranche. Disbursements of the two credits are expected to be completed in about 18 months, with second tranche release anticipated about 12 months after effectiveness.

Appraisal Report: N/A

Map: IBRD-12438R2

REPORT AND RECOMMENDATION OF THE PRESIDENT OF THE
INTERNATIONAL DEVELOPMENT ASSOCIATION
TO THE EXECUTIVE DIRECTORS
ON PROPOSED IDA AND AFRICAN FACILITY CREDITS
TO THE REPUBLIC OF KENYA
FOR AN INDUSTRIAL SECTOR ADJUSTMENT PROGRAM

1.01 I submit the following report and recommendation for proposed credits to the Republic of Kenya to help finance an Industrial Sector Adjustment Program: a development credit for SDR 73.6 million (US$102 million equivalent) on standard IDA terms with a maturity of 35 years and a African Facility Credit for SDR 7.2 million (US$10 million equivalent) on standard terms.

1.02 An economic report entitled "Kenya: Policies and Prospects for Restoring Sustained Growth of Per Capita Income" was distributed to the Executive Directors on March 24, 1986.[1] In addition, an industrial sector report "Kenya: Industrial Sector Policies for Investment and Export Growth" was distributed in June 1987.[2] Part I of this report presents a summary of Kenya's economic situation. Part II discusses the Bank Group's strategy and operations in Kenya. Part III describes the proposed industrial sector adjustment program while Part IV provides details on the proposed credits. Basic economic data and selected social indicators are summarized in ANNEXES I through VI.

PART I - THE ECONOMY

Basic Structural Characteristics

1.03 In 1986 Kenya had a per capita income of US$300, which places it towards the upper end of the range of low-income countries. Social indicators are better than for most African countries in the same income category. However, Kenya's rapidly growing population (about 4 percent per annum) has constrained growth in per capita incomes, and intensified pressure on all sectors of the economy to provide more employment opportunities. Consequently, in its 1986 Sessional Paper No. 1, the Government singled out the acceleration of economic growth, a task mainly for the private sector, as its priority for the period 1985-2000.

1.04 Agriculture is the leading productive sector of the economy, generating 26 percent of GDP and employing about 80 percent of the labor force. Only 18 percent of the land area receives enough rainfall to be considered as having at least medium potential for cultivation and the density of population on this land is two-and-a-half times greater than the Sub-Saharan average. The sector is well-diversified due to variations in climate. It produces coffee, tea and horticultural crops for export

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1/ Report No. 6021-KE.

2/ Report No. 6711-KE.

(accounting for over half of merchandise exports) and maize, pulses, sugar and livestock products for the domestic market. Under normal conditions Kenya is largely self-sufficient in food. Increases in agricultural production in the medium term will depend on improved yields on land already under cultivation.

1.05 Kenya's manufacturing sector accounts for about 11 percent of GDP and 7 percent of employment. It is among the largest industrial sectors in Sub-Saharan Africa with 560 medium- and large-scale, 720 small-scale and 1,600 microenterprises. It has been the fastest growing sector of the economy and has played an important role in Kenya's development since Independence. Ownership of industry is a blend of public, foreign private and domestic private investors. While the sector is substantially efficient and is functioning at a high level of capacity utilization, its growth has slowed in recent years. Investment has fallen and manufactured exports, which account for 8 percent of output and 15 percent of merchandise exports, have been declining. Future performance of this sector depends on reviving investment, especially for export markets. Finally, the service sector accounts for about 45 percent of GDP and includes tourism, the largest single foreign exchange earner for Kenya in recent years.

Past Performance

1.06 Kenya's economic performance since Independence falls into three distinct periods: a decade of rapid growth (1963-73) fueled by favorable weather, rising agricultural incomes and the establishment of industries for import substitution and the East African Community; a period of decelerating growth (1974-79) punctuated by the two oil crises and the coffee boom; and finally, a period (1980-1985) of macroeconomic imbalance and stabilization, followed by renewed growth in 1986. Nonetheless, the Kenyan economy remains vulnerable to shifts in the external terms of trade, especially prices for coffee and tea exports and petroleum imports.

1.07 During the first decade after Independence, GDP grew rapidly at an annual average rate of 6.6 percent in real terms and the average rate of inflation was kept below 4 percent. Agriculture and manufacturing grew at impressive rates, 4.7 percent and 11 percent respectively, in real terms. The agricultural sector was stimulated by the conversion of land use to small holder cultivation, the adoption of high-yield maize varieties and the introduction of high-value production activities. Simultaneously, rising agricultural incomes and the consequent expansion in domestic demand induced growth in the manufacturing sector. It also benefitted from an import substitution policy, based on tariffs and quantitative restrictions, liberal foreign investment policy, active Government participation in manufacturing ventures and continued access to East African Community markets.

1.08 Following the first oil crisis, economic growth decelerated to about 4.8 percent per annum during 1973-80, resulting in little growth in per capita incomes, while inflation rose to an average of about 14 percent per annum. This slowdown in growth arose because of (i) a deterioration in the terms of trade; (ii) poor weather conditions; and (iii) emerging structural problems in the agricultural and industrial sectors. In agriculture, inappropriate pricing policies and inefficient marketing arrangements began to take their toll and land yields stagnated. In industry, the incentives favored the domestic market more than exports, resulting in an increasingly inward-looking sector with declining opportunities for efficient import substitution, while the collapse of the East African Community exacerbated the decline in exports. Taken together, these developments resulted in an economy-wide decline in the efficiency of investment as measured by the incremental capital-output ratio, which deteriorated by more than 50 percent between the early 1970s and the early 1980s.

1.09 In the early 1980s, severe internal and external imbalances developed and stabilization became necessary. The budget deficit reached 9.5 percent of GDP in FY81, the external current account deficit amounted to 12.5 percent of GDP in 1980 and inflation peaked at about 20 percent in 1981. These imbalances arose because of (i) erosion in fiscal discipline; (ii) failure to sterilize the increase in the money supply, creating a liquidity overhang for several years; and (iii) a sharper than expected deterioration in the terms of trade after the 1979 oil crisis. In response, Government tightened fiscal policy, devalued the real effective exchange rate, allowed interest rates to become positive in real terms and real wages to fall and temporarily intensified import restrictions in 1982. Consequently, by FY84, the budget deficit was brought down to 2.9 percent of GDP, the current account deficit to 2 percent of GDP and inflation to 11 percent. GDP growth decelerated further to 2.4 percent p.a. during the stabilization period. At the same time, the Government also began to implement structural reforms. In agriculture, selected key producer prices were increased and extension services improved. In industry, the Government eliminated import bans and no-objection certificates as instruments of protection and implemented a clear system of classifying imports for licensing purposes. Finally, the Government gradually increased the number of items and value of imports that came under the least restrictive import schedule and reduced and rationalized tariff rates in three budgets.

1.10 In 1986 Kenya's external terms of trade improved by 13 percent because of higher coffee and lower oil prices. The external current account deficit was reduced to 1 percent of GDP and the overall balance of payments recorded a surplus. Real GDP growth was 6.5 percent, the highest rate in many years, but other macroeconomic indicators showed mixed results. While the exchange rate was prudently devalued by 4 percent in real terms during the year and inflation kept at a low 4.3 percent, the money supply and domestic credit grew rapidly. By FY87, the budget deficit had increased to 8 percent of GDP, because of a sharp increase in expenditures. The 1986 coffee boom was short lived and Kenya's external terms of trade deteriorated by about 19 percent in 1987. The liquidity overhang from 1986, however, buoyed demand for imports, leading the Government to intensify import restrictions in 1987 despite a gradual and continuing depreciation of the exchange rate.

1.11 In sum, Kenya's macroeconomic management has generally been prudent. It has not experienced any prolonged periods of external or internal imbalance, although performance has sometimes deteriorated in the wake of sharp fluctuations in the terms of trade. In the past decade the short episodes of instability have followed good export years because of fiscal laxity and the adoption of trade liberalization measures without adequate financial policy instruments. Kenya's economic growth performance compares favorably with most countries and is much better than most Sub-Saharan African countries. Its growth rate has declined in recent years, however, because of external circumstances and the increasing structural difficulties in its productive sectors. Given its high population growth rate, Kenya can no longer accept the status quo. In light of the recent deterioration in fiscal discipline and external balance, the Government must now restore macroeconomic stability while pursuing structural adjustment with greater vigor to restore rapid and consistent economic growth.

External Debt

1.12 Kenya remains high on the priority list of many donors. Most of Kenya's debt is from official sources, although in recent years the Government has expanded its commercial borrowings. Total external public debt amounted to US$3,438 million at the end of 1986, equivalent to 50 percent of GDP; multilateral and donor Government sources accounted for 42 and 39 percent, respectively, of total external public debt. Kenya's debt-service ratio increased to 39 percent in 1987, largely because of the decline in coffee export receipts.

Development Strategy: The Sessional Paper

1.13 The Sessional Paper provides policy guidelines for Kenyan development for the remainder of this century and formed the basis for the Government's Policy Framework Paper for the period 1988-90. The Sessional Paper emphasizes the need to accelerate output growth in order to provide productive employment for a labor force which is expected to increase by 86 percent between 1985 and 2000, and targets a GDP growth of 5.6 percent annually. The Paper assigns the private sector the dominant role in revitalizing Kenya's economy, and asserts that the Government will establish market-based incentives for private sector investment, while relying less on instruments of direct control. The strategy highlights increased productivity in agriculture and in rural non-farm activity, a dynamic informal sector, and the restructuring of industry to improve its export competitiveness. In trade policy, more uniform import tariffs and more liberal import licensing are expected to promote greater efficiency in the manufacturing sector and to encourage exports. The paper also indicates that exchange rate management will maintain Kenya's competitiveness in world markets while taking into account the process of import liberalization.

Stabilization

1.14 As a result of the significant swings in the terms of trade during 1986 and 1987, and laxity in the management of fiscal and financial sector policies (para. 1.09), Kenya has recognized the need to implement a stabilization program. In FY87, Government expenditure rose to 33 percent of GDP (from 30.6 percent in FY86) and the budget deficit increased to 8 percent of GDP, up from 5.6 percent the previous year. This increase in expenditure arose because of transfers to the National Cereals and Produce Board to purchase and store the bumper grain harvest; increased expenditures on education; preparation for the Pan African games; and wage increases for Government employees. Domestic credit and broad money also expanded rapidly, creating a liquidity overhang. Furthermore, the external current account deficit widened to about 5 percent of GDP.

1.15 The Government has agreed with the IMF, in the context of a standby arrangement and Structural Adjustment Facility (SAF), on steps to stabilize the economy. The Government intends to reduce the budget deficit to 4.2 percent of GDP during FY88 and 3.8 percent in FY89. In addition, the Government will slow the growth of domestic credit and money, causing the rate of growth of money and quasi-money to decline from 21 percent in 1987 to 7 percent in 1988. Inflation would be held to 7 percent in 1988 and 5 percent in 1989. The accompanying planned depreciation of the real exchange rate, together with a limit on borrowing from non-concessional sources, will curb import demand and ease pressures on the balance of payments. Consequently, the current account deficit, including grants, would be reduced to 3.5 percent of GDP in 1988 and 2.4 percent in 1989 and the external debt-service ratio for publicly guaranteed debt is expected to decline from 39 percent in 1987 to 33 percent in 1989.

Medium-term Macroeconomic Framework, 1988-90

1.16 Over the period 1988-90, the Government intends to maintain macroeconomic stability and sustain the recent improvement in the economy's growth performance. It aims at a GDP growth of at least 5 percent per annum while maintaining a low inflation rate by cutting the budget deficit to 3.4 percent of GDP by FY90 and reducing the external current account deficit to 1.4 percent of GDP by 1990 (3.9 percent excluding grants). To achieve these objectives, the Government will (i) further improve farmer incentives, agricultural input supply and agricultural services, particularly for smallholders; (ii) re-orient trade and other industrial incentives to boost efficiency, promote the growth of manufactured exports and revive industrial investment; (iii) activate the use of monetary policy instruments to place greater reliance on market forces in allocating financial resources and to achieve external balance; (iv) maintain a flexible and realistic exchange rate policy in tandem with changes in the trade regime, in order to encourage exports and discourage imports without the inefficiencies arising from administrative import allocation; and (v) reduce the budget deficit to correspond with available concessional foreign financing and ensure that domestic financing of the deficit will neither be inflationary nor crowd out the private sector. While the reduction in the budget deficit would be accomplished primarily through expenditure restraint, the Government will also (i) implement budget rationalization to maintain, and in some cases, expand delivery of essential Government services; (ii) limit the use of nonconcessional sources of external finance; and (iii) increase mobilization of concessional finance from official sources.

1.17 Because past policies have been more favorable to economic growth in Kenya than in most low-income African countries, the planned measures will have a gradual rather than dramatic impact on economic structure and performance during the period 1988-90. Nonetheless, these measures will lay the foundation for more rapid growth during the 1990s. Manufacturing output, which increased by 4.5 percent during 1985 and then 5.9 percent in 1986, is expected to increase by 5.0 percent per annum over 1987-90, reflecting the gradual recovery in manufactured exports and a revival of manufacturing investment. Overall, GDP is expected to increase by 4.8 percent in 1988 and 5.1 percent in 1989. The gradual acceleration of growth is expected to come primarily from improved efficiency of investment. Coffee exports, which are expected to be subject to quotas once again, will strongly influence export performance. Total export volume is expected to increase by about 4 percent annually, with manufactured exports increasing by 5 percent annually in real terms. If this improvement in policies does not take place, GDP growth in the long term would be about 3 percent per annum compared to the rate of growth of population at 3.8 percent per annum. This implies an extended period of sustained decline in per capita incomes without the program, with inevitable consequences for social and political stability.

1.18 Kenya will need to limit new external debt during the next three years because of the slow increases expected in export earnings. Although most of its debt is in the form of bilateral and multilateral loans on highly concessional terms, the Government has increasingly resorted to commercial borrowings during the last three years. Consequently, debt-service payments have risen, with the debt-service ratio increasing from 29 percent in 1982 to 39 percent in 1987. By limiting new borrowings mainly to official and concessional sources (under the IMF program the Government has established an annual ceiling of US$75 million on commercial borrowing during 1988-90) and gradually increasing exports, the Government anticipates that Kenya's debt-service ratio will decline to 30 percent by 1990 and 21 percent by 1995.

PART II - BANK GROUP STRATEGY AND OPERATIONS IN KENYA

Bank Strategy

2.01 Since the early 1980s, the Bank's assistance strategy has focused on three main objectives: (i) encouraging the Government to implement structural changes to facilitate more efficient resource use in the private and public sectors; (ii) supporting investments that directly enhance growth as well as employment; and (iii) reducing the rate of population growth and expanding the country's institutional capacity. In the short-term, IDA intends to work closely with Government and the IMF to ensure the effective implementation and maintenance of the macroeconomic stabilization measures described above (paras. 1.14 and 1.15). In the medium term, IDA will continue to support structural adjustment and policy reform in a number of key sectors, including agriculture, industry, finance, education and health. Increased attention will be given to the private sector in industry, finance and other services and to smallholder producers in agriculture. In addition, medium-term efforts will focus on more efficient resource utilization, both in the productive sectors as well as in selected social sectors. Finally, in the longer term, IDA will contribute to maintaining and enhancing the human and physical inputs available for growth and development. These efforts, largely through discrete projects, will focus on improving infrastructure, providing better health services, education and training as well as helping Kenya contain its rapid population growth rate. In addition, IDA intends to give increasing attention to preserving Kenya's physical environment, including wildlife conservation.

2.02 The Bank group has at present eight loans and 17 IDA credits under implementation in Kenya, totalling US$305.8 million and US$348 million respectively. Seventy-three loans and credits have been fully disbursed. ANNEX VII contains a summary statement of Bank loans, IDA credits and IFC investments in Kenya as of March 31, 1988.

2.03 The Bank's previous industrial operations in Kenya have been limited to lines of credit to two Government-owned development finance institutions: the Industrial Development Bank (IDB), which has received four lines of credit totalling US$65 million, and Kenya Industrial Estates (KIE), which has received two lines of credit amounting to US$16 million equivalent. These lines of credit have supported the creation and expansion of medium- and large-scale industrial enterprises in the case of IDB and small-scale industries in the case of KIE. Implementation under these operations has been mixed, although the second credit to KIE (FY87) encompassed significant reforms of its lending policies and procedures as well as a financial restructuring. Lending decisions in both institutions have been subject at times to extraneous considerations, leading to an erosion of the quality of their portfolios. In addition, IDB's performance has deteriorated because (i) IDB faces increased competition from other banks and near-bank financial institutions (NBFA) in its traditional markets; (ii) many of IDB's clients are illiquid or insolvent, in part because of the impact of exchange rate devaluations on their foreign-exchange denominated loans from IDB; and (iii) IDB is unable to generate local sources of funding, largely as a result of its own poor financial condition. IDB is one of the institutions to be restructured under the proposed Credits (para. 3.23).

2.04 Prior to 1980, the Bank's operations in Kenya consisted strictly of individual project loans and credits. In 1980, however, the Bank made the first of two Structural Adjustment Loans (SALs) to Kenya (the second was made in 1982). A Project Completion Report (1984) and a Project Performance Audit Report (1985) reviewed the implementation of the two SALs, which were complex multisectoral operations covering policy reforms related to agriculture, industry, trade and Government expenditures. Experience with the SALs was disappointing. In retrospect, inadequate attention was given to developing a broad consensus within the Government in determining the parameters and details of policy actions. Instead, the dialogue was primarily confined to a narrow group of officials (largely in the Ministry of Finance). Other ministries, with responsibility for implementing the program, often were not committed to or did not fully understand the program. The Government also did not have the institutional capability to implement such a complex operation. Other factors which contributed to the disappointing performance under the SALs included: (i) external shocks that made it difficult to sustain the pace of reform, especially in the wake of a stabilization program (1982-83) and drought (1984); and (ii) the Government did not consult sufficiently with the private sector on the proposed reforms.

2.05 Because of the difficulties experienced with the SALs, the Bank has decided to disaggregate future structural adjustment lending into a series of sector operations based on solid economic work and project preparation. While such operations include many of the basic reform measures identified in the SALs, they are more sharply focussed on key sectoral issues, making it easier to achieve intra-governmental coordination and commitment. This approach requires detailed and intensive preparation and "front-loading" of implementation. Recent experience with the Agricultural Sector Operation, the first of these sector adjustment credits, indicates that this approach is enjoying some success. The ISAC program, based on detailed sector work, was prepared over a six-month period with a Government committee, including representatives from all the implementing ministries and other agencies, and regular consultations with the private sector. In addition, Government's Policy Framework Paper (PFP), agreed with the IMF and the Bank, provides the overall macroeconomic framework and a mechanism for ensuring consistency between the individual sector adjustment programs and the macro reforms envisaged under the structural adjustment program.

2.06 The implementation of project investments also faced problems associated with the country's limited administrative and absorptive capacity. In the past few years, the Bank has rationalized and scaled back a number of investment projects to conform better to Government's needs and capabilities. Recent country implementation reviews have focussed on this issue, with greater emphasis given to better donor coordination, more effective use of technical assistance and using pilot projects for designing investment projects.

2.07 These implementation problems of the SALs and projects contributed to a drop in net resource transfers from the Bank and IDA to Kenya in the 1980s. Net disbursements declined from US$125 million in 1982 to a negative US$36 million in 1986 and then rose to a positive US$12 million in FY87. This downward trend is also partially due to rising interest payments on IBRD loans, many of which have been fully disbursed. At the end of 1986, IBRD and IDA respectively held 21 percent and 13 percent of Kenya's stock of long-term public and publicly-guaranteed external debt outstanding and disbursed. IBRD's share in public debt-service payments is expected to range between 25 and 29 percent between 1988 and 1991. Because of the relatively high IBRD exposure and Kenya's already high debt-service ratio (para. 1.12), Bank Group lending to Kenya in the next few years is expected to be entirely IDA.

IFC Operations

2.08 IFC has made investments in 15 enterprises in Kenya, spanning the industrial, financial and tourism sectors. Total net commitments (after cancellations, terminations, repayments and sales) amounted to US$84 million as of March 31, 1988, of which US$5 million represented equity investments, and the remaining US$79 million loans. In industry, IFC has been active in the pulp and paper, textiles, tanning and agroprocessing sectors. Pulp and paper projects represent 56 percent of total gross commitments. Although generally IFC's investments have performed well, several projects encountered difficulties during implementation. IFC has also been quite active in investments in capital market and financial institutions.

Coordination with the IMF

2.09 The proposed Credits are a critical element not only in Government and IDA's strategy for Kenya, but in the overall program of structural change supported by the IMF. Success of the program described below is contingent on appropriate exchange rate and monetary policies. The IMF

Board approved in February, 1988 a standby arrangement for SDR 85 million, and a Structural Adjustment Facility (SAF) for SDR 90 million. IDA staff have discussed the proposed industrial sector adjustment program in detail with IMF staff and these reforms constitute a major component of the PFP underpinning the SAF. Bank staff intend to continue close coordination with the IMF to ensure consistency between different policy instruments during the implementation of the program. The funds made available from IDA, the IMF and related cofinancing should go a long way in filling Kenya's financing gap over the next two years (see para. 4.05).

Coordination with other Donors

2.10 The ISAC represents an important focal point for donor coordination and cofinancing for Kenya at a time when the country is experiencing serious balance of payments constraints coupled with a relatively high debt-service burden. Subject to final decisions by the individual donors, cofinancing for the ISAC is likely to total about US$90 million from the Overseas Economic Cooperation Fund (Japan), African Development Bank, European Investment Bank and others.

PART III - SECTORAL ADJUSTMENT PROGRAM

Sector Background

3.01 Manufacturing. Kenya's manufacturing sector is well diversified and among the largest in Sub-Saharan Africa, contributing about 11 percent to GDP. It has grown continuously since Independence, at a rate exceeding 10 percent p.a. from the mid-1960s to the mid-1970s, and at a lower but still impressive rate, averaging 6 percent per annum during the second decade after Independence. During the last six years, industrial growth has occurred concurrent with a macroeconomic adjustment process (discussed in para. 1.09), including large reductions in the fiscal and current account deficits, a considerable devaluation of the Kenya Shilling in real terms, a slow-down in inflation to less than 5 percent in 1986, the emergence of positive interest rates, some import liberalization and a lowering of tariffs. In the Bank's Industrial Sector Report (1987) (para. 1.02), a survey of 45 industrial enterprises, representing about 40 percent of the sector's value added, showed that although effective protection was relatively high, averaging 90 percent, about 78 percent of the sector was efficient for import-substitution activities and average capacity utilization approached 80 percent. The efficient subsectors included the traditional consumer goods industries (food processing, beverages, tobacco, textiles, leather and wood products), with strong domestic resource links, simpler technology and long production experience. These efficient activities were considerably less protected (average effective protection rate (EPR), 43 percent) than inefficient activities (average EPR, 255 percent) such as metal and steel industries and automobile assembly.

3.02 Despite relatively high average levels of efficiency, industry faces several problems. In particular, export performance has been poor, net investment appears to have been negative for several years and the sector is creating a meager 3,000 to 5,000 jobs a year, against 150,000 new entrants into the labor force annually. The strategy of industrialization through protected import substitution has created a strong anti-export bias and led to an increasingly inward-looking sector. Imports as a percentage of the domestic supply of manufactured goods decreased from 36 percent in 1980 to 19 percent in 1985, and exports as a percentage of gross output declined from 19 percent to 8 percent in the same period. By 1983, the ratio of imports in domestic supply was less than 20 percent in 13 subsectors (out of 19) which accounted for most of manufacturing value added. Annual gross investment in industry has been falling since 1978--in 1985 it was 41 percent of the 1978 level in real terms--and it is estimated that the capital stock in 1985 may have declined to 85 percent of its peak value in 1979. Thus, the relatively high growth rate of manufacturing output has come largely through increased capacity utilization. The low level of new investment has occurred because Kenya's industrial sector is running out of steam. Following the collapse of the East African Community, exports have declined as a proportion of output and the prospects for efficient import substitution are nearly exhausted at present. In the absence of a substantial increase in exports, the main sources of demand growth are reasonable agricultural growth (4.5 percent in 1986) and high population growth. These two alone, however, will not generate the per capita income growth and employment targeted in the Sessional Paper. On the supply side, an aging capital stock with high capacity utilization and investors with little interest in new projects or expansion are constraining increases in sectoral output.

3.03 Financial Sector. Kenya's well diversified financial sector includes nearly 25 commercial banks, more than 50 NBFIs, several specialized development finance institutions (DFIs), a Post Office Savings Bank, as well as an array of insurance companies, building societies, cooperatives and other financial institutions. Although the number of institutions has increased rapidly in recent years, particularly amongst the NBFIs and indigenous Kenyan banks, the banking sector remains dominated by the three major commercial banks and their affiliated companies.

3.04 Historically, Kenya has periodically experienced rapid surges in the money supply, especially in coffee boom years. Without open market operations, the Government has had few options for reducing excess liquidity, and has often tapped these surplus funds for its own expenditures. The high liquidity also leads to increased private sector demand for imports, even when foreign exchange reserves decline, as they did in 1987. In order to attain its macroeconomic objectives, particularly for exchange rate management and inflation, the Government needs to develop additional instruments for managing credit and the money supply. Until now, it has relied on administered interest rates, liquidity ratios, credit ceilings and limited sectoral credit guidelines. Kenya's capital markets at present are also generally inactive. Only two institutions have made public offerings since 1980. Trading is sporadic, with a far larger number of prospective purchasers than sellers. The large oversubscription of the two most recent public offerings indicates that sufficient demand exists to support a more dynamic capital market.

Government Program and IDA Strategy for the Industrial Sector

3.05 Kenya's industrial sector faces an uncertain future. While it has enjoyed good past performance and is currently largely efficient, it urgently needs to search for new markets, modernize and expand existing firms as well as create new enterprises. Reforming Kenya's trade regime--liberalizing imports and reducing and evening out the levels of industrial protection--is important for changing the balance of incentives towards exports and away from the domestic market in the medium term. In this way, Kenya is different from other countries which need to modify, in the very short run, the allocation of recurrent resources among existing enterprises. Moreover, the policy package will need to offer potential investors net positive financial (not only economic) gains to revitalize investment. Thus, a careful balancing of "carrot and stick" is required, with the main "carrot" for industrialists comprising price decontrol, investment and export incentives, to compensate for the "stick" of trade reform. Once again, Kenya differs from many other countries in the region where large amounts of unutilized capacity allow major gains in the short term from a reallocation of recurrent resources. Since average capacity utilization is fairly high in Kenya, the balancing and sequencing of policy reforms should be structured to generate an early and strong supply response from new investment, prior to measures which will result in the closure of inefficient firms, and thus not curtail overall growth of the sector.

Policy Reforms

3.06 As indicated in para. 1.16, the proposed industrial sector adjustment program is set in the context of Kenya's structural adjustment and stabilization program. This has been spelt out in the Policy Framework Paper of January 7, 1988 (SecM88-27), covering a three-year period ending June 1990, which was considered by the Executive Directors meeting as a Committee of the Whole on January 26, 1988 and later approved by the IMF's Executive Board. Under the Fund's SAF and the accompanying standby arrangement, the agreed fiscal, monetary and external reserve targets for 1987/88 would represent a substantial adjustment effort. Bank staff have participated in the discussions with the Government of Kenya on the Policy Framework Paper and will participate in the development of the second one-year action program. Fund staff reviews of the program are to be completed by June 30, 1988 and December 31, 1988. They will assess balance of payments financing, exchange rate, import liberalization and fiscal and monetary policies (including interest rates), and evaluate progress under the agreed benchmarks. The June review will also set the performance criteria for the remaining two years of the SAF.

3.07 The proposed Credit is the first in a series of industrial and financial sector operations, and will provide the foundation for Kenya's medium-term adjustment program outlined in the Government's Letter of Industrial Policy (ANNEX IX) and summarized in its Reform Program policy matrix (ANNEX X). The program directly addresses the most troublesome issues facing Kenya's industrial sector--stagnant investment and exports. Their revival is essential to revitalizing the sector and enabling it to fulfill its otherwise high potential. The reform package has two parts: the first, which includes trade liberalization and tariff reform, is intended to improve the efficiency of the sector and reduce its anti-export bias. Imported inputs for production will be more freely available and greater competition encouraged. The second, which includes price decontrol, tax reform, divestiture of industrial public enterprises, capital and financial market reforms, and easier access to duty free inputs and manufacturing-in-bond (MIB) facilities for exporters, would improve the incentives and environment for investment and exports. The reforms related to investment and export promotion are expected to boost new investment while trade reform will be slower, but surefooted and meaningful. Taken together, they represent a substantial move towards structural adjustment.

Trade Regime

3.08 Import Licensing. The present system of import licensing was developed during the SALs. The Government uses the import licensing system to close the gap between the demand for imports and availability of foreign exchange and to protect domestic production. Imports are currently categorized into four schedules (Table 1). Schedules IA and IB contain mainly raw materials, intermediate capital and non-competing final goods, with Schedule IA imports intended to be without restrictions and Schedule IB licenses issued on an individual item basis. Schedule IIA includes bulk imports such as grains, fertilizer, petroleum and other items that require ministerial approval by law for importation. Schedule IIB contains items that compete with domestic goods, luxury goods and other products controlled for health or safety reasons. This schedule is the most restricted, with licenses issued on an item-by-item basis.

Table 1: PRESENT IMPORT SCHEDULES

	FY84				FY87			
	Items		Imports		Items		Imports	
Schedule	No.	%	KSh Bil.	%	No.	%	KSh Bil.	%
IA	803	29.5	5.9	30.8	1121	40.6	15.3	51.0
IB	961	35.3	3.2	17.0	667	24.2	3.3	11.0
IIA	92	3.4	8.7	45.7	109	3.9	9.3	31.0
IIB	864	31.8	1.2	6.5	863	31.3	2.1	7.0
Totals	2720	100.0	19.0	100.0	2760	100.0	30.0	100.0

3.09 Under SAL II, the Government agreed to a four-year plan for progressively shifting items to the unrestricted list; however, the Government's policy letter noted that the actual pace of implementation would depend on the availability of foreign exchange. Indeed, the import liberalization timetable was disrupted by inadequate availability of foreign exchange in 1982/83, following which the Government re-restricted some items that had been liberalized. The Government then agreed on revised import management arrangements (but not including a medium-term timetable) with the Bank and Fund. Progress was renewed in June 1985, when about 320 items were shifted to Schedule IA, making the system slightly more liberal than that prevailing immediately prior to the SAL II program. In 1986, the Government did not make any further shifts, but instead administered Schedule IB in a liberal manner. In 1987, foreign exchange reserves dwindled but excess liquidity kept the demand for imports high. Since the Government neither moved more aggressively on the exchange rate, nor used monetary policies to absorb liquidity and curb the demand for imports, it resorted to restricting imports of items on Schedules IA and IB. This back-tracking on import liberalization also created uncertainty in the business community because of delays and rejections in obtaining licenses that were readily available before. Applicants then began to submit multiple licenses to increase the probability of success.

3.10 The Government decided recently to rationalize the current import licensing schedules to avoid similar problems in the future (Table 2). Schedule I will consist solely of raw materials, intermediates and capital goods similar to the present Schedule IA; Schedule II will be similar to the current Schedule IIA, consisting of bulk import items requiring ministerial approval; and Schedule III will have all the remaining items. Schedule III will be subdivided into 3 categories: IIIA, with high priority items insufficiently available in the domestic market; IIIB, with items competing with domestic production that have lower tariff protection than category IIIC; and IIIC, containing other competitive goods, luxury goods and items restricted for reasons of public health and safety. The reorganized schedules are intended to keep Schedules I and II inviolate and thus reduce uncertainty in the business community. The Government will issue licenses for items in Schedules I, II and category A of Schedule III expeditiously and without restriction from June 1988. A comparison of Tables 1 and 2 shows that the rationalization will result in a slightly larger percentage of items and imports licensed without restrictions: the percentage of items will rise from 45 to 60 percent and the value of imports will increase from 82 to 88 percent.

Table 2: PROPOSED IMPORT SCHEDULES /a

	Items		Imports		Tariffs	
Schedule	No.	%	KSh Bil.	%	Unweighted	Weighted
I	901	32.6	11.7	43.2	26.9	25.9
II	199	7.2	9.8	36.2	14.9	13.9
IIIA	548	19.9	2.3	8.6	37.2	33.8
IIIB	462	16.7	1.9	7.1	45.1	40.5
IIIC	651	23.6	1.3	4.9	59.5	47.8
Total	2761	100.0	27.0	100.0	38.8	24.3

a/ Import data used are for FY87. 1987 data for Tables 1 and 2 differ because of unclassified items.

3.11 In the current macroeconomic situation, the Government is concerned about moving too far and too fast on liberalization. Under the SAF it has agreed to a significant devaluation of the real exchange rate, decreasing the budget deficit by about half in one year and limiting monetary growth. Nonetheless, there may be continued excess demand for imports that could endanger its prudent management of external reserves and debt. However, the Government is committed to achieving full liberalization, except for a few items restricted for reasons of security and health, by June 1991. Items in category B of Schedule III will be licensed unrestrictively by June 1989 and those in category C of Schedule

III completely liberalized during the ISAC II period. In order to facilitate this process the Government will undertake a study to (i) design an implementation program which will provide domestic industry with equivalent protection by tariffs only; and (ii) draft appropriate anti-dumping legislation. The second phase of the study will prepare action programs for restructuring companies severely affected by liberalization. It is anticipated that these companies will face import competition during ISAC II when Schedule IIIC is unrestrictively licensed.

3.12 By June 1989, when the second tranche of this credit is due to be released, 76 percent of items and 95 percent of imports (1987) will be licensed without restriction. At that point the import system will be somewhat more liberal than under SAL II, had that program been completed. About 26 percent of all items produced in Kenya will be exposed to unrestricted import competition although, because of data limitations, it is not possible to estimate the proportion of domestic value added they constitute. Liberalization of all items in Schedules I and II and categories A and B of Schedule III by June 1989 will have a significant impact on the balance of payments and tariff revenue. It is estimated that imports will increase by about 3 percent in 1988 (16 percent of the current account deficit) and about 8 percent in 1989 (68 percent of the current account deficit). Because of the increase in imports, it is estimated there will be an increase in tariff revenue during 1988-89.

3.13 Tariffs. The unweighted average tariff in Kenya is 39 percent and the weighted average 24 percent. These rates are not excessive but, because of the cascading structure of tariffs and the variability of tariffs on final goods, the average effective protection was a high 90 percent for the sector in 1985. Although the range for individual activities is wide (-167 to 1019 percent), effective protection ranged between 0 and 80 percent for over 60 percent of the value added covered by the Bank's industrial sector survey. While these high and uneven levels of protection shield inefficient activities, they also allow efficient activities, which constitute most of the sector, to be highly profitable at the expense of the consumer. Thus, the objective of lowering and evening protection is important not only for improving efficiency, but perhaps more importantly, for shifting the balance of incentives between production for the domestic market and exports. The Government is committed to lowering and evening out effective protection for the sector. In three budgets in the past four years, it rationalized some tariffs and lowered the average rate by about 8 percent. While lowering protection is the ultimate objective, the major reforms will be implemented in the second and third phases of the adjustment program (1990-1993) to accommodate lifting quantitative restrictions on imports first. However, in the June 1988 and June 1989 budgets, the Government will (i) further rationalize tariffs such that similar goods bear similar tariffs; (ii) reduce the number of tariff levels from 25 to 12, mainly by eliminating tariffs at the high end; and (iii) review specific duties with a view to converting them into ad valorem rates.

3.14 Exports. As noted in para. 1.05 above, Kenya's export performance has been disappointing. The high protection given to industry by tariffs and quantitative restrictions have made production for the domestic market more profitable than for exports, while tariffs paid on inputs for export production make Kenya's exports expensive in world markets. In addition, the past overvaluation of Kenya's currency further eroded the competitiveness of Kenyan exports. The Government implemented its primary policy initiative to counterbalance the anti-export bias in 1974 with the passage of the Export Compensation Act. The Export Compensation Scheme (ECS) is supposed to compensate for duties paid on imported inputs and any unrefunded indirect taxes, but does not counterbalance either domestic protection or exchange rate overvaluation. The scheme has been in place for over 10 years but its effectiveness has been marred by frequent changes and administrative delays. The current compensation rate is 20 percent of export value and applies to a list of 600 eligible products. The ECS has failed to encourage exports. Indeed, only about 40 companies have regularly taken advantage of it and the lion's share of compensation has gone to two firms. Thus, a reform of the ECS is necessary to ensure that exporters have, at minimum, access to duty and tax free inputs. The Government will announce by June 1989 a simple Import Duty Compensation Scheme to replace ECS with three rates reflecting duties actually paid and a wider coverage. The new scheme will be implemented with improved administration guaranteeing reimbursement within one month of exporting. The Government will issue by June 1988, guidelines and procedures for MIB that assure access to foreign exchange within one week of application. The Government will also undertake a study to review the adequacy of incentives for exporters. Based on this study and a review of the performance of MIB, additional incentives may be introduced in June 1989. The Government will also design and start implementing by June 1989 a comprehensive medium-term export promotion program that includes financing and information support to potential exporters. Furthermore, the Government is committed to establishing an export processing zone (EPZ) with bilateral assistance. Donor response to the Government's request for funds has been positive and construction of the EPZ is expected to begin no later than June 1989.

3.15 Price Controls. Prices for a wide range of manufactured products are controlled under the Price Control Act (1956) and its subsequent revisions. The Special Order of the Act applies to about 11 individual consumer items, mainly basic foods and beverages, with the objective of protecting the purchasing power of low income groups. The General Order was originally intended to prevent monopolistic exploitation but now applies to ex-factory prices of 40 manufactured products spread across the sector. Producers submit cost functions when they begin production of new products, and can apply for subsequent revisions only for input price changes, not for improvements in efficiency or changes in the cost structure. In addition, many firms encounter considerable delays (as much as 10 months) in securing price revisions, thus wreaking havoc with corporate planning, profitability, and eventually, investment and employment. In practice the Government enforces these regulations primarily for large manufacturers. Price controls usually do not benefit the consumer; instead they discriminate in favor of traders and against producers, thereby discouraging new investment. The Government is aware of the shortcomings inherent in its attempts to control prices and has taken important steps in decontrolling some prices, including some basic consumer items such as meat. It has also drafted new legislation to monitor monopoly producers and unfair trade practices in restraint of trade as a means of controlling market concentration rather than using price controls. The new legislation, however, defines monopoly too broadly and still provides rather sweeping powers to the Price Controller. Moreover, many of the items covered at present under the General Order are included in the import schedules to be liberalized. Thus, under unrestricted licensing, they would meet sufficient competition from imported goods to ensure fair pricing. Many other items also encounter substantial domestic competition making their price controls redundant.

3.16 The pace of price decontrol will be enhanced under the industrial sector program. As a first step, the Government will decontrol 10 products from the General Price Order by June 1988, and a further 10 by December 1988. Furthermore, the Government proposes to move an amendment to the Restrictive Trade Practices, Monopolies and Price Control Bill which is now before Parliament, and will be enacted by December 1988, to (i) redefine monopoly such that it reflects market power; and (ii) limit the powers of the Price Controller to only items produced under monopoly conditions or traded restrictively as defined in the Bill. All controlled items which will not fall under the new Act will be gradually decontrolled during the second phase of the industrial adjustment program (1990-1991). The Government has agreed to process applications for price revisions of items that will continue to be price controlled, and conform with the Determination of Costs Order, within 90 days.

Investment Incentives

3.17 In addition to the dearth of incentives for manufactured exports, Kenya offers little in the way of incentives for investment in general. Significant disincentives to new investment include: (i) administrative bottlenecks in establishing a business in Kenya; (ii) relatively high effective rates of corporate taxation; and (iii) certain provisions of the Foreign Investment Protection Act (FIPA) and other restrictions on the activities of non-resident companies.

3.18 In the past, the long list of approvals and clearances required to set up a business in Kenya has deterred many investors. The approval and renewal of work permits for expatriate staff has been a particularly sensitive issue. Long delays are common and the grounds for rejecting applications are unclear. The Government will by June 1988 streamline the approval procedures by (i) issuing investment guidelines that detail all the policies and procedures affecting investors; (ii) establishing an interministerial one-stop office in the Investment Promotion Center (IPC), which will be adequately staffed to minimize delays in processing investment applications; and (iii) issuing guidelines that clarify the criteria for issuance and renewal of work permits.

3.19 Marginal effective rates of corporate taxation appear to be higher in Kenya than in several other African and Asian countries. This difference arises because of higher statutory rates (particularly for non-resident branch operations), slower depreciation rates, lower initial allowances for new investment and the double taxation of dividends. In addition, firms borrowing long term in foreign currency for imported capital goods cannot deduct exchange losses for tax purposes. Recent changes in the tax code have generally increased effective rates of corporate taxation. The Government will by June 1988 complete a study of comparative marginal effective company tax rates and will make appropriate changes to reduce the rate in Kenya. It will also allow, by the same date, companies to treat realized exchange losses on foreign currency loans used to purchase fixed assets as deductible expenses for tax purposes.

3.20 Foreign firms operating in Kenya face constraints in repatriating the sales proceeds of their investments and borrowing locally. The present version of FIPA denominates a company's equity investment in Kenyan shillings, and reinvested profits or capital gains are not recognized as part of the equity to be remitted on sale. Moreover, while companies may remit equity immediately, the capital gains must sit in a blocked account earning 2-3 percent interest for five years, and then remain subject to Central Bank approval for transfer out of Kenya. The Government will amend FIPA by June 1988 to enable investors to remit the foreign exchange equivalent of their investment and to provide commercial returns on funds left in blocked accounts.

Public Enterprises

3.21 Kenyan public enterprises, which include manufacturing, agricultural marketing and other public service enterprises, have played a significant role in the Kenyan economy since Independence, accounting for 8 percent of GDP and 15 percent of "modern" employment in 1984. In the industrial sector, where the private sector is the dominant and dynamic force, the Government has investments in 86 enterprises, either through direct ownership or indirectly through the development finance institutions (DFIs). It has majority holdings in 25 of these 86 firms, representing 68 percent of its total investment of KSh 1.4 billion (US$82 million). The performance of these enterprises has been disappointing because of poor investment choices, inadequate management and a changing competitive and economic environment. By 1986, 16 had negative net worth, another 16 had accumulated net losses, and several others faced an uncertain future. Several subsectors, such as textiles, fibers and food and beverages show accumulated losses for the subsector as a whole. Neither the Government nor the DFIs have the capability or the financial resources to resuscitate the troubled enterprises. At the same time, the DFIs have been reluctant to divest their more successful holdings as the dividend stream from these companies is vital for paying salaries and keeping the failing companies afloat. As a result, the financial condition of the DFIs is deteriorating and their competitive position relative to other financial institutions is declining. Unable to extricate themselves from past investment decisions and hampered in their ability to attract new investments, the DFIs are largely stagnant.

3.22 The Government's efforts to improve parastatal performance have focussed on two areas: in the short run, improving supervision of public enterprises, and in the longer term, devising a plan for restructuring and divesting parastatals. The first area has seen more tangible progress than the second. In the area of supervision, Government has (i) reduced direct budgetary transfers to parastatals and established more stringent budgeting and evaluation procedures; (ii) created the office of the Auditor General, Corporations, subjecting all parastatals to an annual independent audit; and (iii) enacted the State Corporations Act, which emphasizes stricter supervision and greater accountability for parastatals.

Nonetheless, supervision of industrial parastatals remains diffused across several Ministries and agencies. In addition, institutional capabilities are limited (particularly in the Ministry of Industry) and the tenor of the State Corporations Act could induce less, rather than more autonomy in decision making, because of its emphasis on <u>ex-ante</u> controls rather than <u>ex-post</u> performance evaluation.

3.23 In the area of divestiture, The Sessional Paper No. 1 of 1986 indicated that Government would retain only those enterprises which offered administrative, public and social services not provided by the private sector. By and large, the industrial public enterprises (IPEs) do not fall into any of these categories. In 1983, the Government established a Task Force on Divestiture, which worked for more than two years and produced a preliminary classification of public enterprises, into those to be retained and those to be divested, analyses of specific subsectors, and a discussion of various mechanisms for divestiture. As in many other countries, Kenya has moved slowly on divestiture to date, handling enterprises on a case-by-case basis. Some progress has been made recently, including the sale of a major food processing firm and the sale of 6 equity holdings by one of the DFIs. In addition, Government recently announced its intention to sell shares in the two largest Government-owned commercial banks.

3.24 The IDA Credit will finance studies to support the restructuring of the DFIs and their portfolios. The consultants will assist the Government in redefining the appropriate roles and structures of the DFIs, and make recommendations for their transformation and for dealing with their portfolios. The Government has also agreed to make the Task Force reports available to IDA and the consultants for this exercise. An action program for DFI restructuring and divestiture of industrial public enterprises will be prepared, agreed, and announced by December 1988. The Government will agree with IDA and commence implementation of the action programs before June 1989. For enterprises to be retained in the public sector, the Government will prepare and implement a monitoring and supervisory system by December 1988.

<u>Financial Sector</u>

3.25 Kenya's financial system, although well developed for a country of Kenya's per capita income level, suffers from some inefficiencies, both in institutional as well as policy aspects. In 1986, two small banks and four NBFIs suspended operations because of inadequate capital and inappropriate lending practices. Subsequently, the Government has amended the Banking Act to strengthen banking supervision and the Central Bank is taking steps to improve its capabilities in this area. The Government is also moving towards greater reliance on market forces in allocating financial resources, through tendering of government paper and introducing other monetary policy instruments. Restrictions on interest rates still exist, however, as do quantitative limits on credit. The Government intends to allow increased market determination of interest rates and has reduced controls on lending spreads. The stock market in Kenya remains relatively inactive, although the success of two offerings in the last few years demonstrated that significant demand exists for such securities. Further development of capital markets is constrained by the controls of the Capital Issues Committee (CIC). The CIC, established in 1971 to regulate, among other responsibilities, the size, timing and pricing of issues, has been a major deterrent to firms tapping the equity market. At the same time, however, no institution exists to act on policies related to the development and regulation of capital markets. In addition, certain tax provisions and regulations over holdings of institutional investors (particularly insurance companies) and other legislation (disclosure, restrictive admission to the Stock Exchange, etc.) are disincentives for using the capital market.

3.26 The Government, as set out in its Policy Framework Paper, will take several steps to strengthen its money and capital markets to provide more flexibility in financial sector policies and support the divestiture of industrial public enterprises. The Government has begun to issue longer term Treasury Bonds and improve the system for their auctioning. It will establish a discount facility at the Central Bank by June 1988 to facilitate open market operations and the development of a secondary market. These measures will also introduce greater flexibility in the interest rate structure. As a first step, the Government will establish a Capital Markets Development Authority (CMDA) by June 1989 and strip the CIC of its power over timing and pricing of issues of domestically-owned firms, with the ultimate objective of moving toward market-determined prices for all equities. The proposed Financial Sector Operation will assist the Government in carrying this process further.

Conclusions

3.27 The preceding policy package, based on thorough sector work, covers many aspects of the industrial sector. It will immediately establish a much-improved environment for investment and exports to elicit a quick supply response. The program includes the decontrol of prices, lower taxation, streamlining procedures and regulations for investment, divestiture of industrial public enterprises, and easier access to duty free inputs and manufacturing-in-bond facilities for exporters. At the same time, the Government will liberalize the trade regime and reform the tariff structure. These policy changes constitute important steps in improving the sector's efficiency and will also reduce the anti-export bias of the present incentive structure. This program will provide the crucial first steps in this process. Bank staff consider the pace to be prudent, enabling investors to respond to the new incentives and adjust to import competition while allowing the Government to develop alternative policy instruments for external balance. Thus, the total reform package represents a serious and practical program for industrial structural adjustment.

PART IV - THE PROPOSED CREDITS

Background and Rationale for IDA Involvement

4.01 In 1986, Government opened discussions with the Bank on the need for adjustment in the industrial sector. The main elements of the adjustment program, as summarized in Part III, emerged as part of extensive sector work done in 1986. Detailed discussions of the Bank's sector report

(Kenya: Industrial Sector Policies for Investment and Export Growth) began in May 1987, and continued through August 1987 with an inter-ministerial committee representing the Ministries of Finance, Commerce, Industry and Planning and the Office of the President as well as the Central Bank. The proposed Credit was preappraised in October 1987 and appraised in January 1988. Negotiations were held in Washington in April 1988. The Kenyan delegation was led by Professor G. Saitoti, Minister of Finance. Supplementary data on the Credit is presented in ANNEX VIII.

4.02 With the support of the Bank Group and the IMF, Kenya has started to implement the macroeconomic reforms necessary to stabilize the economy and prepare for resumed growth. At the same time, it has begun to implement significant sectoral adjustment programs in agriculture and industry. The benefits of policy reform, however, will not appear overnight; consequently, Kenya will continue to depend on larger net external inflows of resources. Its already high debt-service ratio dictates that new external finance be on concessional terms.

4.03 The policy package described in Part III and in Government's Letter of Industrial Policy (ANNEX IX) directly addresses the most troublesome issues facing Kenya's industrial sector: stagnant investment and exports. Their revival is essential to revitalizing the sector and enabling it to fulfill its otherwise high potential. The liberalization of the trade regime and tariff reforms will help reduce the anti-export bias of industry and improve efficiency. The proposed program, including the decontrol of prices, lower taxation, streamlined procedures and regulations for investment, divestiture of industrial public enterprises and easier access to duty free inputs for exporters, represents a break from the Government's past policies. The timing of implementation and a brief description of proposed reforms in each of the main policy areas are presented in the matrix in ANNEX X.

Credit Description

4.04 The Bank Group would support this adjustment program with an IDA Credit of SDR 73.6 million (US$102 million equivalent) and an African Facility Credit of SDR 7.2 million (US$10 million equivalent). The borrower would be the Government of Kenya, with the Ministry of Finance as the implementing agency. In addition, several bilateral and multilateral donors (Japan, United Kingdom, European Investment Bank and African Development Bank) will cofinance the program, with total cofinancing over the two-year period amounting to about US$90 million equivalent.

Financing Plan

4.05 Kenya's gross external financial requirements during 1988-90, consisting of the current account deficit, debt amortization and necessary buildup in reserves, are expected to be US$2,807 million. Disbursements from past grant and loan commitments are expected to be US$609 million. Normal grant and loan disbursements from bilateral and non-World Bank multilateral sources are projected to increase by 4 percent annually. Adding the planned World Bank lending program, IMF stand-by and SAF arrangements still leaves a financing gap of US$143 million for 1989-90. The Government's medium-term adjustment program includes a substantial reduction in the budgetary and current account deficits by 1990 (para. 1.16). This adjustment effort, however, needs to be supported by increased foreign assistance, to finance the additional imports implied by the trade liberalization reforms (para. 3.12), the current account deficit, rebuilding reserves, and the net transfer of resources to the IMF. Quick-disbursing assistance is necessary for this operation because of the limited capacity to absorb additional project aid and the need to ensure that trade liberalization is not postponed due to a foreign exchange shortage. The ISAC and its likely cofinancing, together with the second tranche of the Agriculture Adjustment Operation, would eliminate the financing gap in 1988 and leave small gaps in 1989 and 1990. The Government will attempt to fill this gap by mobilizing additional concessional, quick-disbursing finance from bilateral sources. Given Kenya's high debt-service ratio, the Government has rightly decided to limit its borrowing from commercial sources. To the extent that financing gaps are not closed, the Government would have little option other than to adopt tighter demand management policies and delay import liberalization measures, thereby yielding slower growth, and possibly stagnation of per capita income and consumption. The ISAC and its likely cofinancing will thus play a key role in support of Kenya's adjustment efforts.

Table 3: EXTERNAL FINANCING
(US$ millions)

	1988	1989	1990
Total Financing Requirements	976	968	863
Disbursements from Existing Commitments	279	203	127
Disbursements from Expected New Commitments	697	688	670
Of which: ISAC	(62)	(50)	---
Total Identified Financing	976	891	797
Financing Gap	---	77	66

Disbursement and Procurement

4.06 The proposed Credits would finance the foreign exchange cost of imported goods, using a negative list. The items not to be financed include goods financed by other sources and a specific list of excluded items, such as military or para-military items and luxury goods such as tobacco, precious stones, etc. Disbursements from the Credit account would be made against 100 percent of the foreign cost of eligible imports. The Credits would also refinance the Project Preparation Facility and finance technical assistance for studies on the costs of adjustment, taxation, export incentives and promotion, and the restructuring of development banks (ANNEX XI). The IDA Credit will be disbursed in two tranches: the first SDR 37.5 million (US$52 million equivalent, including

US$1 million for technical assistance) would be available upon Credit effectiveness and the remaining SDR 32.1 million (US$50 million equivalent) would be made available about 9-12 months later. The African Facility Credit will be disbursed with the first tranche. Disbursement of the second tranche would be conditioned upon satisfactory implementation of the actions described (ANNEX VIII) in the legal documents and general progress under the program. The Credits are expected to be fully disbursed within 18 months of effectiveness. The Closing date will be March 31, 1990. During this period, ISAC disbursements are projected to be equivalent to 3.7 percent of import payments, 39 percent of the current account deficit and 2.9 percent of Central Government expenditures. Local currency funds generated by the sale of foreign exchange provided by the credit would not be earmarked for specific purposes, but rather, would be available without restriction for use in the Government's budget. However, the Government has given assurances that these funds will be used only for its development budget.

4.07 Disbursements for contracts procured through international competitive bidding (ICB) would be made against fully documented withdrawal applications. Disbursements for other items would be made on the basis of statements of expenditures (SOE) detailing individual transactions in a given period, together with certification of payment of the amounts involved and of their eligibility under the Credits. The Ministry of Finance would retain supporting documentation for SOEs until at least 12 months after the closing of the Credit accounts and make it available for review to IDA supervision missions. In order to accelerate disbursements, a special account with an authorized allocation of US$20 million (corresponding to about four months' payments expected to be made through the special account) would be established in dollars at the Central Bank of Kenya. Replenishments would be made monthly or when half of the initial deposit has been utilized.

4.08 Procurement of imports would be made following regular commercial practices using not less than three quotations from suppliers or manufacturers whenever possible, except when any one contract, for either public or private sector imports, exceeds US$3.5 million, in which case, ICB would be used and subjected to prior review by the Bank in accordance with World Bank guidelines.

Audits, Reporting and Monitoring

4.09 The Ministry of Finance and the Central Bank would maintain records of all transactions under the Credits in accordance with sound accounting practices. Not later than six months after the end of each fiscal year of the Borrower, all accounts, including the Special Account, would be audited by independent auditors acceptable to IDA, and submitted to the Association. Audit reports would include a separate opinion with regard to the claims submitted to IDA on the basis of SOEs and would state whether such claims have been effected in accordance with the Credit Agreements.

4.10 Monitoring will cover both the progress made in implementing the specific reforms under the proposed Credits as well as regular assessments of the adequacy of the macroeconomic policy framework. The Ministry of

Finance, as the implementing agency, will provide semiannual reports focusing on trends in import and export volume and composition, changes in tariff levels, prices and exchange rate, balance of payments position, trends in money supply and credit, and actions taken in reference to public enterprises, investment incentives and export promotion. In addition to regular review missions during Credit implementation, IDA staff will coordinate with the IMF to ensure adequate monitoring of key economic policies and indicators.

Impact of the Program

4.11 Benefits. Over the medium term, the reforms anticipated under the proposed Credits will encourage a reorientation of the Kenyan economy toward increased and more diversified exports of manufactured goods and should help boost overall levels of investment in the industrial sector. These reforms would also increase employment opportunities in the industrial sector and would help soften the blows incurred from sharp changes in the terms of trade. Moreover, the introduction of new financial policy instruments and weaning Government from using import restrictions in times of constrained foreign exchange resources will provide greater flexibility and improve the effectiveness of overall macroeconomic management. The trade liberalization measures will help improve efficiency in the sector, while the restructuring of the DFIs and their portfolios will facilitate better utilization of public resources. Lower corporate tax and tariff rates will reduce Government revenues, but will largely be offset by increased revenues from a larger volume of imports.

4.12 Social Costs. Nonetheless, it is anticipated that the reform program will incur some real transitional costs, as a result of the removal of price controls and as inefficient enterprises are closed or restructured. These transitional costs, however, are expected to be small. Although price controls will be removed during the first phase of the adjustment program, the impact on prices is expected to be limited for several reasons. First, recent experience with the decontrol of meat prices in Kenya suggests that the supply response combined with consumer resistance can effectively limit the extent of price increases. Second, decontrol of prices for manufactured goods is not expected to adversely affect consumers since competing imports will be more readily available. Third, in a number of instances, controlled items encounter substantial domestic competition which will help reduce the scope for raising prices. Fourth, price decontrol can also be expected to encourage investment and increased capacity utilization, which will both generate additional employment and dampen price increases. Although the costs associated with price decontrol are expected to be small and shortlived, the Bank will regularly review the impact on prices and consumers as part of its ongoing economic and sector work and the monitoring of the adjustment program.

4.13 The trade liberalization component of the program is also expected to affect inefficient industries, especially in the second phase as competition from imports increases. Much of Kenya's current industrial sector, however, is sufficiently efficient to respond to gradual trade liberalization through modest improvements in efficiency rather than widespread plant closings and layoffs. The loss of jobs will be minimized by introducing incentives for new investment prior to the lowering of protection. Although the additional jobs necessary to absorb Kenya's rapidly expanding labor force will need to come mainly from agriculture, rural non-farm activities, and the informal sector, a more efficient industrial sector will make an important contribution through its strong backward and forward linkages with these sectors. As part of planned work on the social dimensions of adjustment, the Bank will review the impact of adjustment measures in Kenya and, where appropriate, support Government efforts to reduce transitional costs that may arise.

Risks

4.14 The risks associated with the proposed Credits relate to the overall macroeconomic framework, the Government's commitment to the program, and its capability to implement it. First, macroeconomic stability may be elusive, particularly in the face of unforeseen external events or internal pressures. Second, although the Government backs the proposed program, some officials and politicians remain skeptical, particularly in light of the failure of similar programs in other African countries. Finally, weak administrative capabilities in Kenya could slow the implementation of the program. Several steps have been taken in the preparation and design of this program to mitigate these risks. IDA staff have worked closely with officials in the Ministry of Finance and elsewhere in Government to ensure solid commitment to and understanding of all elements of the program. The studies supported by the IDA Credit will also provide direct assistance to the Government in implementing key components of the program. Finally, the intensive collaboration between the Government, IDA and the IMF which has brought the proposed Credit to its present status will be maintained in order to ensure its successful implementation.

PART V - RECOMMENDATION

I am satisfied that the proposed IDA Credit and African Facility Credit would comply with the Articles of Agreement of the Association and with Resolution No. IDA 85-1 adopted on May 21, 1985 by the Executive Directors of the Association. I therefore recommend that the Executive Directors approve the proposed Development Credit and African Facility Credit.

Barber B. Conable
President

Attachments
Washington, D. C.
May 24, 1988

ANNEX I

KENYA - ECONOMIC INDICATORS

	ACTUAL			EST.	PROJECTION				
	1984	1985	1986	1987	1988	1989	1990	1991	1995
GDP (at n.p.) Growth Rate	2.3	3.7	6.5	5.1	4.8	5.1	5.4	5.1	5.1
GNP Growth Rate	2.0	3.6	6.5	5.2	4.8	5.7	5.6	5.3	5.3
GNP/Capita Growth Rate	-1.7	0.0	2.4	1.4	1.0	1.9	1.7	1.5	1.5
Consumption/Capita Growth Rate	2.5	3.8	1.3	6.8	-1.8	1.0	1.6	1.4	1.6
Total DOD (US$ millions) a/	3444	3838	4114	4203	4505	4768	4942	5135	5967
DOD/XGS/a/	206.3	240.4	217.9	243.1	247.9	239.4	233.5	226.2	201.7
DOD/GDP a/	58.8	65.6	59.4	54.6	52.9	50.5	49.8	48.7	44.0
Debt Service (US$ millions) b/	581	629	711	679	647	666	637	590	612
Debt Service/XGS b/	34.8	39.4	37.7	39.3	35.6	33.4	30.1	26.0	20.7
Debt Service/GDP b/	9.9	10.7	10.3	8.8	7.6	7.1	6.4	5.6	4.5
Gross Investment/GDP	21.0	21.8	25.7	23.7	24.2	23.9	23.8	24.0	23.9
Domestic Savings/GDP	19.6	20.7	25.1	18.3	20.5	21.0	21.5	21.7	21.5
National Savings/GDP c/	16.8	17.9	22.2	15.6	17.9	18.9	19.7	19.9	20.3
Marginal National Savings Rate	5.1	28.6	54.1	-10.4	67.6	35.1	32.5	21.3	20.9
Public Investment/GDP d/	8.0	7.1	9.0	9.0	8.2	7.6	7.0	7.0	7.0
Government Savings/GDP	-1.6	-0.8	-0.1	0.3	0.8	1.0	0.8	1.0	1.5
Private Investment/GDP d/	9.5	11.8	12.6	13.2	13.3	13.1	12.7	12.8	13.5
Private Savings/GDP e/	18.4	18.7	23.1	15.3	17.1	17.9	18.9	18.9	18.8
Public/Private/Investment d/	84.2	60.7	71.2	68.2	61.7	58.0	55.1	54.7	51.9
Government Revenue/GDP f/	23.0	22.7	23.3	23.7	24.2	24.8	25.0	25.0	24.5
Grants/GDP	0.7	1.7	1.1	2.4	2.9	2.7	2.6	2.5	2.0
Government Expenditures/GDP	27.6	30.6	30.6	33.4	31.3	31.3	30.9	30.0	27.5
Budget Deficit/GDP f/ g/	3.9	5.3	5.6	8.1	4.2	3.8	3.4	2.5	1.5
Exports Growth Rate	1.9	5.9	10.2	-2.7	0.9	3.5	2.9	3.6	4.0
Exports/GDP	27.7	26.5	26.7	22.0	21.1	20.8	21.0	21.2	21.4
Imports Growth Rate h/	17.9	-6.2	17.3	-3.5	0.8	4.8	2.6	5.0	4.7
Imports/GDP h/	29.2	27.6	27.3	27.3	24.8	23.7	23.3	23.5	23.9
Current Account Balance, including official transfers (US$ millions) i/	-120	-93	-88	-403	-302	-226	-143	-158	-152
As % of GDP	-2.0	-1.6	-1.3	-5.2	-3.5	-2.4	-1.4	-1.5	-1.1
Current Account Balance, excluding official transfers (US$ millions) j/	-236	-203	-237	-608	-525	-459	-384	-412	-460
As % of GDP	-4.0	-3.5	-3.4	-7.9	-6.2	-4.9	-3.9	-3.9	-3.4
Terms of Trade Index (1986=100)	106.3	88.6	100.0	74.3	78.5	82.8	86.8	89.1	93.7

a/ Including public debt, IMF credit, financing gap and estimated non-guaranteed private debt.
b/ Including public debt service, obligation and charge to IMF, debt service for financing gap and estimated non-guaranteed private debt service.
c/ Excluding official transfers.
d/ Gross fixed investment; excludes changes in stocks.
e/ Implicitly includes parastatal savings, for which separate data are not available.
f/ Year ending June 30.
g/ Including cash adjustments.
h/ Refers to goods and non-factor services. Special imports are excluded in 1987 and 1988.
i/ Counting official transfers "above the line" as an item contributing to the determination of the current account deficit.
j/ Counting official transfers "below the line" as an item contributing to the financing of the current account deficit.

KENYA - NATIONAL ACCOUNTS

1986 Per Capita GNP in US$: 300
Mid-1986 Population (Mill): 21.0

A. National Accounts Indicators as Shares of GDP (%):

	Historical shares of GDP (in Current Prices)							Prelim.	Projected shares of GDP (in Constant 1986 Prices)			
	1965	1973	1980	1982	1984	1985	1986	1987	1988	1989	1990	1995
Gross Domestic Product m.p.	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Net Indirect Taxes	8.1	10.1	15.1	13.7	14.0	13.0	13.9	13.8	13.8	13.8	13.8	13.8
Agriculture	32.4	31.9	27.5	28.2	27.3	26.5	25.6	25.4	25.4	25.2	24.9	23.4
Industry	16.7	18.6	18.8	18.0	17.7	18.1	17.3	17.3	17.3	17.3	17.3	17.9
(of which Manufacturing)	10.5	10.8	11.2	10.9	10.9	10.8	10.3	10.2	10.2	10.2	10.2	10.7
Services	42.8	39.4	38.6	40.1	41.0	42.4	43.2	43.5	43.6	43.7	44.0	44.9
Resource Balance	0.7	-1.3	-11.4	-4.6	-1.5	-1.1	-0.5	-2.7	-1.1	-0.5	-0.4	-1.4
Exports of GNFS	31.4	27.4	28.6	24.8	27.7	26.5	26.7	24.8	23.9	23.5	22.9	21.7
Imports of GNFS	30.7	28.7	40.0	29.5	29.2	27.6	27.3	27.5	24.9	24.0	23.4	23.0
Total Expenditures	99.3	101.3	111.4	104.6	101.5	101.1	100.5	102.7	101.1	100.5	100.4	101.4
Total Consumption	84.9	75.5	81.4	82.2	80.4	79.3	74.9	79.0	76.9	76.6	76.6	77.5
Private Consumption	70.1	59.0	61.1	63.2	62.0	60.9	55.5	59.7	60.1	60.7	61.7	66.3
General Government	14.8	16.5	20.3	19.0	18.4	18.4	19.4	19.3	16.7	15.9	15.0	11.2
Gross Domestic Investment	14.4	25.8	30.0	22.4	21.0	21.8	25.7	23.7	24.2	23.9	23.8	23.9
Fixed Investment	12.8	20.4	23.6	19.6	17.5	18.9	21.6	20.0	21.2	21.4	21.6	22.0
Changes in Stocks	1.6	5.4	6.3	2.8	3.6	2.9	4.1	3.7	3.0	2.5	2.2	1.9
Capacity to Import	---	---	---	---	---	---	26.7	22.1	21.2	21.1	21.1	20.6
Terms of Trade Adjustment	---	---	---	---	---	---	0.0	-2.7	-2.7	-2.4	-1.8	-1.1
Gross Domestic Income	---	---	---	---	---	---	100.0	97.3	97.3	97.6	98.2	98.9
Gross National Income	---	---	---	---	---	---	96.3	93.7	93.8	94.6	95.3	96.9
Gross National Product							96.3	96.4	96.5	97.0	97.2	98.0
Gross Domestic Saving	15.1	24.5	18.6	17.8	19.6	20.7	25.1	18.3	20.5	21.0	21.5	21.5
Net Factor Income	-2.6	-5.0	-3.2	-4.1	-3.6	-3.8	-3.7	-3.6	-3.5	-3.0	-2.8	-2.0
Net Current Transfers a/	..	1.2	2.0	2.1	3.0	3.3	3.1	3.7	3.7	3.5	3.7	3.9
Gross National Saving	..	20.7	17.4	15.8	19.0	20.2	24.5	18.4	20.7	21.5	22.4	23.3

a/ Including official transfers.

B. National Accounts Growth Rates (%) at Constant Prices:

	Actual							Prelim.	Projections			
	1965-73	1973-80	1980	1982	1984	1985	1986	1987	1988	1989	1986-91	1990-95
Gross Domestic Product m.p.	8.5	4.8	5.6	0.6	2.3	3.7	6.5	5.1	4.8	5.1	5.1	5.1
Net Indirect Taxes	..	..	14.0	-12.0	12.2	-0.7	11.5	4.0	4.8	5.1	4.9	5.1
Agriculture	6.2	3.7	1.1	4.7	-3.3	3.6	4.8	4.5	4.5	4.5	4.3	3.8
Industry	12.4	5.7	5.1	-0.6	2.2	5.0	5.2	4.9	4.8	5.2	5.2	5.8
(of which Manufacturing)	12.4	6.9	5.2	2.2	4.3	4.5	5.9	4.7	4.7	5.0	5.1	6.0
Services	7.6	5.2	5.5	3.4	3.4	4.8	6.6	5.8	5.0	5.5	5.5	5.5
Exports of GNFS	4.3	0.3	5.4	-0.4	1.9	5.9	10.2	-2.7	0.9	3.5	1.9	3.9
Imports of GNFS	5.7	2.5	10.0	-16.5	17.9	-6.2	17.3	5.8 b/	-4.9 b/	1.3	1.3	4.8
Total Expenditures	8.8	5.2	7.3	-4.6	6.2	0.6	8.2	7.3	3.2	4.6	4.9	5.3
Total Consumption	6.6	5.7	0.0	2.1	6.5	0.0	5.2	10.9	1.9	4.8	5.2	5.3
Private Consumption	5.3	4.7	-0.7	3.2	9.0	0.9	4.6	14.7	5.5	6.2	7.4	6.6
General Government	13.1	9.1	2.2	-1.5	-1.0	-2.8	7.3	4.2	-9.0	0.0	-1.8	-0.9
Gross Domestic Investment	15.9	4.1	34.6	-23.2	-0.1	7.6	21.0	-3.2	7.2	3.8	4.1	5.1
Fixed Investment	..	..	2.5	-20.8	-5.3	13.5	13.3	-2.8	11.3	6.1	6.0	5.4
Changes in Stocks	..	..	..	-36.3	40.4	-23.6	81.0	-4.9	-14.9	-12.4	-8.4	2.1
Capacity to Import	..	..	..	..	..	..	..	-13.3	0.5	4.8	1.2	4.2
Terms of Trade Adjustment	..	..	..	..	..	..	..	..	..	..	..	..
Gross Domestic Income	7.9	4.4	2.6	..	..	..	..	2.2	4.8	5.5	5.0	5.2
Gross National Income	7.7	4.6	3.2	..	..	..	..	2.3	4.9	6.1	5.2	5.4
Gross National Product	8.3	5.0	6.3	..	..	..	..	5.2	4.8	5.7	5.3	5.3
Gross Domestic Saving	12.0	0.1	17.3	..	..	..	..	-23.7	17.3	7.9	4.5	4.9
Net Factor Income	..	..	..	..	..	..	..	-0.2	-3.7	10.1	-2.2	-6.8
Net Current Transfers	..	..	..	..	..	..	..	25.0	5.6	-0.5	7.2	6.3
Gross National Saving	..	5.8	27.9	..	..	..	..	-26.2	19.8	11.2	5.7	5.7

b/ Includes special imports of gunboats and airbuses.

C. Price Indices (1980=100):

	Actual					Prelim	Growth Rates (% p.a)		
	1980	1982	1984	1985	1986	1987	1965-73	1973-80	1980-85
Consumer Prices (IFS 64)	100.0	134.7	165.4	187.0	194.4	213.8	3.2	13.8	13.1
Wholesale Prices (IFS 63)	..	..	..	..	..	..	..	..	..
Implicit GDP Deflator	100.0	124.1	147.8	162.5	178.1	195.9	2.4	11.9	10.2
Implicit Expend. Deflator	100.0	133.1	156.7	177.0	188.6	207.5	2.6	12.4	11.7
Deflators for Sector VA:									
Agricultural Sector	100.0	119.7	142.1	151.8	163.2	179.5	6.2	11.7	10.3
Industrial Sector	100.0	119.7	139.6	155.1	164.4	180.9	12.4	10.8	10.5
Services Sector	100.0	121.9	145.0	163.3	182.1	200.3	7.6	10.8	12.7

D. Other Indicators:

	1965-73	1973-80	1980-85	1985-95
Growth Rates (% p.a.)				
Population	3.8	4.0	4.1	3.7
Labor Force	..	..	..	..
Gross Nat'l Income p.c.	3.7	0.5	-2.9	1.6
Private Consumption p.c.	1.5	0.5	-2.3	3.0
Import Elasticity:				
Imports (GNFS)/GDP(mp)	0.7	0.5	-4.4	0.7
Marginal Savings Rates:				
Gross National Savings	..	-11.6	23.5	22.7
Gross Domestic Savings	33.4	-19.1	16.3	21.6
ICOR (period averages)	3.6	5.8	9.2	4.7

	1965	1973	1980	1986	1991
Share of Total Labor Force in:					
Agriculture	86.1	83.7	81.0	..	..
Industry	5.1	6.0	6.8	..	..
Services	8.8	10.4	12.1	..	..
Total	100.0	100.0	100.0	..	..

E. National Accounts (millions of LCUs at 1986 Prices):

	Actual						Prelim.	Projections				
	1980	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1995
Gross Domestic Product m.p.	4688	4889	4958	5080	5270	5615	5899	6183	6501	6851	7198	8777
Net Indirect Taxes	842	690	630	707	702	782	814	853	897	945	993	1211
Agriculture	1181	1310	1369	1323	1370	1436	1501	1568	1639	1708	1773	2058
Industry	814	844	861	879	923	971	1019	1068	1123	1185	1254	1571
(of which Manufacturing)	451	478	499	521	544	576	603	632	663	700	742	937
Services	1851	2045	2099	2171	2275	2425	2566	2694	2842	3013	3179	3938
Resource Balance	-883	-199	81	-106	57	-30	-159	-66	-34	-30	-54	-121
Exports of GNFS	1302	1242	1262	1286	1363	1502	1461	1475	1526	1571	1627	1901
Imports of GNFS	2185	1441	1181	1392	1306	1531	1620	1541	1561	1601	1682	2022
Total Expenditures	5571	5088	4877	5186	5213	5645	6058	6249	6536	6881	7252	8898
Total Consumption	3818	3779	3764	4078	4017	4203	4662	4753	4982	5251	5525	6800
Private Consumption	2721	2757	2707	3032	3000	3111	3524	3718	3947	4225	4499	5820
General Government	1097	1023	1057	1046	1017	1092	1138	1035	1035	1026	1026	980
Gross Domestic Investment	1752	1308	1113	1108	1197	1442	1396	1496	1554	1630	1727	2098
Fixed Investment	1395	1155	995	942	1070	1212	1178	1311	1391	1480	1569	1931
Changes in Stocks	358	154	118	166	127	229	218	185	163	151	158	167
Capacity to Import	1543	1198	1145	1305	1239	1502	1302	1309	1371	1447	1518	1807
Terms of Trade Adjustment	225	-59	-132	4	-140	0	-160	-166	-155	-125	-110	-94
Gross Domestic Income	4913	4830	4826	5084	5130	5615	5740	6017	6346	6726	7088	8683
Gross National Income	4786	4672	4664	4935	4950	5406	5530	5800	6151	6532	6897	8507
Gross National Product	4561	4731	4796	4932	5090	5406	5690	5966	6306	6656	7007	8601
Gross Domestic Saving	1094	1051	1062	1006	1114	1412	1078	1265	1364	1476	1563	1883
Net Factor Income	-127	-158	-162	-149	-180	-209	-210	-218	-196	-195	-191	-176
Net Current Transfers	96	100	96	144	159	174	218	230	229	257	257	342
Gross National Saving	1063	993	996	1001	1093	1377	1086	1277	1397	1538	1629	1783

ANNEX III

KENYA - EXTERNAL TRADE

A. Volume, Value and Prices

	ACTUAL 1980	1982	1983	1984	1985	1986	Prelim 1987	Projections 1988	1989	1990	1991	1995
Merchandise Exports	Volume Index 1980=100											
Commodity 1 Coffee	100.0	126.1	112.9	121.0	130.7	157.9	131.2	136.2	141.6	143.8	148.9	170.9
Commodity 2 Tea	100.0	107.5	133.6	121.9	168.9	155.7	178.6	168.9	168.9	166.9	166.9	189.3
Commodity 3 Petroleum	100.0	54.8	41.9	43.6	40.1	45.7	29.9	30.5	31.1	31.8	32.4	35.1
Manufactures	100.0	69.4	87.8	99.3	103.2	96.1	99.9	103.9	109.1	115.7	122.6	154.8
Other Exports	100.0	99.0	102.8	93.4	92.0	119.2	121.6	108.8	113.2	117.7	122.4	143.2
Total Merch. Exports FOB	100.0	91.7	88.1	87.2	90.8	104.6	97.6	96.7	99.8	102.0	105.4	123.0
Merchandise Exports	Value-Current Prices (million US$)											
Commodity 1 Coffee	291	265	241	283	281	479	254	269	293	313	332	428
Commodity 2 Tea	156	142	185	263	233	214	204	208	234	260	290	377
Commodity 3 Petroleum	445	277	206	198	146	128	97	104	106	114	123	166
Manufactures	282	194	166	162	169	192	211	232	256	271	291	387
Other Exports	215	164	183	172	148	205	219	206	225	246	270	396
Total Merch. Exports FOB	1389	1042	981	1078	977	1217	985	1018	1115	1204	1306	1753
Merchandise Imports	Volume Index 1980=100											
Food	100.0	82.0	69.7	168.9	129.5	94.3	94.3	94.3	96.2	98.1	103.8	110.2
POL and Other Energy	100.0	76.9	70.8	69.2	70.0	72.3	73.7	75.2	76.7	79.0	81.4	91.6
Other Imports	100.0	60.8	50.1	60.8	58.9	70.2	72.0	72.2	76.5	78.2	82.1	99.6
Other Consumer Goods	100.0	55.9	42.0	49.8	46.5	52.6	53.9	54.0	57.0	58.2	61.4	75.7
Intermediate Goods	100.0	59.8	59.3	65.2	70.8	68.3	70.0	70.1	74.2	75.9	79.8	97.5
Capital Goods	100.0	62.5	44.2	59.4	51.6	75.2	66.6	65.7	69.4	70.2	74.0	87.4
Total Merch. Imports CIF	100.0	65.4	47.1	61.4	54.2	67.3	65.2	65.3	68.4	69.9	73.5	88.4
Merchandise Imports	Value-Current Prices (million (US$)											
Food	199	126	130	185	141	154	163	172	185	188	205	294
POL and Other Energy	876	613	501	466	461	295	308	331	338	368	400	560
Other Imports	1509	909	731	871	853	1201	1395	1345	1422	1446	1546	1978
Other Consumer Goods	148	82	60	70	66	88	98	107	121	128	140	201
Intermediate Goods	614	364	352	380	417	475	516	546	609	620	660	850
Capital Goods	747	463	319	421	370	637	597	622	692	698	745	928
Total Merch. Imports CIF	2584	1648	1362	1522	1455	1649	1866	1848	1945	2002	2151	2832
Terms of Trade	Price Indices 1980=100											
Merch. Exports Price Indice	100.0	120.5	144.6	173.5	171.1	183.1	158.9	165.9	175.9	185.7	195.0	224.3
Merch. Imports Price Indice	100.0	147.1	188.2	192.6	227.9	216.2	252.4 a/	249.6	250.7	252.5	258.2	282.6
Merch. Terms of Trade	100.0	81.9	76.8	90.1	75.1	84.7	62.9 a/	66.4	70.2	73.5	75.5	79.4

B. Share of Total X or M (%) at Current Prices

C. Growth Rates (%) at Constant Prices

	B. 1965	1973	1980	1986	1991	1995	C. 1965-73	1973-80	1980-85	1986-91	1990-95
Merchandise Exports											
Commodity 1 Coffee	25.1	29.2	21.0	39.3	25.4	24.2	6.4	2.0	4.2	0.1	3.5
Commodity 2 Tea	12.9	13.8	11.2	17.5	22.2	21.5	14.9	9.2	10.0	0.4	2.7
Commodity 3 Petroleum	0.1	7.7	32.0	10.5	9.4	9.5	6.8	-2.5	-16.8	-4.3	2.0
Manufactures	32.9	15.3	20.3	15.8	22.3	22.1	-	-	2.7	5.0	6.0
Other Exports	61.9	49.3	15.5	16.8	20.7	22.6	-	-	-1.6	0.2	4.0
Total Merch. Exports FOB	100.0	100.0	100.0	100.0	100.0	100.0	3.8	-1.5	-2.3	0.6	3.8
Merchandise Imports											
Food	6.9	6.9	7.7	9.3	9.5	10.4	-	-	8.9	1.8	6.0
POL & Other Energy	11.3	11.1	33.9	17.9	18.6	19.8	-	-	-7.1	2.4	3.0
Other Imports	80.7	82.0	58.4	72.8	71.9	69.8	-	-	-9.7	2.0	5.1
Other Consumer Goods	15.7	10.8	5.7	5.4	6.6	7.1	-	-	-14.1	6.0	7.9
Intermediate Goods	8.3	15.1	23.8	28.8	30.7	30.0	-	-	-6.2	3.1	5.1
Capital Goods	56.6	56.1	28.9	38.6	34.6	32.7	-	-	-12.1	0.4	4.5
Total Merch. Imports CIF	100.0	100.0	100.0	100.0	100.0	100.0	5.9	2.4	-11.4	2.0	4.8

a/ Import price index is derived by dividing the import value index by the import volume index. The import value for 1987 includes two naval vessels, which are not reflected in the import volume index. The derived import price index is therefore exaggerated. Without the value of the naval vessels, the import price index would be 227 in 1987, and the terms of trade index would be 70.

KENYA - BALANCE OF PAYMENTS
(US$ millions at Current Prices)

	Actual						Prelim.	Projections			
	1980	1982	1983	1984	1985	1986	1987	1988	1989	1990	1995
A. Exports of Goods & NFS	2030	1570	1497	1621	1553	1851	1690	1793	1964	2084	2895
1. Merchandise (FOB)	1261	936	927	1034	943	1217	985	1018	1115	1204	1753
2. Non-Factor Services	769	643	570	587	610	634	705	775	849	880	1143
B. Imports of Goods & NFS	2837	1749	1524	1709	1615	1888	2103	2111	2236	2307	3240
1. Merchandise (FOB)	2378	1468	1198	1348	1276	1440	1697	1646	1722	1775	2526
of which: special	0	0	0	0	0	0	167	63	0	0	0
2. Non-Factor Services	460	281	326	361	339	448	406	464	514	533	714
C. Resource Balance	-807	-170	-27	-88	-62	-37	-413	-318	-272	-223	-344
D. Net Factor Income	-226	-255	-191	-208	-223	-258	-263	-282	-268	-252	-203
1. Factor Receipts	54	65	37	48	43	37	39	24	28	33	64
2. Factor Payments	280	320	228	257	266	295	302	306	295	285	267
(interest payments)	180	212	198	211	219	248	237	241	229	217	199
E. Net Current Transfers	147	133	180	177	192	206	273	298	313	333	395
1. Official	120	50	116	117	110	149	205	224	233	242	308
2. Private	27	83	63	60	81	57	68	74	81	91	87
F. Current Account Balance	-886	-292	-38	-120	-93	-88	-403	-302	-226	-143	-152
G. Long-Term Capital Inflow	547	84	118	133	-51	274	201	271	319	252	226
1. Direct Investment a/	78	3	9	4	13	0	0	0	14	14	14
2. Official Capital Grants	0	0	0	0	0	0	0	0	0	0	0
3. Net LT Loans (DRS data)	420	215	124	289	36	327	203	258	212	169	160
a. Disbursements	538	398	307	509	288	582	485	539	488	443	433
b. Repayments	118	183	184	220	252	256	282	281	276	274	274
4. Other LT Inflows (net) b/	49	-134	-15	-160	-100	-52	-2	13	93	69	53
H. Total Other Items (net)	144	11	6	31	30	-96	103	45	20	20	20
1. Net Short Term Capital	134	29	-14	41	25	-83	0	0	0	0	0
2. Capital Flows N.E.I.	0	0	0	0	0	2	103	25	0	0	0
3. Errors and Omissions	10	-19	20	-10	5	-15	0	20	20	20	20
OVERALL BALANCE (F+G+H)	-195	-198	86	45	-115	90	-98	15	113	130	94
I. Financing	195	198	-86	-45	115	-90	98	-15	-113	-130	-94
1. Net Credit from IMF	69	149	94	-11	55	-105	-107	31	-41	-71	-36
2. Other Reserve changes	126	49	-180	-34	59	15	205	-46	-72	-59	-59
(- indicates increase)											
Shares of GDP (Current US$):											
1. Resource Balance	-11.4	-2.7	-0.5	-1.5	-1.1	-0.5	-5.4	-3.7	-2.9	-2.3	-2.5
2. Total Interest Payments	2.5	3.4	3.5	3.6	3.7	3.6	3.1	2.8	2.4	2.2	1.5
3. Current Account Balance	-12.5	-4.7	-0.7	-2.0	-1.6	-1.3	-5.2	-3.5	-2.4	-1.4	-1.1
4. LT Capital Inflow (line G)	7.7	1.3	2.1	2.3	-0.9	4.0	2.6	3.2	3.4	2.5	1.7
5. Net Credit from the IMF	1.0	2.4	1.6	-0.2	0.9	-1.5	-1.4	0.4	-0.4	-0.7	-0.3
Memorandum Item:											
GDP in Current US$	7095	6244	5740	5854	5855	6921	7693	8515	9437	9914	13549
Foreign Exchange Reserves:											
1. Int'l. Reserves (IFS 11d)	492	212	376	390	391	425	220	265	337	395	875.3
2. Gross Reserves incl. Gold	539	248	406	414	417	--	--	--	--	--	--
3. Gross Res. in Months Import	2.1	1.5	3.0	2.7	2.9	2.7	1.3	1.5	1.8	2.1	3.2
Exchange Rates (LCU/US$):											
1. Nom. Off. X-Rate (IFS rh)	7.42	10.92	13.31	14.41	16.43	16.23	16.87	--	--	--	--
2. Real Eff. X-Rate (1980=100)	100.0	100.6	95.3	102.1	101.0	--	--	--	--	--	--
3. X-Rate for GNP Conversion	7.42	10.92	13.31	14.41	16.43	16.23	16.87	--	--	--	--

a/ Source: IFS.

b/ Residual between total MLT capital in the official Kenya BOP and the above components.

KENYA: EXTERNAL FINANCING REQUIREMENTS 1987-1995
(US$ millions)

	1987	1988	1989-91 (annual average)	1992-95 (annual average)
Financing Requirements	845	976	899	925
Current Account Deficit (excluding official transfers)	608	525	418	442
Public Debt Amortization	334	318	330	387
IMF Repurchases	107	87	87	38
Change in Reserves (minus = decrease)	-205	46	63	59
Identified Financing	845	976	815	786
Official Transfers	205	224	243	287
Public MLT Loan Disbursements	535	589	500	465
IMF Purchase	0	118	38	0
Other (net)	104	45	34	34
Financing Gap	0	0	-84	-139
Memorandum Items				
Current Account Deficit, excluding official transfers as % of GDP	7.9	6.2	4.2	3.6
Net Bank/IDA Transfers	12	70	39	23
Disbursements	130	195	177	156
Amortization	49	57	71	80
Interest	68	68	66	53

KENYA - EXTERNAL CAPITAL AND DEBT
(US$ millions at Current Prices)

	ACTUAL						Prelim	Projections				
	1980	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1995
A. Disbursements												
1. Public & Publicly Guar. LT	538	398	307	509	288	582	485	539	488	443	420	433
Official Creditors	266	320	281	486	249	284	416	431	387	350	334	338
Multilateral	174	205	150	182	141	137	196	270	250	236	230	224
of which IBRD	45	88	100	130	77	51	43	48	39	31	27	6
of which IDA	72	85	20	36	40	33	87	147	144	144	145	154
Bilateral	92	114	131	304	108	146	221	160	137	114	104	114
Private Creditors	272	78	26	23	39	299	69	108	102	93	86	96
Suppliers	25	0	2	12	29	44	31	24	21	18	16	19
Financial Markets	247	78	24	10	11	255	37	84	80	75	70	77
2. Private Non-Guar. LT	87	92	173	44	169	50	50	50	127	122	153	196
3. Total LT Disbursements	625	490	480	553	457	632	535	589	615	565	573	629
4. IMF Purchases	66	167	140	49	0	0	0	118	86	28	0	0
5. Net Short-Term Capital	126	29	-14	41	25	-83	0	0	0	0	0	0
6. Total incl. IMF & Net ST	818	687	606	642	482	549	535	707	701	593	573	629
B. Repayments												
1. Public & Publicly Guar. LT	118	183	184	220	252	256	282	281	276	274	289	274
Official Creditors	39	50	64	96	123	145	158	174	188	202	202	164
Multilateral	12	22	28	42	56	67	81	94	97	106	108	97
of which IBRD	11	16	17	26	36	42	47	54	60	69	73	69
of which IDA	1	1	1	1	2	2	2	2	3	4	5	9
Bilateral	27	29	36	54	67	78	76	80	91	96	94	67
Private Creditors	79	132	119	124	129	111	124	107	88	73	87	110
Suppliers	24	23	20	20	15	16	15	19	14	15	17	25
Financial Markets	55	109	99	104	114	95	109	88	75	58	70	85
2. Private Non-Guar. LT	88	73	77	96	86	102	53	37	34	47	54	103
3. Total LT Repayments	205	256	261	316	338	258	334	318	310	321	343	377
4. IMF Purchases	9	19	46	59	71	105	107	87	127	99	36	36
C. Interest												
1. Public & Publicly Guar. LT	133	153	131	135	144	174	188	182	180	177	171	142
Official Creditors	62	68	77	92	107	133	132	133	131	127	122	102
Multilateral	37	39	45	58	63	85	80	81	81	79	77	58
of which IBRD	31	29	35	48	54	73	64	63	62	60	56	35
of which IDA	1	2	2	3	3	4	5	5	6	7	8	11
Bilateral	25	30	33	34	44	48	52	52	50	48	46	44
Private Creditors	71	85	53	43	37	41	55	49	49	49	49	40
Suppliers	14	9	6	6	5	8	11	11	12	12	12	10
Financial Markets	57	75	47	37	32	33	44	37	37	38	37	30
2. Private Non-Guar. LT	39	32	35	37	38	31	14	15	18	25	30	56
3. Total LT Interest	173	185	166	172	182	205	202	197	198	202	201	198
4. IMF Service Charges	7	23	28	34	38	42	36	44	30	15	11	2
5. Interest on ST Debt	n.a	n.a	n.a	n.a	n.a	0	0	0	0	0	0	0
6. Total incl. IMF & Net ST	180	208	193	206	220	248	237	241	229	217	211	199

KENYA - EXTERNAL CAPITAL AND DEBT
(US$ millions at Current Prices)

	ACTUAL						Prelim	Projections				
D. External Debt (DOD)	1980	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1995
1. Public & Publicly Guar. LT	2214	2438	2435	2619	2877	3438	3636	3894	4106	4275	4406	4967
Official Creditors	1361	1726	1861	2189	2482	2798	3056	3313	3512	3661	3792	4391
Multilateral	707	947	1047	1226	1346	1451	1565	1741	1894	2025	2147	2599
of which IBRD	308	424	506	669	711	720	715	709	687	649	603	345
of which IDA	220	319	334	363	414	459	544	689	830	970	1110	1673
Bilateral	654	779	815	963	1137	1347	1491	1571	1617	1636	1646	1791
Private Creditors	854	712	574	430	395	640	580	581	594	615	614	576
Suppliers	171	93	66	52	79	113	125	130	138	140	139	123
Financial Markets	683	620	508	378	316	527	455	451	457	475	474	454
2. Private Non-Guar. LT	437	385	481	428	511	263	260	273	366	441	540	963
3. Total Long-Term DOD	2651	2823	2916	3047	3389	3701	3896	4167	4472	4716	4946	5930
4. IMF Credit	198	342	426	397	449	413	306	337	296	225	189	38
5. Short-Term Debt	n.a	n.a	n.a	n.a	n.a	0	0	0	0	0	0	0
6. Total incl. IMF & Net ST	2849	3166	3342	3444	3838	4114	4203	4505	4768	4942	5135	5967
Percent of Total LT DOD:												
1. On Concessional Terms	27.5	32.4	31.8	33.5	36.6	41.2	46.8	50.4	53.2	56.2	58.6	66.5
2. With Variable Int. Rates	25.8	22.0	17.4	12.4	9.3	14.2	11.7	10.8	10.2	10.1	9.6	7.6
E. Bank and IDA Ratios												
Share of Total LT DOD												
1. IBRD as % of Total	11.6	15.0	17.4	22.0	21.0	19.5	18.4	17.0	15.4	13.8	12.2	5.8
2. IDA as % of Total	8.3	11.3	11.5	11.9	12.2	12.4	14.0	16.5	18.6	20.6	22.4	28.2
3. IBRD+IDA as % of Total	19.9	26.3	28.8	33.9	33.2	31.9	32.3	33.5	33.9	34.3	34.6	34.0
Share of LT Debt Serv												
1. IBRD as % of Total	2.9	3.7	4.2	5.6	7.1	20.3	20.7	22.8	24.1	24.7	23.7	18.1
2. IDA as % of Total	8.6	7.2	9.0	10.5	10.7	0.0	1.2	1.5	1.8	2.0	2.2	3.5
3. IBRD+IDA as % of Total	11.5	10.9	13.1	16.1	17.8	21.3	21.9	24.3	25.9	26.7	26.0	21.7
F. DOD-to Exports Rations a/												
1. Long-Term Debt/Exports	130.1	171.8	190.1	182.5	212.2	196.0	225.4	229.3	224.5	222.8	217.9	200.4
2. IMF Credit/Exports	9.7	20.8	27.7	23.8	28.1	21.9	17.7	18.6	14.9	10.7	8.3	1.3
3. Short-Term Debt/Exports	n.a	n.a	n.a	n.a	n.a	0.0	0.0	0.0	0.0	0.0	0.0	0.0
4. LT+IMF+ST DOD/Exports	139.8	192.6	217.8	206.3	240.4	217.9	243.1	247.9	239.4	233.5	226.2	201.7
G. DOD-to-GDP Ratios												
1. Long-Term Debt/GDP	37.4	45.2	50.8	52.1	57.9	53.5	50.6	48.9	47.4	47.6	46.9	43.8
2. IMF Credit/GDP	2.8	5.5	7.4	6.8	7.7	6.0	4.0	4.0	3.1	2.3	1.8	0.3
3. Short-Term Debt/GDP	n.a	n.a	n.a	n.a	n.a	0.0	0.0	0.0	0.0	0.0	0.0	0.0
4. LT+IMF+ST DOD/GDP	40.2	50.7	58.2	58.8	65.5	59.4	54.6	52.9	50.5	49.8	48.7	44.0
H. Debt Service/Exports a/												
1. Public & Publicly Guar. LT	12.3	20.4	20.5	21.3	24.8	22.8	27.2	25.5	22.9	21.3	20.2	14.1
2. Private Non-Guar. LT	6.2	6.4	7.3	8.0	7.8	7.1	3.9	2.9	2.6	3.4	3.7	5.4
3. Total LT Debt Service	18.6	26.8	27.8	29.2	32.6	29.8	31.0	28.3	25.5	24.7	23.9	19.4
4. IMF Repurchases+Serv.Chgs.	0.8	2.5	4.8	5.6	6.8	7.8	8.3	7.2	7.9	5.4	2.1	1.3
5. Interest only on ST Debt	n.a	n.a	n.a	n.a	n.a	0.0	0.0	0.0	0.0	0.0	0.0	0.0
6. Total (LT+IMF+ST Int.)	19.4	29.3	32.6	34.8	39.4	37.7	39.3	35.6	33.4	30.1	26.0	20.7
I. Interest Burden Ratios												
1. Total Interest/GDP	2.5	3.3	3.4	3.5	3.8	3.6	3.1	2.8	2.4	2.2	2.0	1.5
2. Total Interest/Exports a/	8.8	12.9	12.5	12.4	13.9	13.1	13.7	13.3	11.5	10.3	9.3	6.7

a/ Exports include merchandise, all services and workers remittances.

KENYA - PUBLIC FINANCE, MONEY AND CREDIT

	Actual				Prelim.
	FY83	FY84	FY85	FY86	FY87
I. Public Finance (% shares of GDP)					
Budget (Central Government)					
Current Revenue	23.1	23.0	22.7	23.3	23.7
Current Expenditure	22.1	21.5	23.1	23.4	23.8
Current Budget Balance	1.0	1.5	-0.3	-0.1	-0.1
Development Expenditure	6.2	6.1	7.5	7.2	9.7
Total Expenditures	28.2	27.6	30.6	30.6	33.4
Overall Cash Deficit, excl. Grants, incl. cash. adjustment	-5.2	-4.6	-7.0	-6.6	-10.5
External Grants	1.6	0.7	1.7	1.1	2.4
Overall Cash Deficit, incl. Grants & Adjustment	-3.6	-3.9	-5.3	-5.6	-8.1
External Borrowing, net	1.4	0.2	1.2	-0.9	0.7
Domestic Financing, net	2.2	3.8	4.0	6.5	7.4

II. Money and Credit	1982	1983	1984	1985	1986	June 1987	Growth Rate (% p.a.) 1983	1984	1985	1986	June 1987
In millions of LCUs at end year:											
Money Supply	10753	11945	13628	14474	18151	18499	11.1	14.1	6.2	25.4	1.9
Money + Quasi-Money	21431	22838	25775	28405	36231	38246	6.6	12.9	10.2	27.6	5.6
Total Net Domestic Credit	25344	25375	28094	31600	40775	43916	0.1	10.7	12.5	29.0	7.7
To Government (net)	9988	8141	9037	9954	15301	17109	-18.5	11.0	10.1	53.7	11.8
To Official Entities	999	1854	2113	2397	2790	2905	85.6	14.0	13.4	16.4	4.1
To Private Sector	14357	15380	16944	19249	22684	23902	7.1	10.2	13.6	17.8	5.4
Net Foreign Assets	-1577	-534	86	-1759	-255	-759					
Net Other Assets & Liabilities	-2324	-2003	-2405	-1438	-4289	-4911					

Schedule D

THE STATUS OF BANK GROUP OPERATIONS IN KENYA

A. Statement of Bank Loans and IDA Credits as of March 30, 1988

Loan or Credit No	Year	Borrower	Purpose	-------US$ Million------- Amount (Less Cancellations) Bank 1/	IDA	Undis-bursed
Forty three (43) Loans, of which six were cancelled, thirty-two (32) Credits and two (2) Third Window Loans Fully Disbursed*				690.21	377.22	
1817	1980	IDB	Fourth Industrial Dev. Bank	30.00		5.27
1107	1981	Kenya	Fifth Education		40.00	20.00
1995	1981	Kenya	Fourth Agriculture	25.00		1.83
2098	1982	Kenya	Forestry III	21.50		18.93
1237	1982	Kenya	Cotton Proc. & Marketing		22.00	10.95
1238	1982	Kenya	Integrated Rural Health & Family Planning		23.00	9.66
1387	1983	Kenya	National Extension		15.00	6.32
2319	1983	Kenya	Secondary Towns	7.00		6.98
1390	1983	Kenya	Secondary Towns		22.00	11.42
2359	1984	Kenya	Kiambere Hydroelectric	95.00		29.22
2409	1984	Kenya	Second Highway Sector	50.00		49.21
F017	1984	Kenya	Second Highway Sector		40.00	39.44
1486	1984	Kenya	Geothermal Exploration		24.50	11.58
1566	1985	Kenya	Water Engineering		6.00	2.93
2574	1985	Kenya	Third Telecommunications	32.60		30.85
1673	1986	Kenya	Sixth Education		37.50	36.88
1675	1986	Kenya	Petroleum Explor. Tech. Assist.		6.00	5.57
1717	1986	Kenya	Agric. Sector Adjustment		20.00	9.13
1718	1986	Kenya	Agric. Sector Management		11.50	9.77
1738	1987	Kenya	KIE 2nd Small Scale Industry		6.00	5.71
1758	1987	Kenya	Animal Health Services		15.00	15.00
1820	1987	Kenya	Second Railway		27.95	27.95
1849	1988	Kenya	Agriculture		19.60	19.60
			Total	951.31	713.27	384.20
			of which has been repaid	529.75	11.40	
				421.56	701.87	
			Total now outstanding 11.74			
			Amount sold			
			of which has been repaid 11.74	.00		
		TOTAL now held by Bank and IDA		421.56	701.87	
		TOTAL undisbursed		142.29	241.91	384.20

---

* In addition, Kenya was one of the beneficiaries of 10 loans totalling US$244.8 million which were extended for the development of common services (railways, ports, telecommunications, and finance for industry), operated regionally for the three partner states of the former East African Community (EAC).

KENYA
Schedule D
Page 2 of 2

B. Statement of IFC Investment in Kenya as of March 30, 1988

Fiscal Year	Obligor	Type of Business	Amount in US$ Million		
			Loan	Equity	Total
1967,1968, and 1973	Kenya Hotel Properties	Hotels	5.2	0.7	5.9
1970,1974, 1977,1979 and 1981	Pan African Paper Mills	Pulp and Paper	22.2	6.3	28.5
1972	Tourism Promotion Services	Hotels	2.4	-1/	2.4
1976	Rift Valley Textiles Ltd.	Textiles	6.3	2.8	9.1
1977	Kenya Commercial Bank Ltd.	Capital Market	2.0	-	2.0
1980	Development Finance Company of Kenya Ltd.	Development Finance	5.1	1.3	6.4
1981	Kenya Commercial Finance	Money & Capital Mkt	5.0	-	5.0
1982	Bamburi Portland Cement Co., Ltd.	Cement & Construct. Material	4.4	-	4.4
1982	Diamond Trust of Kenya Limited	Money & Capital Mkt	-	0.8	0.8
1982	Industrial Promotion Services (Kenya) Ltd.	Money & Capital Mkt	-	2.0	2.0
1983	Tetra Pak Converters Limited	Pulp & Paper Prod.	2.2	0.3	2.5
1984	Leather Industries of Kenya Limited	Tanning	2.1	0.6	2.7
1984	Madhu Paper International Limited	Pulp & Paper Prod.	37.1	2.0	39.1
1985	Equatorial Beach Properties	Tourism	3.7	-	3.7
1985	Oil Crop Development Ltd.		9.7	1.4	11.1
	Total Gross Commitments		107.4	18.2	125.6
	less cancellations, terminations, repayments and sales		78.9	5.0	83.9
	Total Commitments now held by IFC		28.5	13.2	41.7
	Total Undisbursed		.2	1.5	1.5

1/ $51,395.

KENYA

INDUSTRIAL SECTOR ADJUSTMENT CREDIT

SUPPLEMENTAL CREDIT DATA SHEET

I. Timetable of Key Events

(a) Time taken to prepare the project:	10 months
(b) Project prepared by:	Ministry of Finance
(c) First presentation to the Bank:	September, 1987
(d) Departure of appraisal mission:	January, 1988
(e) Date of completion of negotiations:	April 15, 1988
(f) Planned date of effectiveness:	July, 1988

II. Special Bank Implementation Action

None

III. Special Conditions

Conditions of Release of Second Tranche

Implementation of the Industrial Sector Adjustment Program satisfactory to the Association, including:

(i) liberalization of imports in category B of Schedule III, agreement on a timetable for liberalizing category C of Schedule III and reduction in the number of tariff rates from 25 to 12;

(ii) agreement on and commencement of implementation of an action program for export promotion and implementation of the Import Duty Compensation Scheme;

(iii) decontrol of prices for at least 10 products from the General Price Order and agreement on a timetable for removal of remaining price controls not covered by the Restrictive Trade Practices, Monopolies and Price Control Bill;

(iv) agreement with the Association on, and commencement of, implementation of an action program for restructuring the development finance institutions and divestiture of industrial public enterprises;

(v) implementation of improved processes, to be agreed with the Association, for monitoring the remaining industrial public enterprises; and

(vi) establishment of the Capital Markets Development Authority and discontinuation of the Capital Issues Committee's review of share issue prices for locally owned firms.

Telegraphic Address:
FINANCE-NAIROBI
Telephone: 338111
When replying please quote
Ref. No. ..CONF...65/02/74
and date

REPUBLIC OF KENYA
MINISTRY OF FINANCE

THE TREASURY
P.O. Box 30007
NAIROBI, KENYA
19th May, 1988.

CONFIDENTIAL

Mr. B. Conable,
President,
International Bank of Reconstruction and
Development,
1818H Street, N.W.,
Washington D.C. 20433,
U.S.A.

Dear Sir,

LETTER OF INDUSTRIAL POLICY

I. INTRODUCTION

1. Kenya's economic performance in the coming years will depend on financial stabilization and developments in the productive sectors, agriculture and industry. The potential for industrial development will depend on investment and export incentives as well as a more favourable business climate. Kenya has built a relatively large inward-looking industrial base which is on the whole efficient but still cannot compete in the world market. The principal objective for the future is to eliminate the anti-export bias and adjust the industrial sector so as to return it to a path of dynamic and sustained growth.

II. BACKGROUND

2. Kenya's economic performance was remarkable during the first decade after independence. GDP grew annually by 6.6% in real terms due to favourable weather, agricultural land expansion and establishment of import substituting industries. Rapid growth of the manufacturing sector (11% p.a.) was stimulated by protection, a liberal foreign investment policy, active Government participation in industrial ventures and continued access to East Africa Community markets. Between the two oil booms (1974-80), economic growth decelerated to about 4.5% per annum and Kenyans thus enjoyed little growth on a per capita basis. This slowdown in growth arose because of several reasons, notably the deterioration in the terms of trade and structural problems in agriculture and industry. In industry, the incentives favoured production for the domestic market more than for exports, resulting in declining opportunities for import substitution and in a strong anti-export bias.

3. In the early eighties, severe internal and external imbalances developed and stabilization became necessary. In 1981, the budget deficit reached 9.5% of GDP, the current account deficit over 11% of GDP, and the inflation rate picked up to over 20%. The Government

made considerable progress in redressing these imbalances and by 1984 both budget and current account deficits and the inflation rate were under control. Economic growth, on the other hand, did not recover sufficiently to match the population growth. During the same period, the Government also began implementing a structural adjustment programme which was short lived primarily because of severe drought and unfacourable terms of trade. In more recent years, the balance of payments and the budgetary situations have again been under severe pressure because of sharp deterioration in Kenya's terms of trade, increasingly high debt service payments and the burden on the budget created by Government policy of buying large surplus grain during two consecutive good harvest years.

4. The Government of Kenya has embarked on a fiscal and monetary policy programme in order to restore fiscal stability in the short-term and has launched structural adjustment reforms in its productive sectors in order to increase and sustain economic growth over the medium-term. Further to the ongoing adjustment efforts in the agricultural sector, the Government of Kenya has began implementing a programme of reform in the industrial sector for which it seeks support from IDA. While Kenya's manufacturing sector, representing 11% of GDP and 14% of total modern employment, has enjoyed good past performance and is currently relatively efficient and operating at nearly full capacity, it faces two major difficulties: low level of new investment (and hence low job creation) and poor export performance. The low level of investment has occurred because the prospects for efficient import substitution are nearly exhausted and the export incentives in place are not adequate.

III. OBJECTIVES AND STRATEGY

5. The Government's objectives in the industrial sector are (i) to accelerate growth in order to provide productive employment opportunities for a labour force which is expected to nearly double between now and the turn of the century; and (ii) to improve export performance so as to increase efficiency and foreign exchange earnings. The diversification of sources of foreign exchange earnings is an important Government policy objective since it will buffer terms of trade volatility.

6. The Government strategy in this area is well spelt out in Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth and in the Policy Framework Paper for the period 1988-90. Basically, the two documents assign the private sector the dominant role in revitalizing the economy, emphasize high priority for agricuture and rural non-farm activity, and highlight the need for restructuring industry to improve its export competitiveness. These policy documents also assert that market-based incentives will be relied on rather than direct Government controls.

IV. PROGRAMME OF POLICY REFORM

7. The objectives and strategy for the industrial sector described above will be pursued through the following major policy actions which are detailed in the attachment to this letter :

- greater incentives for promotion efficient investment by streamlining administrative procedures, reviewing corporate taxation with the view to reducing marginal effective tax rates and elimination of domestic price controls with the exception of few essential items;

- export promotion to expand and diversify Kenya's manufactured exports so as to reduce reliance on agricultural exports, namely, coffee and tea;

- increase the outward orientation and efficiency of the industrial sector by making protection transparent, even across the sector and lower;

- broaden the range of financial instruments available for private sector investment and improve the capital market;

- maintain external balance and competitiveness by prudent management of the exchange rate ; and

- limit public sector participation in the economy through a programme of restructuring DFIs and their portfolios.

Trade Regime

8. Policy changes in this area will concentrate on improving the efficiency of the sector as well as encouraging exports.

9. Import Licensing. The Government is currently reviewing the licensing system with a view to liberalizing imports. The Government has already reorganized the present four import schedules into three which will be implemented soon. Schedule I consists of raw materials, intermediate and capital goods (similar to the present schedule IA but with a fewer items); Schedule II consists of commodities requiring ministerial approval (similar to IIA); and Schedule III contain all remaining items. Schedule III is divided into three categories : IIIA containing high priority items insufficiently available in domestic market; IIIB consisting of items competing with domestic production; and IIIC consisting of luxury goods, items restricted for public health and security reasons and other items competing with domestic production.

10. The Government will, from June 1988, issue licenses for items in Schedules I and II and categoryA of schedule III expeditiously and without restrictions. These items account for about 60% of all items and 88% of total import value (1986). The Government is committed to undertake a study to examine the impact on domestic industries of unrestrictive licensing for categories IIIB and IIIC. The study will lead to the formulation of an action programme which will provide domestic industries equivalent protection by tariffs only. Anti-dumping legislation will also be reviewed for adequacy. Unrestrictive licensing for items in category IIIB, which will account for at least 11% of all items and 6% of import value will be implemented in June 1989. Again unrestrictive licensing for items in category IIIC (with the exception of a few items for reasons of public security and health) will be introduced gradually in June 1990 and June 1991. In the event that any company is faced with restructuring or liquidation, appropriate rescue programmes will be prepared and estimates of the adjustment assistance that will be required for training and re-employment of the labour force will be made and submitted to the World Bank for assistance.

11. Tariffs. As stated in the Sessional Paper, the Government is committed to lowering and evening out effective protection which at present encourages inefficient activities and allows high profitability at the expense of consumers. While lowering protection is the ultimate objective, the major reforms will be implemented during the second and third phase of the adjustment programme. However, the Government will in June 1988

and June 1989 (i) reduce the number of tariff rates from 25 to 12; (ii) rationalize tariffs such that similar goods bear similar tariffs; and (iii) reduce the weighted average tariff of category IIIA from its present level of 53% to around 45%. Tariff adjustment of categories IIIB and IIIC will occur during the second and third phases of the programme with the objective of lowering and evening out protection.

12. Exports. The Government recognizes that the current Export Compensation Scheme (ECS) has had only a limited impact on increasing exports and is administratively inefficient. A reform of the ECS is, therefore, necessary to ensure that exporters at least have access to duty and tax free inputs. The Government will therefore simplify and streamline the ECS to make export compensation more readily available to manufacturers. By June 1989, the Government will announce and implement a simple Import Duty Compensation Scheme to replace ECS with a wider coverage than is currently the case and with three rates reflecting duties actually paid. The new scheme will be speedily administered so as to guarantee reimbursement within one month of exporting. The Government will issue by June 1988 guidelines and procedures for manufacturing in-bond (MIB) that assure access to foreign exchange within one week of application. The performance of MIB will be reviewed, and improved incentives will be implemented by June 1989. The Government will also design, and start implementing bu June 1989, a comprehensive medium-term export promotion programme that includes financing, insurance and information support from a joint public/private export promotion agency to potential exporters. Furthermore, the Government is committed to establishing an export processing zone (EPZ) with financial assistance from donors. If such assistance is forthcoming, actual construction of the EPZ will begin no later than June 1989.

13. Price Control. The need to dismantle the price control system has long been recognized by the Government and some progress has already been made. The pace of price decontrol will be enhanced under the industrial sector programme. As a first step, the Government will decontrol prices of 10 products from the present list of 40 under the General Price Order by June 1988 and a further 10 by December 1988. Moreover, the Government will endeavour to decontrol prices on additional products, particularly those which under the programme would face increased competition. Furthermore, the Government will move an amendment to the Restrictive Trade Practices, monopolies and Price Control Bill which is now before Parliament, and will be enacted by December 1988, to (i) redefine monopoly as representing a market share of 50%; and (ii) limit powers of the Price Controller to only items produced under monopoly or traded under restrictive conditions as defined in the Bill. All controlled items which will consequently not fall under the new Act will be gradually decontrolled during the second phase of the industrial adjustment operation. Finally, applications for price revisions of items that will continue to be price controlled and conform with the Determination of Costs Order will be processed within 90 days.

Exchange Rate

14. To support the import liberalization programme (removal of quantitative restrictions and moderation of tariff levels) and further enhance manufacturing exports, the Government will continue its prudent management of the exchange rate, i.e. appropriate adjustment of the real exchange rate.

............5/

Investment Incentives

15. In an endeavour to ameliorate the investment climate, the Government intends to eliminate the administrative bottlenecks that investors face in establishing businesses in Kenya, reduce the relatively high effective rates of corporate taxation, and amend the Foreign Investment Protection Act (FIPA) and other restrictions on activities of non-resident companies. More specifically, the Government will streamline the investment approval procedures by establishing by June 1988 a one-stop office in the Investment Promotion Center (IPC) which will be adequately staffed to minimize delays in processing investment applications. IPC will, by June 1988, also prepare and issue investment guidelines detailing policies and procedures affecting investors.

16. The Government will study effective rates of corporate taxation by April 1988 with a view to reducing the rates by June 1988. The Government will also allow companies to treat realized exchange losses on foreign currency loans used to purchase fixed assets as a deductible expense for tax purposes by June 1988. FIPA will also be amended by June 1988 so as to ease repatriation of capital gains by foreign firms operating in Kenya. The criteria for issuance and renewal of work permits will be made more transparent by June 1988. It should be highlighted that the Government has already completed much of the work in this area and is ready to move soon.

Industrial Public Enterprises

17. The Government's intentions in this area are, as stated in the Sessional Paper, to improve the efficiency of these enterprises by way of restructuring, divestiture and improvement in monitoring and supervision. The Government has already requested a Project Preparation Facility from the Bank to finance a study of the development finance institutions (DFIs) and their portfolios, especially the textile, steel and motor vehicles subsectors. The Government will use the study to prepare, by December 1988, an action programme for restructuring the DFIs and restructuring as well as divestiture of their portfolios. This action programme will be discussed and agreed with the Bank so that implementation can commence by June 1989. For the enterprises to be retained in the public sector, the Government will prepare and implement by December 1988 monitoring and supervisory system that will improve the performance of these enterprises.

Financial Sector and Capital Market

18. As set out in its Policy Framework Paper, the Government intends to provide more flexible financial sector policies and strengthen the money and capital markets. Thus, under the industrial adjustment programme the Government will (i) operationalize the existing discount facility at the Central Bank to permit open market operations and a secondary market by June 1988; (ii) discontinue the review by the Capital Issues Committee of share issue prices for locally-owned firms by June 1989; and (iii) establish a Capital Markets Development Authority with appropriate responsibilities by June 1989. A flexible and strong money and capital market will support the divestiture of industrial public enterprises.

.........6/

V. MONITORING OF IMPLEMENTATION

19. For the proposed industrial adjustment programme to succeed, a monitoring mechanism has to be put in place. The Government therefore intends to establish an inter-ministerial committee composed of representatives from concerned ministries as well as the Central Bank to closely monitor the implementation of this programme. The Government will submit a progress report to the World Bank every six months. The Government is fully committed to implementing all the actions discussed above and in the time specified and will deal with unforeseen events using appropriate market-oriented policy instruments rather than direct Government control.

Yours sincerely,

HON. PROF. GEORGE SAITOTI
MINISTER FOR FINANCE

KENYA - INDUSTRIAL SECTOR ADJUSTMENT CREDIT (ISAC)
SUMMARY OF GOVERNMENT REFORM PROGRAM

OBJECTIVES	STATUS AND RECENT ACTION	ACTION PROGRAM	TIMING	CONDITION FOR
		I. TRADE REFORM		
		(i) Licensing		
(a) Import Liberalization Increase the outward orientation and efficiency of the industrial sector by making protection transparent, even across the sector and lower.	Progress in reform program under SAL I & II was arrested due to macroeconomic imbalance. Program implementation was resumed through tariff reduction in the 1984, 1985 and 1987 budgets. The number of items in Schedule IA (automatic license) were increased. During 1983-1986 quotas were binding only for Schedule 2B (most restrictive). In 1987 quotas became binding in all schedules due to a foreign exchange shortage.	- Reorganize Schedules into I, II, and III and announce: Unrestricted licensing in I, II and III (category A).	6/88	Board Presentation ISAC I
		- First phase of study to examine the impact on domestic industries of unrestrictive licensing for schedule III categories B and C and formulate an action program which will (a) provide domestic industries equivalent protection by tariffs only; and (b) draft appropriate anti-dumping legislation. The second phase of the study will prepare action programs for restructuring companies severely affected by liberalization.	6/88	Board Presentation ISAC I
		- Implement unrestricted licensing for items in schedule III, category B.	6/89	Snd. Tr. ISAC I
		- Implement unrestricted licensing for schedule III, category C during the ISAC II period.	6/90) 6/91)	ISAC II
		(ii) Tariffs and Taxes Rationalize and simplify tariff structure:		
		- Rationalize tariffs such that similar goods bear similar tariffs.) - Reduce number of tariff rates from 25 to 12.) - Review specific duties with the objective of converting them into ad valorem duties.)	6/88 and 6/89	Board Presentation ISAC I Snd. Tr. ISAC I

OBJECTIVES	STATUS AND RECENT ACTION	ACTION PROGRAM	TIMING	CONDITION FOR
(b) <u>Export Promotion</u> Expand and diversify Kenya's manufactured exports to reduce reliance on coffee and tea.	Export compensation scheme is ineffective and administratively burdensome. Implementation of manufacturing-in-bond has been started and will be expanded. Green channel procedures to expedite administative processing of export production has not been implemented. Kenya External Trade Authority remains weak.	- Design a simple import duty compensation scheme to replace the export compensation scheme with wider coverage and three rates reflecting duty actually paid.	9/88	Snd. Tr. ISAC I
		- Implement the import duty compensation scheme with improved administration guaranteeing reimbursement within one month.	6/89	Snd. Tr. ISAC I
		- Issue guidelines and procedures for manufacturing-in-bond that assures access to foreign exchange within one week of application.	6/88	Board Presentation ISAC I
		- Review and implement incentives for manufacturing-in-bond with a view to making them more competitive.	6/89	Snd. Tr. ISAC I
		- Design and commence implementation of a comprehensive export promotion program that includes financing, insurance and improved information support from a joint public/private sector export promotion agency.	6/89	Snd. Tr. ISAC I
		- Prepare feasibility study and implement an export processing zone subject to donor support.	6/89	Snd. Tr. ISAC I

OBJECTIVES	STATUS AND RECENT ACTION	ACTION PROGRAM	TIMING	CONDITION FOR
(c) Price Controls Make the Kenyan economy more responsive to market forces to increase investment and efficiency.	Price controls in Kenya include (a) direct controls on about 11 essential consumer items; and (b) controls on ex-factory prices of 40 manufactured products. The Government, in recognition of the disincentive effects of price controls, has prepared legislation to create a Department of Price and Monopoly Control to monitor actions in restraint of trade. The new bill, however, retains broad powers for the Price Controller and needs to be limited to items produced under monopoly conditions and for a few basic commodities. Prices of some items, including meat, have been decontrolled. Government has also proposed a revision of the formula for price determination from being cost-based to one based on import parity. The Price Control Department's manpower has been increased to speed the processing of applications.	- Remove price controls on 10 products in the General Order of the Price Control Act.	6/88	Board Presentation ISAC I
		- Remove price controls on at least another 10 products.	12/88	Snd. Tr. ISAC I
		- Gradually decontrol prices of all remaining items not falling under the new Restrictive, Trade Practices, Monopolies and Price Control Bill.	6/90) and) 6/91)	ISAC II
		- Move amendment of Restrictive, Trade Practices, Monopolies, and Price Control Bill to (i) redefine monopoly such that it reflects market power and (ii) limit powers of Price Controller to items produced under monopoly conditions or traded under restrictive conditions, as defined in the bill.	6/88	Board Presentation ISAC I
		- Applications for price revision of items that will continue to be controlled under the new bill, and that conform with the cost determination order, should be processed within 90 days.	6/88	Board Presentation ISAC I

OBJECTIVES	STATUS AND RECENT ACTION	ACTION PROGRAM	TIMING	CONDITION FOR
		II. FOREIGN EXCHANGE REGIME		
Maintain external balance and competitiveness by prudent management of the exchange rate.	A major devaluation in December 1982 restored the real effective exchange rate back to its 1976 level. Since then, Government has periodically adjusted the exchange rate to avoid any sustained appreciation of the real exchange rate.	Maintain present policy. Discrete adjustments may be necessary to compensate for removal of quantitative import restrictions and adoption of a more moderate tariff structure.		Coordinated with changes in Section I(a).

OBJECTIVES	STATUS AND RECENT ACTION	ACTION PROGRAM	TIMING	CONDITION FOR
		III. INVESTMENT INCENTIVES		
(a) Taxation Make Kenyan effective corporate taxes competitive with other countries to encourage investment.	Effective corporate tax rates are generally higher in Kenya than in many other developing countries because of limited tax deductions and allowances.	- Improve incentives for investment by reducing marginal effective company tax rates and allowing exchange losses as tax deductions on foreign currency loans used to purchase fixed assets.	6/88	Board Presentation ISAC I
(b) Investment Promote investment.	Investment is hampered by complicated approval procedures and foreign investment suffers from restricted access to domestic credit and delayed transfer of capital gain on sale. Recent changes in the Exchange Control Act have eased somewhat the restrictions on domestic borrowing and the one-stop investor center has been gazetted.	- Streamline investment approval procedures by establishing one-stop investment center at the IPC which will be adequately staffed to ensure expeditious processing of applications.	6/88	Board Presentation ISAC I
		- Issue investment guidelines.	6/88	Board Presentation ISAC I
		- Amend Foreign Investment Protection Act to ease transfers of capital gains on sale of equity.	6/88	Board Presentation ISAC I
		- Establish clear criteria for rejection to make work permit policy transparent.	6/88	Board Presentation ISAC I

OBJECTIVES	STATUS AND RECENT ACTION	ACTION PROGRAM	TIMING	CONDITION FOR
		IV. PUBLIC ENTERPRISES		
Promote private sector as the engine of industrial growth by confining public enterprises to essential Government services and strategic investments.	The Government is directly and indirectly through development banks, involved in 86 industrial enterprises, many of which are experiencing financial difficulties. Although the Government's recent investments have been minimal, it has made halting progress in divestiture (despite a high profile report) and improved efficiency. Government recently announced its intent to sell shares in the two Government-owned banks, and has completed the divestiture of KENATCO and Uplands Bacon.	- Based on a study of the development finance institutions (DFIs) and their portfolios, especially the textile, motor vehicles and steel subsectors, prepare an action program for restructuring the DFIs and divestiture/restructuring of their portfolios.	12/88	Snd. Tr. ISAC I
		- Agree with IDA on an action program for the DFIs and divestiture/restructuring of industrial public enterprises and commence implementation.	6/89	Snd. Tr. ISAC I
		- Improve performance monitoring system for enterprises to be retained in the public sector.	12/88	Snd. Tr. ISAC I

OBJECTIVES	STATUS AND RECENT ACTION	ACTION PROGRAM	TIMING	CONDITION FOR
		V. FINANCIAL SECTOR AND CAPITAL MARKETS		
Develop alternative instruments for managing domestic money supply and foreign reserves. Broaden the range of financial instruments available for private sector investment.	Government has stepped up its use of tendering T-Bills and introduced longer maturities. An Interministerial Committee has developed terms of reference for the Capital Markets Development Authority.	- Establish Capital Markets Development Authority with appropriate incentives and investor protection regulations.	6/89	Snd. Tranche ISAC I
		- Discontinue Capital Issues Committee review of pricing of share issues of domestically owned companies.	6/89	Snd. Tranche ISAC I
		- Establish and operate discount facility in the Central Bank.	6/88	Board Presentation ISAC I

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ANNEX XI

STUDIES TO BE UNDERTAKEN UNDER ISAC I

DESCRIPTION	AREA	RESPONSIBILITY	TIMING BEGINNING	TIMING COMPLETION
1. First phase of study to examine the impact on domestic industries of unrestrictive licensing for schedules IIIB and IIIC and formulate an action program which will (a) provide domestic industries equivalent protection by tariffs only; and (b) draft appropriate anti-dumping legislation. The second phase of the study will prepare action programs for restructuring or liquidating companies severely affected by liberalization.	Trade	Ministries of Finance and Planning	6/88	3/90
2. Study to design an Import Duty Compensation Scheme and improve its implementation.	Trade	Ministry of Finance	4/88	9/88
3. Study to assess the impact of decontrolling prices remaining controlled after January 1989.	Prices	Ministry of Finance	6/88	12/88
4. Study to design a comprehensive medium term export promotion program that includes financing, insurance, an EPZ and improved information support from a joint private/public sector export promotion agency.	Trade	Ministry of Finance	6/88	12/88
5. Study to (i) examine the marginal effective tax rate and design a reduction; (ii) design a tax treatment for exchange losses on foreign currency loans; and (iii) estimate the revenue effects of both. Additionally, the study will also present a cross country analysis of tax incentives for capital market development.	Taxation	Ministry of Finance	2/88	4/88
6. Study of DFI s and their portfolios, especially the motorvehicle, textile and steel subsectors, to prepare an action plan for their restructuring, rehabilitation or divestiture.	Industrial Public Enterprises	Ministry of Finance	4/88	12/88
7. Study to design an implementation program, including legislation, for the Capital Markets Development Authority.	Capital Markets	Ministry of Finance	6/88	12/89
The total cost of these studies is expected to be about US$1 million.				

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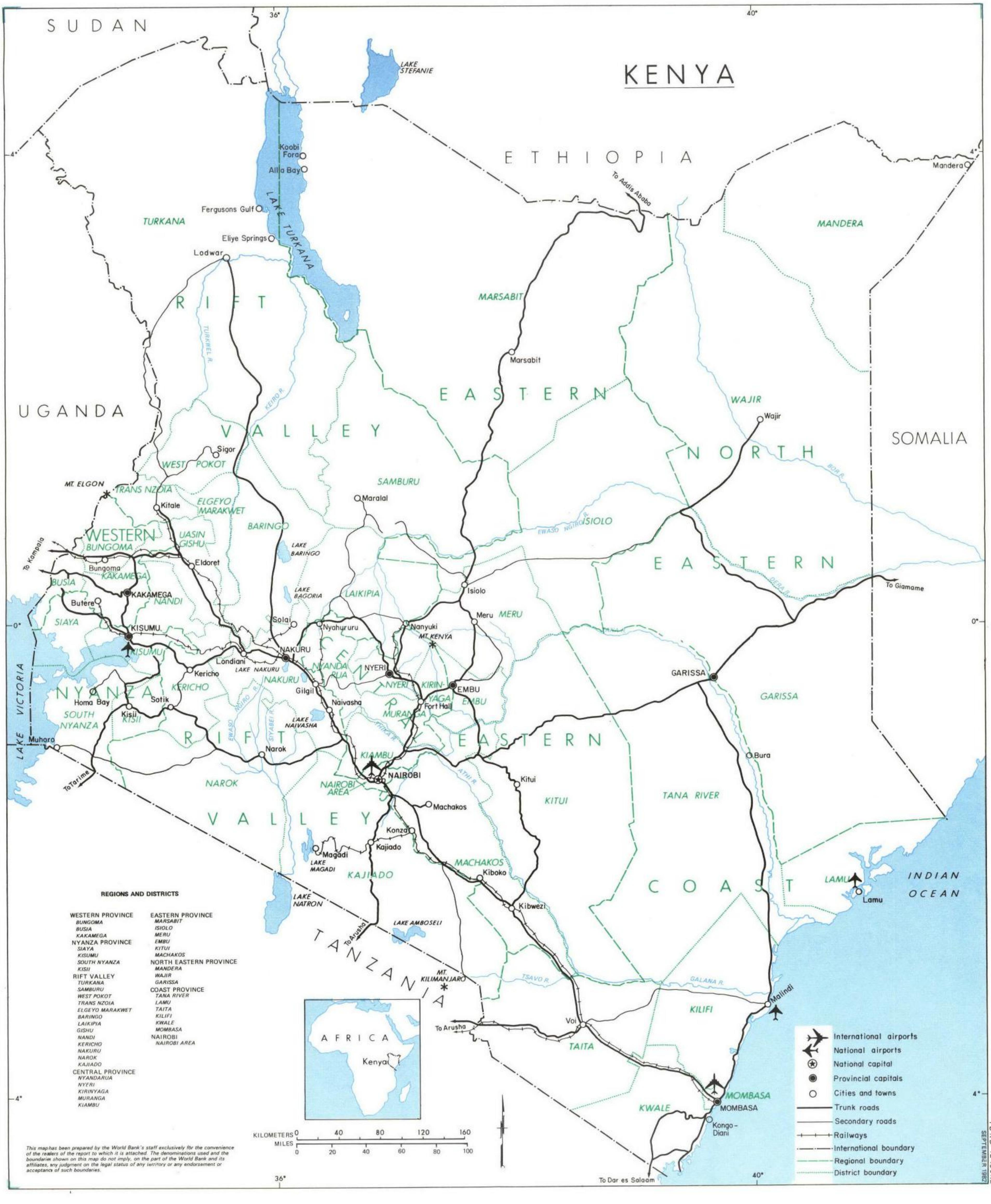
KENYA
SUDAN
ETHIOPIA
UGANDA
SOMALIA
TANZANIA
INDIAN OCEAN
LAKE STEFANIE
LAKE TURKANA
LAKE VICTORIA
LAKE BARINGO
LAKE BAGORIA
LAKE NAKURU
LAKE NAIVASHA
LAKE MAGADI
LAKE NATRON
LAKE AMBOSELI
MT. ELGON
MT. KENYA
MT. KILIMANJARO
RIFT VALLEY
EASTERN
NORTH EASTERN
CENTRAL
WESTERN
NYANZA
COAST
TURKANA
MARSABIT
MANDERA
WAJIR
SAMBURU
WEST POKOT
TRANS NZOIA
ELGEYO MARAKWET
BARINGO
UASIN GISHU
BUNGOMA
KAKAMEGA
BUSIA
NANDI
SIAYA
KISUMU
KERICHO
SOUTH NYANZA
KISII
LAIKIPIA
ISIOLO
MERU
NAKURU
NYANDARUA
NYERI
KIRINYAGA
MURANGA
EMBU
KIAMBU
NAIROBI AREA
NAROK
KAJIADO
MACHAKOS
KITUI
GARISSA
TANA RIVER
LAMU
KILIFI
TAITA
KWALE
MOMBASA
Koobi Fora
Allia Bay
Fergusons Gulf
Eliye Springs
Lodwar
Marsabit
Mandera
Wajir
Sigor
Kitale
Maralal
Eldoret
Bungoma
KAKAMEGA
Butere
KISUMU
Solai
Nyahururu
Nanyuki
Isiolo
Meru
NAKURU
Londiani
Kericho
Homa Bay
Sotik
Kisii
Muharo
Gilgil
Naivasha
NYERI
EMBU
Fort Hall
GARISSA
Bura
Narok
NAIROBI
Kitui
Machakos
Konza
Kajiado
Magadi
Kiboko
Kibwezi
Lamu
Malindi
Voi
MOMBASA
Kongo-Diani
To Addis Ababa
To Kampala
To Giamame
To Tarime
To Arusha
To Dar es Salaam
TURKWEL R.
KERIO R.
EWASO NGIRO R.
DERA R.
BOR R.
TANA R.
ATHI R.
TSAVO R.
GALANA R.
NGIRO R.
SIYABEI R.
THIKA R.
36°
40°
4°
0°
AFRICA
Kenya
REGIONS AND DISTRICTS
WESTERN PROVINCE
BUNGOMA
BUSIA
KAKAMEGA
NYANZA PROVINCE
SIAYA
KISUMU
SOUTH NYANZA
KISII
RIFT VALLEY
TURKANA
SAMBURU
WEST POKOT
TRANS NZOIA
ELGEYO MARAKWET
BARINGO
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NAIROBI
NAIROBI AREA
KILOMETERS 0 40 80 120 160
MILES 0 20 40 60 80 100
International airports
National airports
National capital
Provincial capitals
Cities and towns
Trunk roads
Secondary roads
Railways
International boundary
Regional boundary
District boundary
This map has been prepared by the World Bank's staff exclusively for the convenience of the readers of the report to which it is attached. The denominations used and the boundaries shown on this map do not imply, on the part of the World Bank and its affiliates, any judgment on the legal status of any territory or any endorsement or acceptance of such boundaries.
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BLANTYRE, MALAWI

3-8 DECEMBER 1984

PRIVATIZATION OF PUBLIC ENTERPRISES:
THE CASE OF KENYA

by

GERHARD ECKERT

PRIVATIZATION OF PUBLIC ENTERPRISES:
THE CASE OF KENYA

1. The International Context

The present economic world crisis brings about both high balance-of-payments deficits and high budget deficits for the developing countries. In order to help them, the World Bank and the International Monetary Fund have developed a so-called "Structural Adjustment Programme". It consists of a package of measures combined with loans which are supposed to foster an export-oriented policy. Because the achievement of the intended stabilization by export-orientation alone is not a long lasting solution, basic reforms of the interior structure are also necessary to prevent new destabilizations. That is why the World Bank and the IMF demand to increase the public enterprises" performance and to emphasize the private sector and thus the price mechanism by, for example, privatizing public enterprises.[1]

1

2. The Kenyan Context

The above mentioned world-wide general objectives and the instruments to achieve them do also apply to Kenya.

The ideas of the Structural Adjustment Programme are reflected in the "Sessional Paper on Development Prospects and Policies".[2] Concerning privatization, it points out that "structural adjustment must embrace a more constructive and profitable role for essential parastatals and the return of others to private sector operation (Paragraph 42) and "the possibility that Government will sell shares in selected parastatals enterprises or holding company to Kenyans would increase Kenyanization of the economy without entailing the transfer of scarce domestic saving to foreigners." (Paragraph 44).

3. On September 21, 1982, the President stated: "In view of the substantial government deficits and serious balance-of-payments problems, the government has decided to reduce its subsidies to parastatals and may even withdraw its participation from businesses which have failed to perform well."

4. The "Working Party on Government Expenditures"[3] also recommends that the government should divest of a part of its commercial activities and reduce new commercial activities to a minimum. The working party even suggests already an institution which should work out corresponding strategies "The Parastatal Advisory Committee should be given the responsibility of preparing strategies and mechanisms for divestiture."

5. The "KANU manifesto 1983" States:

"Government participation in commercial enterprises has been carried well beyond the original conception of effective Kenyanisation and effective public regulation and control in the key sectors of the economy. The Government will now therefore carry out a careful review of all parastatals and Government investments to determine:

(i) those whose retention as Government agencies or enterprises is essential to accelerated and equitable national development and the regulation of the private sector;

(ii) those whose objectives have been achieved and which should be discontinued;

(iii) those whose functions could be absorbed by parent ministries; and

(iv) those whose functions would be more efficiently performed by the private sector without passing the Government assets to foreign ownership or control."

6. As all these statements suggest a privatization of Kenyan public enterprises the author examines some fundamental problems on the privatization issue - most of them are not only valid for Kenya - by putting some questions and by attempting to give some at least preliminary answers.

These questions are in the following order:

- What were the objectives for the establishment of public enterprises in Kenya?

- What are the events or circumstances necessitating the privatization of public enterprises in Kenya?
- What does efficiency of public enterprises mean?
- Are there any policy alternatives before deciding on privatization?
- Which public enterprises should be privatized?
- What are the results of a privatization?

7. What were the Objectives for the Establishment of Public Enter-Prises in Kenya?

Before being able to answer the question why there are efforts at present to privatize Kenyan public enterprises, the question concerning their objectives has to be dealt with.

Before going into detail, we can already state that public enterprises in Kenya have not been established for ideological reasons, (as it was the case for example for Tanzania) i.e. ideological reasons are no barriers for a return to private sector operation. The share of public enterprises of the Kenyan economy is the result of political, historical not ideological decisions. In general, there is no theoretically fixable borderline between the public and the private sector of any economy.

Public enterprises in Kenya served and still serve as instruments to achieve different objectives. These main objective are:

(i) An essential reason for the existence of public enterprises in Kenya was the lack of sufficient indigenous private capital and private entrepreneurship after independence. (This seems to be true for most of the other developing countries as well).

In order not to leave the enterprises in the hands of white settlers and foreigners, there was only one chance: nationalization, that is to say, the government had to fill the existing capital gap and entrepreneurship gap. This objective is wellknown under the heading of Kenyanization viz. Africanization of the economy. Besides political independence, Kenya wanted to achieve its economic independence as well.

(ii) A second objective was to promote development. National development was considered as too important as to leave it under the control of private enterprises with their own particular interests. So public enterprises served as an indispensable instrument for economic development.

not only so they had even more impt jobs to do

Both of the objectives mentioned so far are of course closely linked together, the Kenyan Government wanted to create a national base for development and public enterprises served as the appropriate meeting point of both decolonialization and economic development.

(iii) Another very interesting objective for Kenya is: Kenyan public enterprises serve as a means to promote the establishment of private African enterprises. That is the case for ICDC, KIE and NCC[4] which provide financial as well as technical assistance to indigenous private entrepreneurs. This is a proof that Kenya did not establish public enterprises for ideological reasons. ICDC also serves to achieve another objective viz. the acquisition of shares in foreign firms producing in Kenya. Both are measures of Africanisation.

(iv) Another objective is the preference or even insistence on the part of the external investor for some government shareholding in order to reduce the risk of the external investor.[5]

(v) Moreover, the Kenyan Government wanted to achieve some other objectives which are not only applicable to Kenya. These are objectives which are pursued by such enterprises in other countries as well. For example, the government has to use public enterprises as an instrument when because of lack of profit outlooks private capital is reluctant to invest. In this case, the government has to fill another gap, viz. the profit-outlook-gap. We shall deal with the importance of these objectives in our chapter: What does efficiency of public enterprises mean?

8. By scrutenizing these objectives, it seems that public enterprises in Kenya in most cases can be considered as only transitory instruments used as long as certain objectives are achieved. This statement seems to be true for public enterprises in countries which have not established public enterprises for ideological reasons. If public enterprises are considered as only transitory instruments, the reasons for their existence can be compared with the reasons for the "Infant-industry-protection" in the theory of international trade. Which states - and even liberal economists agree with it - that the indigenous infant industry of a country should be protected against foreign competitors only transitorily, viz. until the indigenous industries are competitive to their foreign competitors. A very similar argument is used concerning the public enterprises in Kenya: they should stay transitorily in public ownership until they have reached at least one of their stated objectives. So the two measures: liberalization of imports and privatization are linked together.

In a wider context nowadays, a world-wide trend can be observed showing a diminishing of statal presence in the economy of many countries. (Interesting to note that many Kenyan public enterprises were established during the world depression from 1929 to 1932 in order to increase the states influence, for example the marketing boards for several crops. Whereas the remedy for the present economic crisis seems to be the contrary, viz. the diminishing of statal presence in the economy).

9. After having discussed the most important objectives of Kenyan public enterprises, we now deal with the question what are the events or circumstances necessitating the privatization of public enterprises

in Kenya? Are the above mentioned reasons for their existence no longer valid? Or, can we assume that their objectives have been achieved and that public enterprises therefore have become redundant as instruments? In these cases, the above mentioned role of public enterprises as transitory instruments would be fulfilled successfully. Or have policies changed or has even ideology changed?

What are the events or circumstances necessitating the privatization of public enterprises in Kenya?

First of all, the Kenyan Government regards a privatization of its public enterprises as an instrument to improve the efficiency of the economy as a whole, i.e. as an instrument to better allocate the scarce resources of Kenya. The hypothesis (a hypothesis is not a proof) that the private sector is more efficient than the public one is therefore the essential underlying assumption.

10. There is a number of examples to support this hypothesis:

- The (private owned) informal sector in Kenya seems to be very viable and efficient, most likely because of the high competition in these fields.
- According to a Nairobi newspaper, a private company is willing to take over the garbage disposal in Nairobi which has been carried out by the suspended Nairobi City Council rather unsatisfactorily. This particular company offered to do it at the same price, the City Council charges.
- Even socialist and communist countries try to privatize in some sectors of the economy step by step, that is to say, they rely more and more on the free market pricing mechanism. For example, Romania offers shares to workers of the company they work for. In Hungaria government owned restaurants and shops are leased to private businessmen.

11. The fact that there is a link between privatization and a transfer of ownership is considered only as a side effect not as its main objective

in Kenya. In England, however, the situation is completely different. The present privatization campaign there, has a more ideological background, and for that reason, it can be compared with the privatization campaign in Chile after Allende's death and with the present privatization in Turkey. According to liberal ideas, the Government has to get rid of commercial undertakings unless they serve the safeguarding of important public interests.

Another main objective was pursued by the privatization of some public enterprises in Germany, for example the Volkswagen company. Its privatization was mainly understood as a means to narrow the gap in the existing wealth and income distribution. Only people whose income was below a certain limit could acquire shares. That is to say, they were granted a so-called social discount. Therefore, in the Volkswagen case, a very wide-spread distribution of shares took place, about 1,600,000 people bought them. Of course, this "social" privatization has an ideological background, too.

Simply said, people who own shares are normally not interested in changing the existing societal and economic system by revolutions. Thus, such a wide-spread ownership serves as a political tranquilizer. This tranquilizer effect is reinforced when workers get - maybe even preferential - shares of that particular company they work for.

12. According to its main objective, one can at least theoretically distinguish between three different types of privatization, although, there are in most cases combinations of them:

- Privatization for improving efficiency reasons
- Privatization for ideological reasons
- Privatization for social reasons

13. Except of the improvement of the efficiency of the economy, there are still some other reasons for the ongoing discussion on privatization of Kenyan public enterprises. These reasons are similarly linked to each other as the above mentioned objectives of their establishment.

- To cut down Government spendings and thus to narrow the huge budget deficit. (This is the reason the President mentioned in his statement on the economy, see our paragraph 3). One obvious measure in this respect is the cutting down of the permanently rising and uncontrolled subsidies to public enterprises.
- Recently there were some scandals concerning Kenyan public enterprises, for example the "Kenren" case and the Kisumu "Molasses" case. Both of these undertakings failed after huge government investments. They are "white elephants" now and the "wananchi" seems to be disgusted with them.
- Public enterprises are often sources of corruption everywhere in the world and also in Kenya.
- Back to the main reason for the establishment of Kenyan public enterprises, the Kenyanization issue. This surprisingly leads to one of the reasons for their now intended privatization: the post-colonial-or era with its above mentioned scarce-production-factor-situation seems to be over twenty years after independence and one seems to believe that neither indigenous capital nor indigneous entrepreneurship are any longer scarce production factors in Kenya. This seems to be the opinion of the authors of the already cited Sessional Paper and of the KANU manifesto, too, where they state that not any longer public enterprises but their privatization is considered as the appropriate instrument to achieve Kenyanization.

14. At the beginning of this chapter, we asked the question whether or not the objectives of Kenyan public enterprises are already achieved and whether or not they are planned to be transformed into private enterprises just for this particular reason. This seems obviously not the case because still the same objective, viz. Kenyanization is now tried to be achieved by just the

contrary, the abolition of public enterprises. Consequently, one can assume that public enterprises must have failed as an instrument to achieve Kenyanization.

It was stated that the essential reason for the intended privatization is the improvement of the economy's efficiency. Consequently, the following question arises:

15. What does efficiency of public enterprises mean?

The efficiency of public enterprises can not only be measured by its profit or loss at the end of the enterprises' budget year. Because public enterprises normally still pursue other - in a hierarchy of objectives even superior - objectives than profit-making. In other words: losses in the balance-sheet do not automatically mean an overall bad efficiency. Losses could even be a stated objective, for example, when commodity prices are artificially kept down for social reasons. This can be the case for basic needs commodities. Therefore, profits and losses as they occur in a normal balance-sheet can never be the appropriate yardstick for the overall efficiency of public enterprises. The reasoning is as follows: in a balance-sheet only such services of an enterprise are included which were sold on markets, that means those which have a market price. Other services which are produced because other objectives besides profit are pursued and for which market prices do not exist because they are not sold on markets (because there do not exist markets for such services) are never included in a normal balance-sheet. Thus, social benefits as well as social losses of an enterprise are not taken into account. Except if there exists a so-called social balance-sheet as an additional part of the normal balance-sheet, which some enterprises in developed countries are beginning to introduce.

16. Such superior macro-economic objectives can be for example: (here we mention only those objectives which have not yet been mentioned in our paragraphs 7-11)

- promoting development, in such a way that public enterprises act as innovators and therefore as proto-types for private enterprises. Later on, when this function is fulfilled and they begin to earn profits they are being privatized. (This sequence is, by the way, often just the other way around in developed countries. Private enterprises there are usually transformed into public enterprises then when they do not gain profits any longer).
- social objectives, for example to keep down the prices for basic needs commodities,
- regional objectives, to foster development in remote areas,
- employment objectives, public enterprises in India, for example, are supposed to overstaff at least for about 25%.

In all these cases again public enterprises serve as instruments to achieve certain macro-economic objectives.[6]

17. These macro-economic objectives on the one side and the micro-economic objective of profit maximization on the other side are in most cases contradictory to each other, that is, both cannot be fully achieved in the same moment. In case the profits are to be increased then only at the expense of the other objective(s). That is why the politicians have to balance which one of the objectives they prefer, and often public enterprises have to subordinate economic rationality to political rationality. This problem does not arise, however, when the macro-economic objective is best or even only achieved by public enterprises. The most crucial problem is that potential welfare losses due to micro-economic in efficiency on the one hand and welfare gains due to the achievement of macro-economic objectives on

the other hand cannot be set off against each other because these two counter-rotating welfare effects can hardly be quantified. Due to this missing quantificability there always exists the danger that uneconomic behaviour is being disguised in referring to the fulfillment of public functions.

A cost-benefit analysis could be a helpful instrument by balancing the contradictory objectives. But also here the decision-maker has to quantify what the achievement of the stated macro-economic objective is worth to him. Did he make up his mind for a certain amount, which means a subsidy to the public enterprise, then, however, this amount has to be disposed of only at the beginning of the enterprises' budget year. Then the manager has to economize with this given subsidy. In case he did not perform well he won't be able to get more subsidies at the end of the budgeting period. Proceeding in this described manner means that no new accounting system for public enterprises is necessary. Again, the most crucial point is the problem of how to quantify the value of achieving certain hardly quantifiable objectives. In solving this problem economists can only give help to the politicians. Economists can never alone solve this problem. It is always up to the politicians to decide. Public enterprises are some kind of a compromise between market and politics.

Without being able to give a solution to the quantification problem we summarize here: Efficiency of a public enterprise can only be measured by taking into account the achievement of their micro- and of their macro-objectives together. We will then call it their "overall efficiency".

After having given some introductory comments on the problem of efficiency of public enterprises we will now turn to the question.

18. Are there any policy alternatives before deciding on privatization?

We will see, there are at least two such methods. These methods, however, do not involve a shift in ownership. And a shift in ownership is not, as we learnt, an objective of privatization in Kenya. The reason for privatization there is not an ideological one.

We distinguish two such methods. According to their approach, we call them the Management and the Labour Force Method (or their combination).

19. The Management Method:

The overall efficiency of public enterprises can be improved without any shift in ownership if they are managed according to market commercial rules. This has to include the end of their tight control by government. Thus, what has to be changed is the managers' and the politicians' behaviour. It can be changed as follows, by:

- changing, viz. improving of Management Training by, for example, teaching commercial Management Techniques,
- improving of managers' motivation by granting income incentives according to performance and by also granting them independence from their respective parent ministries which includes more responsibility for the managers.

20. The Labour Force Method:

Here again there are the same two approaches: the improvement of training and the improvement of motivation. Motivation can be improved by, for example, payment according to performance and/or by labour forces' participation, their co-determination in the company, i.e. by giving more responsibility to the labour force which in most cases includes more training as a precondition.

21. Here again one can distinguish between different kinds of privatization, now depending on the extent one privatizes:

1. kind: a shift only in behaviour and not in ownership, i.e. enterprises are to work according to market commercial rules without any tight control by the administration. We call it a "Proforma Privatization".

2. kind: a shift in ownership which usually includes the above mentioned shift in behaviour, i.e. the proforma privatization is part of this second kind, the "real privatization"[7]

22. Our distinction has a consequence which ought to be emphasized because it is not familar to everybody.

Because,

- a proforma privatization is a question of the managers' behaviour, and
- a real privatization is a question of ownership (either private ownership - "capitalism" - or public ownership - "socialism" -)

We can argue: the decision of any country to manage its public enterprises according to market commercial rules does not at all include a decision for capitalism. Our distinction furthermore includes: a lack of private capital and/or a lack of private entrepreneurship is by no means an obstacle for a behaviour according to market commercial rules. Because capital can belong to the public and entrepreneurs do not have to be private ones. Again:

a market commercial behaviour is not identical with capitalism. The managements behaviour and the ownership pattern do not have to be linked together. Often they are, but this is not a must.

23. We conclude with repeating some important statements: the essential objective of privatization is the improvement of the economy's efficiency, the means to achieve this objective can be:

- the transfer of private business behaviour only
- the transfer of ownership to private entrepreneurs (which includes the transfer of private business behaviour)

The underlying hypothesis is: the private sector is more effective than the public sector.

24. Thus, an initial and maybe even sufficient policy alternative towards improving efficiency of Kenyan public enterprises could be a mere proforma privatization.[8] This has to include that the environment of the enterprise has to be changed towards more competition, for example by the abolition of import restrictions, government control and monopolies.

Our distinction between a proforma privatization and a real privatization is used again in the following chapter. Here we ask:

25. Which public enterprises should be privatized?

To be able to answer this question we have to deal with two other questions first. These are:

1. Do public enterprises pursue macro-economic objectives?
2. Do public enterprises earn profits or make losses in terms of market commercial rules?

26. For that reason we will divide public enterprises into three different groups.

Group A: If the public enterprises are pursuing such superior macro-economic objectives which the Government does not want to give up because they cannot be sufficiently achieved by other instruments then there should by no means be a real privatization. This can be stated without asking the second question.

In these cases there is no reason in handing them over into private ownership. (The so-called "public utilities" certainly belong to this group). There should only be a proforma privatization including all the above described consequences. Now to these groups of public enterprises which do not pursue such objectives. Here we should use the efficiency standards of private business and ask our second question.

Group B: If public enterprises do earn profits, there should be no real privatization and thus no transfer into private ownership because such enterprises increase the government's revenue. In this case they serve as a certain instrument, too. To serve as an instrument to increase the government's revenue was the original objective of public enterprises in Europe.

but earlier said decided to privatize anyway.

If there was a privatization campaign in Kenya for idelogical reasons then such profit-making-public enterprises had to be privatized as well, irrespective of their profit-making. Of course, private entrepreneurs wish that such enterprises which earn profits are privatized and that only those stay in public ownership which make losses. That is to say, they would like to privatize profits but to socialize losses.

Group C: If public enterprises do not earn profits (and do not pursue macro-economic objectives) then there should be a real privatization. The Kenyan President apparently had this group in mind when he stated that the Government may "withdraw its

or abandon, like other countries.

participation from businesses which have failed to perform well" (see our paragraph 3).

The question then arises whether or not the sale of these enterprises would be possible. The answer is obvious, these public enterprises are able to be sold. Their sale is only a question of their market price. In case it is sufficiently low, there will be enough potential buyers. Then, however, the tax-payer "pays" for the losses of these public enterprises in the past. Their buyers usually will dismiss people and/or increase the prices of their produced commodities to be able to earn profits in the future because these enterprises will be bought by private businessmen to earn profits. And private businessmen normally will ensure that prices are at levels that bear proper relationship with the real costs of production.

27. An important note has to be made here. In dealing with the proforma privatization we already spoke about the necessary improvement of competition by the abolition of monopolies. This is valid in the context of a real privatization, too. It makes no sense at all to only transfer public owned monopolies into private ones because, according to economic theory, both behave in the same way concerning their pricing. In this case a transfer of ownership has to be accompanied by a fostering of competition as well.

28. After having distinguished these three groups and their respective differences the following idea arises: Why not using money earned by group-B- enterprises and by the sale of group-C- enterprises as the necessary subsidies for group-A-enterprises?

29. As a conclusion to this chapter our decision scheme is being formalized:

Do public enterprises pursue
(superior) macro-economic objectives?

YES

proforma privatization

(Group A)

NO

Do these enterprises make
profits or losses?

no privatization

or only *proforma*

(Group B)

real privatiz.

(Group C)

According to our reasoning following this decision scheme a real privatization should only take place for a part of the public enterprises, viz. our Group-C-public enterprises.

The statement above that private businessmen will dismiss people and/or increase prices after having acquired a former public enterprise leads to our next question:

30. What are the results of a privatization?

1. It is likely that in many cases prices - also for basic needs commodities - will be increased. The standard of living will go down. This can lead to social and political problems. If the prices for export-goods will go up, this will tend to decreasing exports. (But maybe then the taxes out of which the losses of the former public enterprise were paid as subsidies can be decreased. A consequence which seems to be very unlikely in reality.)

2. In many cases the employment rate will fall because workers will be declared redundant, i.e. the employment rate of a country will tend to fall.

3. A privatization will most likely worsen the existing problems of the income and wealth distribution in Kenya, i.e. it will widen the gap in their distribution. There are at least two reasons for this:

   - very often the former public enterprise produced basic needs commodities which are bought proportionately more by the poorer people. When as a consequence of privatization the prices of basic needs commodities go up the poorer suffer more from it than the rich.

   - Only rich people can afford to buy shares of the privatized companies unless there is a social discount as we saw in the Volkswagen case. But this seems to be a method which is not possible in developing countries.

31. If a country privatizes public enterprises the achievement of four fundamental macro-economic objectives, as:
- price-stability
- equilibrium in the balance on current account
- high employment
- reduction of the gap in the country's income and wealth distribution

tend to be sacrificed for the sake of the achievement of only one of such an objective, viz. efficiency and thus economic growth. (We cannot discuss here all the interdependencies between these macro-economic objectives). Such a sacrifice cannot only have economic onsequences but may also lead to social and political disturbances in the country. One could argue that economic growth will automatically lead to higher employment. But economic growth will usually worsen two other objectives, viz. price stability and the income and wealth distribution of a country. And increasing prices in general will worsen the country's ability to compete on international markets and thus worsen the influx of foreign currency and can lead to even more serious balance-of-payments problems.

The costs in form of subsidies for the public enterprises which are intended to be cut down with a privatization are very often imposed on the citizen again at another place, for example as higher commodity prices or as higher taxes to be able to pay unemployment benefits to more people. Privatization leads in general to a crucial conflict between efficiency on one side and the reduction of the gap in the distribution on the other side. By neglecting the distribution issue and thus emphazising only the efficiency issue there can be unforeseen social and political consequences.

After all, it seems to be easier to establish public enterprises than to get rid of them. Consequently the Government should at least restrain from establishing new ones. (A recommendation of the already mentioned working party, too.) Even if one does not agree with all the uttered arguments and implications, however, one finding seems to be certain: privatization is by no means a panacea to solve all economic problems of a country.

Incidentally consequences of "pro forma privatization" should be very much the same.

FOOTNOTES

1. The paramount importance of a better performance of their public sector including their public enterprises for the developing countries is shown by the very broad treatment of this particular issue in the World Development Report 1982.

2. Sessional Paper No. 4 of 1982 on Development Prospects and Policies, Nairobi 1982.

3. Working Party on Government Expenditures: Report and Recommendations, Nairobi 1982.

4. ICDC = Industrial and Commercial Development Company.

   KIE = Kenya Industrial Estates

   NCC = National Contruction Company

5. This objective is mentioned in: Ndegwa, Philip, Accelerated Development in Sub-Saharan Africa, p. 18, Paper presented to a Symposium of the Society for International Development "Options for Africa in the 1980's and beyond", Nairobi, March, 1983.

6. We could add here training objectives. Many managers of private multinational companies in Kenya have been employed before as managers in public enterprises. This finding can mean that public enterprises fulfill involuntarily a kind of practical training for the private sector in Kenya. In this case the private sector would act as a "free-rider". Maybe one reason for this is the better payment by the Multinationals.

7. In Germany it is discussed that the Government only leases certain public enterprises to private businessmen. We learnt that this method is being used in Hungaria for state owned restaurants and shops. This procedure implies that the financial consequences for the Government are exactly to be calculated in advance. Using our two kinds of privatization we can see that the leasing includes a shift not in ownership, therefore it is a proforma privatization.

8. Jamaica, for example uses this method by "importing" managers and their skills for its public enterprises. This particular method, however, would be in the case of Kenya contradictory to the idea of Kenyanization.

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AAPAM SIXTH ROUNDTABLE

BLANTYRE, MALAWI

3 - 8 DEC. 1984

PRIVATIZATION OF PUBLIC ENTERPRISES

The case of Canada

by

James Gillies

Privatization of Public Enterprise: The Case of Canada

By

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Toronto, Canada.

For the

African Association for Public Administration and Management

Sixth Roundtable, Blantyre, Malawi

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Privatization of Public Sector Enterprises: The Case of Canada*

During the past few years the privatization of public enterprise, that is the transfer of functions undertaken by the public sector to the private sector, has become a matter - and a policy - of increasing importance in Canada. Moreover, its significance is certain to increase. The government elected in 1984 was given a broad mandate for change and it interprets part of that mandate as a call for the re-examination of the role of Crown corporations in the Canadian economy, and where appropriate, the privatization of their activities. This development is of great interest - and importance - because it runs contrary to much of Canadian history and tradition.

I

Historically, ideology has played very little part in economic policy making in Canada. Unlike their neighbours in the United States, Canadians have never been particularly concerned about direct intervention by the government in economic activities. Indeed, one of the conditions for the Maritime provinces joining confederation was that the government would build a railroad connecting them with central Canada. Ever since governments - federal, provincial and municipal - regardless of their political persuasion have established and operated a wide variety of institutions whenever they deemed it to be in the national interest to do so - and Canadians have usually supported such initiatives.[1]

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[1] See James Gillies, Where Business Fails (Montreal: Institute for Research on Public Policy, 1981), pp. 5-11

Indeed, the standard interpretations of Canadian economic history have always assigned to the state a major role in guiding and stimulating growth[2] and there are those who argue that Canada "is essentially a public enterprise country - that it always has been and always will be".[3] Whether or not this is true it is a fact that the federal government is the largest single investor in business activities in Canada today.

In 1981 the federal government had an interest in 463 corporations. Seventy-five of these were wholly owned, 25 jointly so, and in 26 it had a continuing role through equity and management participation. These firms had an interest in 213 subsidiaries and 134 affiliated companies. Great as these figures may be it is equally interesting to note that 80 per cent of the corporations in which the government shares ownership have been established since 1960.

In addition to the extensive federal presence in the economy the ten provinces in 1980 operated 233 corporations and had equity in an additional twelve. Seventy-six per cent of the wholly owned provincial corporations have been created since 1960.[4]

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[2] See H G. J. Aitken, "Defensive Expansion: The State and Economic Growth in Canada" in Approaches to Canadian Economic History, edited by W. T. Easterbrook and M. H. Watkins (Toronto: McCelland and Stewart, 1967), p. 184.

[3] Herschel Hardin, A Nation Unaware: The Canadian Economic Culture (Vancouver: J. J. Douglas, 1974), p. 140.

[4] B. E. C. Boothman, In Business for Canada: The Strategic Behaviour of Canadian Government Controlled Enterprises. Draft Manuscript, Faculty of Adminstrative Studies, York University, Toronto, 1984. Unpaged. Quoted by permission of the author.

In 1982 there were 38 Canadian government controlled enterprises on the Financial Post[5] list of the top 500 non-financial corporations in Canada and in 1981 wholly owned government controlled enterprises had expenditures of $30.4 billion and employed 263,000 people, in comparison with all government departments which spent $75 billion and employed only 221,000 people.[6]

Government corporations were active in all areas of the economy, as indicated by Table I and their variety can be grasped by an examination of the random illustrative list provided in Table 2.

The reasons for the movement of governments - both provincial and federal - into the ownership of various sectors of the economy are so complex and varied that it is difficult to generalize about them. Originally, the government created Crown corporations to assist in the process of building an infra-structure for the nation. Later direct government intervention was exercised for all the usual reasons - to regulate natural monopoly (Ontario Hydro) to serve as a yardstick competitor (Petro-Canada) to ensure proper use of natural resources (Uranium Canada Ltd.), to assist in the rationalization and revitalization of sick industries (St. Anthony's Fisheries Ltd.), to control the external benefits and costs of activities (National Capital Commission), to achieve economies and social equity (Agriculture Stabilization Board), to produce military equipment (Canadian Arsnols Ltd.), to provide more control over specific sectors of the economy (Petro-Canada) and so on. Each - from the Canadian Broadcasting Corporation to the

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5 The Financial Post is a leading Canadian business newspaper.

6 Boothman, Op. cit.

Table 2 - An Illustrative Listing of Canadian Crown Corporation

Air Canada
Atomic Energy of Canada
Bank of Canada
Canada Deposit Insurance Corporation
Canadair
Canadian Broadcasting Corporation
Canadian Commercial Corporation
Canadian National Railways
Cape Breton Development Corporation
Central Mortage and Hosuing Corporation
Eldorado Nuclear Limited
Export Development Corporation
Farm Credit Corporation
Federal Business Development Bank
National Harbours Board
Loto Canada
National Arts Centre Corporation
National Capital Commission
National Film Board
National Research Council
National Transportation Company Limited
Petro-Canada
Royal Canadian Mint
Teleglobe Canada
VIA Rail Canada Incorporated
Atomic Energy Control Board
National Research Council
The National Battlefields Commission
Atlantic Pilotage Authority
Canada Post Corporation
Canadian Livestock Feed Board
Canadian Saltfish Corporation
Canagrex
The St. Lawrence Seaway Authority
Canadian Development Investment Corporation

[9]Selected largely from Schedule I, Bill C-24, House of Commons of Canada, June 28, 1984

The rapid increase in the direct intervention by governments in the Canadian economy in the past two decades cannot, however be totally explained in terms of the development of specific institutions to meet particular needs. It was also the result of an increasing belief on the part of many policy makers that such intervention would improve the total performance of the economy.

During most of the post-World War II period Canadian economic policy was based largely on Keynesian economic theory. Indeed, Canada has been characterized as one of the most Keynesian countries in the world - and the policies worked well. Until the 1970's through the judicious application of macroeconomic measures successive governments were able to maintain a pattern of relatively low unemployment, rapid growth and stable prices. However, by the 1970's it was becoming apparent that Keynesian policy alone were no longer capable of assuring a high level of economic performance. As to be expected policy-makers (and governments) looked for new approaches - not to have done so would have been to commit political suicide - and many of the policies that were chosen more often than not involved the direct participation of the government in economic activity, usually through the creation of a crown corporation.

Whether or not this was the proper response to the problems is open to debate. What is not debatable is that the rapid increase in the use of public sector enterprises in Canada was seldom challenged by the Canadian people. And this is not astonishing for as Peter Drucker, the management philosopher has written "rarely has there been a more torrid love affair than that between the government and the generation that reached manhood between 1948 and 1960. Anything anyone felt needed doing during this period was to be turned over the the government".[10]

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10 Peter F. Drucker, The Age of Discontinuity (New York : Harper and Row, 1969), p. 213

The reason for this attitude is easy to understand - during most of the post World War II period governments in the western industrialized world were effective in solving most economic problems and the Canadian people expected their governments to continue to do so. If this resulted in an increasing amount of direct intervention by the government in the market place, it was a matter of indifference to most as long as the policies worked.

This historic and traditional pattern with respect to the use of public enterprises in Canada is, therefore, very clear. When there are economic and social problems that must be resolved the government is expected to take action to solve them and if such action involves the acquisition of private sector firms, the creation of crown corporaions, or the development of mixed-enterprises the electorate has normally supported such moves. Given this history, and the extensive experience of the Canadian people with Crown corporations and other forms, of public sector enterprises why is the question of privatization now of such importance in Canada?

II

The Canadian people are above all pragmatic. When, during the latter part of the 1970's and the early 1980's unemployment reached the highest level since the depression, there was little real growth in the economy, inflation reached new heights, interest rates soared and productivity ceased to increase, faith in government policies began to waver. Moreover, the explanation on the part of the government that the problems were international in cause and scope, while recognized as possessing some validity were not entirely satisfactory because the performance of the Canadian economy, relative to other countries - particularly the United States - was poor.[11]

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11 See James Gillies, "Agenda for the Economy", Policy Options, May-June, 1984, pp. 17-21

Since Canada is rich in resources, has a large well-trained force, social stability, and relatively easy access to one of the largest, richest markets in the world, it is not astonishing that there began to be reservations about the policies being followed by government. Since the heart of many of these policies involved the intervention by the government in the market place through the creation of Crown corporations and other initiatives there began to be questioning as to whether or not so much government intervention was productive.

While the poor performance of the economy was a significant factor in the increase in concern about public sector corporations it in itself would have led to the strength of the movement for privatization. Far more important was the increasing evidence that many Crown Corporations were badly managed and increasingly non-accountable to the government, let alone to parliament. Various inquiries[12] into the business activities of some Crown corporations - Air Canada, Polysar Corporation, and Atomic Energy of Canada have involved "allegations of conflict of interest, kickbacks, secret commissions, and ineffective oversight".[13] The Final Report of the Royal Commission on Financial Management and Accountability as well as a special study[14] made by the Privy Council Office of Crown corporations both pointed out massive deficiencies in the control and accountability of corporations.

In spite of these studies - perhaps more properly called warnings - both publiched in the 1970's, relatively little was done to change the system and

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12 See Canada, Royal Commission on Financial Management and Accountability: Final Report (Ottawa: Ministry of Supply and Services, 1979); Air Canada Inquiry Report (Ottawa: Information Canada, 1975); Minutes of Proceedings and Evidence of the Standing Committee on Public Accounts, Issue Number 39, July 7, 1977 (Ottawa: Queen's Printer for Canada, 1977); Ibid., Issue Number 21, March 17, 1978 (Ottawa: Queen's Printer for Canada, 1978).

13 M. J. Trebilcock and J. R. S. Prichard. Op. cit., P. 2

14 Canada, Privy Council Office, Crown Corporations: Direction, Control, Accountability (Ottawa: Ministry of Supply and Services, 1977).

literally dozens of new Crown corporations were created. Many of the possible consequences of the lack of proper control on Crown corporations came forcefully to the attention of the government and the public in 1984. Canadair, the Crown corporation producting aircraft,,had a debt of $1.4 billion which had to be absorbed by the government (in fact, it was simply written off) in order for it to be able to continue to operate, otherwise it would have had to declare bankruptcy. In addition, the government had to supply the company with an additional infusion of capital to assure its continuation. DeHavilland, another Crown corporation in the aircraft industry needed an additional captial input of $300 million. Petro-Canada, the national oil company, asked the government for additional funding of $25 million and went on record that it would need a further $275 million in 1985, in addition to more than $5.4 billion over the next decade to finance exploration in the off-shore oil basins and northern Canada lands. Air Canada, the national airline, projected that it would need an additional $10 billion from the government over the next ten years and Via Rail, the passenger train system, had a deficit of more than $750 million in 1983 in spite of a legislated ceiling for its deficit of $240 million.[15]

This great drain on the consolidated revenue fund of the government of Canada called into question two things - the management and accountability of corporations and whether or not they are the most effective policy instrument for fulfilling the public purpose. All Crown corporations, at the federal level,

15 Problems of public corporations were not limited to Canada. Boardman and Vining report there "is fairly strong evidence that, after controlling for a number of other factors, mixed and state owned companies , on average, perform significantly worse than private companies, State owned enterprises have a return on equity of 13 per cent less than private companies, a return on assets and return on sales which is about 2 per cent less and profits which are 50 to 67 per cent less than private companies..." The data on which their findings are based are from 500 largest (in terms of sales) manufac - turing or mining industries in the world, excluding the U.S. and eastern block as reported in the Financial Post International500 in 1983, and based on 1982 annual reports. See Anthony E. Boardman and Aidan Vining, "A Comparison of the Performance of Private, Mixed and State Owned Enterprises", Unpublished paper. Faculty of Commerce, University of British Columbia, Vancouver, Canada

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are created by a special act of parliament, letters patent (normally) pursuant to the Canada Corporations Act) or by articles of incorporation under the Canada Business Corporations Act. Their functions are designed by their charter and it is the duty of parliament to hold them accountable, both for the fulfillment of their mandated purpose, and their financial operations, primarily through scrutiny by the Public Accounts Committee of the House of Commons. Theoritically, the Cabinet provides the major policy thrusts and participates in the major decisions of the corporation. The Treasury Board exercises financial control and the books are audited either by the Auditor-General or by an approved chartered accountant firm. But given the record of the past few years it is clear that the control system is not working. The members of the Public Accounts Committee do not have the staff to provide control, and managers and boards of Crown Corporations complain that quite often the Cabinet minister responsible for a company is reluctant to specify what the corporation should do for fear of being charged with interfering in operations.[16] The double mandate of many Crown corporations, that is to operate effectvely as a Commercial enterprise and also serve the public purpose, often lead them into conflict situations which make them almost impossible to manage.[17]

In addition to the accountability and management problem there is concern

[16] For an extensive discussion of these issues see Maurice F. Strong, "Government Private Sector Relations in Canada - The Federal Government as Investor in Business", The James Gillies Alumna Lecture, Faculty of Administrative Studies, York University, Toronto, Canada, March 23, 1983, pp. 9-24. I served as a member of the Public Accounts Committee in 1976, 1977 and 1978 and can attest from first hand experience to the inability of the Committee, given its present structure, to effectively assess the operations of Crown corporations.

[17] Joel Bell, "The Role of the Board in Crown Corporations: Responsibility, Accountability and Flexibility in Commercial Crown Corporations", Notes for a Speech, Conference Board of Canada, Toronto, November 30, 1983, pp. 7-12.

about the growth of their activities - growth far beyond their original mandates. For example, Canadian National Railways has 73 subsidiary companies, Air Canada has 24 and Petro-Canada 56. Activities range from running tourist agencies to interest in the fashion industry.[18] Such activities seem a far cry from the original mandate of the corporations, but management often insists that if they are to be completely integrated corporate ventures they must move into all related fields. And yet, there often seems to be little national public purpose served by such ventures.

As a consequence of these public disclosures and concerns a recent effort has been made to bring about more control and accountability. Bill C-24 - An Act to Amend the Financial Administration Act in relation to Crown Corporations and amend other Acts in consequence thereof was passed on June 28, 1984. However, simply gaining more control and accountability is not considered the entire answer; rather, there is a strong belief on the part of the new government, and many Canadian citizens, that those Crown Corporations which basically peform public functions and which are totally supported by the crown are similar to government departments and should be run as such - they do not need Crown corporation status, and Crown Corporations which are basically commerically oriented - Air Canada, Petro-Canada and others - should be operated as commercial ventures in the private sector, i.e. they should be privatized.

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[18] These numbers, of course are constantly changing, as is the range of activities in which crown corporations engage.

In short, the movement for privatization in Canada at the present time springs primarily from the concern that many Crown corporations have not been well managed, have often exceeded their mandate, and that they do not have a policy function to fulfill that cannot be fulfilled at less cost to the taxpayer, and with more accountability to parliament, by some other policy instrument. Moreover, there is growing belief that the effectiveness of public sector corporations in dealing with broad general economic problems of unemployment, inflation and economic growth, at least in Canada, has yet tobe demonstrated.

The remarkable change in the public perception of the effectiveness and benefits of Crown corporations was evident to a modest degree in the election of 1979 when a minority Progressive Conservative government, which had campaigned on the need for decreasing the role of the government in the economy, was elected. The Liberal government, which succeeded it in 1980, went boldly forward with a great deal more public sector development, but its defeat in 1984, when the Progressive Conservative government, was returned with a massive majority suggests that the judgement of the electorate is that government policies of direct intervention were not working and that government was too large to operate effectively. At least, they were willing to elect a government who campaigned on such a platform. As one of the leading members of the Progressive Conservative government stated after the election of 1979 "we are determined to get the federal government out of ordinary business and commercial operations and hand them over to private enterprise where they belong"[19] - and this view which was prevalent in 1979 is dominant in the government in 1984.

III

When a government decides that a Crown corporation or some other type of public sector enterprise should be privatized it must have a rational reason for doing so. The reason may be that the government:

(i) perceives the purpose for the creation of the Crown corporation in the first place no longer exists, that is the public policy objectives that the Crown corporation was created to fulfill has been met;

(ii) perceives that there are more effective policy instruments which may be used for achieving public objectives;

(iii) perceives that a Crown corporation has reached a state of development where it in fact fulfills policy goals without the need for government support or control.

There is no question that the conditions which call for the creation ofa Crown corporation at one moment in history may change for a wide variety of reasons. In Canada, during World War II, 28 Crown corporations were established in the Department of Munitions and Supply - more than were created in the entire period between the founding of the country in 1867 and 1939.[20] These corporations were used for a vast array of purposes from building houses to manufacturing rubber to building ships and airplances. Their overall purpose was clear - to assist in the prosecution of the war. Obviously, when the war was over they were no longer necessary and so many - although not all - were closed down. Some were retained because the objectives for which they were created - for example security of supply of uranium - were unchanged. Others - for example, Polymer - the Crown Corporation which produced synthetic rubber - was maintained because they were judged to have economic viability, i.e. they could operate effectively in the market place. The point is, however, that Crown corporations may be candidates for privatization because the government no longer has a goal of policy the fulfillment of the objective for which tye were created.

Additionally, the government may decide that a Crown cor-

19 Sinclair Stevens, Toronto Star, June, 1979.

20 Sandford R. Borins, "World War II Crown Corporations : Their Functions and Their Fate" in Prichard, Op. cit., p. 447

poration is sufficiently viable that it can exist outside of the public sector with the public policy objectives still fulfilled. Air Canada was created as a Crown corporation in the 1930s when there was insufficient market demand to create a successful national airline. The government decided as a matter of policy - to create a national airline connecting all parts and regions of the country. By 1984, it is contended, by those who favour privatization, that Air Canada could operate as aviable private corporation; that, it no longer needs to be owned by the government, Certainly, regardless of whether it is publicly or privately owned, it will operate across the nation and so the major policy objective will be fulfilled - but it may not have to any longer be fulfilled by a government entity.

Another reason for privatization is that the government may decide that there are better policy instruments for achieving the objectives of government than direct ownership. Regulations, joint ventures, subsidies, tax policies, etc. may all be used to achieve certain goals in a more effective and efficient fashion, than through public ownership. And there are many reasons why this may be true. It is more plausible to believe that the effectiveness of different types of instruments to achieve policy goals alter over time than to thank that they do not. Changing legal, social and economic conditions lead one to conclude that they would. Consequently, the creation of a Crown corporation at a cetain time in history, because it was the most effective way to achieve a policy objective, does not necessarily mean that the existence of such a corporation will always be the most effective way to achieve that policy. Consequently, the privatization of the Crown corporation, need not in any way mean the abandonment of the objective by the government. [21]

It is very important in making a decision to privatize to calculate the

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[21] See Trebilcock and Prichard, Op. cti., p. 76

Cost of using other policy instruments - be they regulations, subsidies, or tax holidays - in determining the benefits from privatization. There may be good reason to privatize but it must be remembered that the costs of maintaining policy objectives which were present when the Crown corporation was established, and which are still present, must be included in all assessments of the costs of privatization. This can only be done, of course, when there is a complete understanding of what the substitute instruments for achieving the goals of policy are and how effective they will be. If Air Canada is privatized it may not wish to fly to non-profitable locations. But if it is government policy that all communities which had service from Air Canada before privatization are to have similar service after privatization, the cost of the subsidy for assuring that this policy goal is met must be included as part of the cost of the change.

In Canada, government is more and more accepting the view that once the policy objectives for which a Crown corporation was created have been fulfilled privatization is an appropriate measure. If the sole objective of a corporation is profit maximization, within the guidelines of good corporate citizenship there appears to be little reason to retain ownership in the hands of the government. By privatizing such companies they benefit from the discipline and competition of the market place and the removal of any apparent or real restraints placed on their operations by the government. The government, for its part, gains form not having the costs of monitoring, and not having to accept responsibility for the operation of a company whose existence is not vital for the fulfillment of national policy objectives.

Difficulties arise, however, when you have Crown corporations which have both profit maximization and public policy objectives of government. Such situations almost always mean there is a la lack of agreement on the part of policy makers on what the corporation should be emphasizing and how it should be managed. When such disagreement exists - and it can be very great as was the case in Canada when the Progressive government in 1979 made the decision to privatize Petro-Canada - it is imperative that before privatization begins that the government carefully thinks through its position for "only if it is prepared to articulate the reasons for the change in objectives warranting the return of corporations to the private sector and to subject these reasons to debate in the appropriate polical forums can these privatization decisions be made politically acceptable."[22]

This point is fundamental. There are many who contend that one of the reasons for the defeat of the minority Progressive Conservative government in 1980 was because it moved ahead with its plans to privatize the national oil company. While many citizens believed that there were too many Crown corporations, they were not willing to see them abandoned without a clear understanding of the reasons for the change and of how public objectives were going to be met through other policy instruments. In the case of the national oil company, the government failed to make these points clear to the public - and as a consequence they could not generate sufficient public support to proceed with their plant.

Once the decision to privatize is made the government must, therefore, be certain that it knows the true strengths and weaknesses of the corporation which is being privatized so that it can properly measure the cost of fulfilling any policy objectives which may have to be met by other instruments and it must be able to explain, with great clarity, to the public precisely how the policy goals will be carried out after the privatization is complete.

The Process of Privatization

In Canada, there has been three approaches to privatization by three different governments[23] - the Progressive Conservative government of Joe Clark in 1979, the Liberal government of Pierre Trudeau in 1980 and the Social Credit government of William Bennett in the province of British Columbia in 1977. Each approach was different.

(i) The Clark Government Approach - One of the issues upon which the Clark government was elected was a promise to reduce the size of government through returning some governemnt Crown corporations to the private sector.
Amont these were Petro-Canada, the national oil company.

Upon formation of the government Sinclair Stevens, a strong proponent of privatization was appointed President of the Treasury Board. Shortly, after his appointment he organized, with Cabinet approval, a Privatization Unit, with the responsibility of identifying and preparing for sale those Crown corporations which could be effectively privatized. The criteria to be used was somewhat vague, but basically it was that functions performed by the corporations could be equally well performed as private corporations, that is the policy goals of the government could equally well be achieved by the enterprise operating in the private sector as in the public. Eight corporations were identified as suitable for sale - Canadair and DeHavilland (both producers of aircraft), Eldorado Nuclear (mining uranium), and Northern Transportation Company (shipping on the McKenzie River) and their four subsidiaries were eventually announced for

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[23] There have, of course, been cases of "privatization" to meet specific conditions. Many of the Crown corporations created to fulfill wartime needs were privatized at the end of World War II; Canada Development Corporation which was created in 1971 as a vehicle through which Canadians could invest in various enterprises, while originally 100 per cent owned by private investors (although the process is slow - in 1984 it was still 50 per cent owned by the government); and there may be others.

sale. Before this could be accomplished, however, the government was defeated so in fact none were sold.

Handled separately, because it was of such a major matter and so politically sensitive, was the privatization of Petro-Canada. A special task force under the leadership of a Canadian business executive, who had no formal position within the government was appointed to recommend to the government the most effective way of proceeding. The Committee eventually reported that the company should be divided into two parts - one part retained to carry out activities which were deemed to be in the national interest; the other, the conventional refining and retailing of gasoline and oil, to be privatized through the sale of shares to the public. It was recommended that individual investors be limited to holding one per cent of the total number of outstanding shares and that institutional investors be limited to three per cent. It also suggested that the government retain twenty-five per cent interest in the privatized company.[24] Again nothing was completed because the government fell, as a consequence of the defeat of its budget in the House of Commons, before any aciton could be taken.

The attempt to privatize Petro-Canada revealed many difficulties which the government had not contemplated when it first decided to move the oil company from public to private ownership. First, there was little or no sympathy within the Department of Energy, Mines and Resources for the plan. Indeed, many of the senior officials in the department had been instrumental in the creation of the Crown corporation and were actively opposed to seeing it placed in the private sector. They felt strongly that the goals of public policy -self-sufficiency in energy supply, less foreign ownership in the oil industry, larger proportions of the unearned increment from price increases (as a result of the OPEC) going to government, more revenues

[24] See Canada, Department of Energy, Mines and Resources, Report of the Task Force on Petro-Canada (Ottawa: Department of Energy, Mines and Resources, 1979).

for the federal government (as opposed to the provincial governments) - could not be achieved without a national oil company. Moreover, they did not believe that these goals could be achieved if the corporation was divided into two parts. They did not belived that effective policy instruments were at hand that could achieve the national policy objectives. The new government, of course, disagreed. It believed that they could achieve their policy objectives with a split and partially privatized company. The consequences of this difference in view was that the new government found it extremely difficult to proceed rapidly with privatization. The traditional bureau - cratic strategy of delay was practised with skill. There was even delay in the preparation by the department of such a simple document as the terms of reference establishing the committee to examine privatization. Eventually it was prepared in the Prime Minister's Office.

Privatization was also hindered by the fact that the Minister of Finance was something less than enthusiastic about the proposal on both political and financial grounds. He was not convinced that privatization was acceptable to the Canadian public, and he was certain that the final consequences of the move would be to increase the public debt. This latter result would come about because Petro-Canada in its early day was funded by an enormous amount of borrowing - much of it from the government, but also a great deal from private sector lenders.

This debt would have to be moved to the government - something that the Minister, whose goal was to reduce the deficit - did not accept with any degree of pleasure.

Finally, the idea of splitting the company - to retain certain [illegible] functions in a state-owned organization - while probably correct for policy purposes was difficult for political reasons. It seemed to destroy the basic reasons for privatization, i.e. the opponents of privatization were able to argue that the company should be maintained as an intergrated whole, as it was first designed, in order for it to operate effectively.

The net result of the first attempts at privatization, by the Clark government, in 1979, was that nothing was accomplished. No Crown corporations were in fact, privatized and the attempts to do so had negative impacts on the perception of the government by the public. The lessons for any government are (i) there must be support by the public administrators for the process if it is to go forward smoothly and this probably means that officials, other than those who have created Crown corporations, should be responsible for their privatization, (ii) the financial implications should be clearly understood and accepted before any type of policy towards privatization is announced and (iii) the political support for privatization is essential if it is to go forward smoothly.

(ii) The Trudeau 1980 Approach - The Trudeau government, unlike the Clark, had no mandate and no particular interest in privatization of Crown corporations.[25] Rather, it saw the need to have more control over Crown corporations, and of the advantage of perhaps privatizing some, which were no longer serving their original purposes. The question the government was faced with was how to decide which corporations were ineffective and which should be left to operate without any change. The departments of government to which many Crown corporations reported, and their ministers, were usually too busy with other matters to take the time to systematically review the Crown corporations under their jurisdiction and the management and boards of corporations seldom, if ever, recommended radical changes.

In order to assess the role of individual Crown corporations more effectively, as well as to bring them under more stringent control, the government organized a holding company - the

[25] President of the Treasury Board, Honourable Donald Johnston, quoted in the Toronto Globe and Mail, May 1, 1980, pp. 9. However, the Chairman of the Canadian Investment Development Corporation makes it very clear that part of the responsibility of the CDIC is to examine crown corporations to determine whether or not they might be candidates for privatization. See Maurice F. Stong, Op. cit.

Canadian Development Investment Corporation (CDIC). In the words of its first chairman, the CDIC was created because the government needed "an organization that has or can acquire, the kind of commercial investment and management capabilities which are so difficult to assemble within the more constrained structure of government departments ... to assist the government to respond to the growing needs for more active management of its business-related investments, to facilitate a great degree of flexibility in dealing with these investments in ways that will ensure the maximum economic return to the government as well as contributing to the realization of larger policy"[26]. Part, although not an overwhelming part, of its responsibility was to determine which, if any, of the Crown corporations should be privatized.

Again, as in the case of the Clark government, the Trudeau government of 1980 fell before the CDIC was involved in any privatization. It does, however, demostrate a different approach - that is, the organization of a government owned holding company for a vast array of Crown corporations with one of the responsibilities of that holding company being to recommend to the government the divestment of a Crown corporation, when it appears the public policy function for which it was originally incorporated no longer exists.

(iii) The Bennett Approach The provincial New Democratic Party was elected to power in the province of British Columbia, on the West coast of Canada, in 1972 and retained power until 1975. During its regime it nationalized a number of organizations. It took over Canadian Cellulose Corporation (a major pulp and lumber producer), Kootenay Forest Products (a medium sized lumber and plywood operator), Plateau Mills

[26] Maurice F Strong, Op. cit., p. 33

(a medium sized lumber producer), and acquired ten per cent of West Coast Transmission Corporation (a natural gas pipeline company). It also entered the housing field, coal mining, purchased a bus company and an alfalfa plant, provided a grant for a fishing co-operative, planned a poultry corporation and created a government monopoly in automobile insurance.[27] The government was replaced by the Social Credit party in 1975 under the leadership of William Bennett, which had as one of its avowed purposes, the reduction of the role of public owned corporations in the British Columbia economy.

Immediately upon election the new government began the search for a way of privatizing the operations which the NDP had nationalized. In principle the new government wished to allow citizens to participate in resource ownership directly, not through the state. Moreover, the government wanted to eliminate the inherent conflict between ownership of resources and their regulation. Being both an owner and a regulator created enormous problems of equity and balance.

As a first step in the privatization process the government on September 1, 1977 enacted a law establishing the British Columbia Resources Investment Corporation (henceforth referred to as BRIC). Under terms of the legislation the government could appoint five people to form a new company. As long as the governmetn owned more than ten per cent of the shares of the company it could appoint one director if the total number in the Company is four or less; two if the total is five to eight; and three if the total is more than eight. The law allowed the company to sell its shares, with preference being given to the residents of British Columbia, but shareholdings by individuals were restricted to one per cent of all outstanding shares, and to three per cent by institutional investors. People or corporations doing business with BRIC

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[27] T. M. Ohashi, "Selling Public Enterprise to the Taxpayers" in Managing Public Enterprises edited by W. T. Stanbury and Fred Thompson (New York: Praeger Publishers, 1982), p.111

could be deemed, under particular circumstances as being associates of the company, and when they were so identified they had to sell any shares which they held within sixty days or have the shares redeemed at the lesser of issue or market price. The company was in no respect an agent of the government.[28]

In 1978 the company was organized with a board of directors, a president and chief executive officer. It then issued fifteen million shares to the government of British Columbia in exchange for $151.5 million in assets consisting of eighty-one per cent of Canadian Cellulose Corporation, one hundred per cent of Kootenay Forest Products, one hundred per cent of Plateau Mills and ten per cent of the shares of the West Coast Transmission Corporation. In short, the government transferred all of its interests in the four Crown corporations which had been created by the preceeding government in exchange for a promissory note from BRIC of $151.5 million.

This transaction created two dilemmas - one for the government and one for the company. The company was concerned about its capacity to raise equity capital from the public because, while it had substantial assets, the rate of return on those assets was not large, and it now had a very substantial level of debt - the promissory note to the government of British Columbia. In order to solve this problem for the company the government accepted fifteen million shares of BRIC from the company in full settlement of the debt.

The question for the government then was: What should it do with the shares? Its intent was to place ownership in the hands of the people - that is to privatize - but how could it do so without exposing itself to serious political risk? If the shares were sold to the public at too high a price, as demostrated by a later fall in their value, the government would certainly be condemned by everyone who had bought them. If the shares were issued at too low a price, as

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[28]Ibid., p. 112.

demonstrated by an increase in their value at a later date, the government would be condemned for giving BRIC assets at too low a price. But most telling of all was the criticism that the government was asking the citizens of British Columbia to pay twice for the same assets - once when they were acquired by the government with tax payers money, and now again when the shares were sold to the public.

The solution was single. The government decided to give five shares to each resident of British Columbia who applied for them. If the value of the shares fell there was no political loss since the people who received them did not pay anything for them, and if they went up in value the government would benefit.

At the same time BRIC offered to sell, at a market price of $6 per share, up to 5,000 shares to any resident of the province who wanted to buy them.

The offering of shares was the most successful in Canadian history and the underwriting turned out to be the third largest in North American history. Eight-six per cent of those eligible - 2,072,807 residents - applied for and received five free shares. In addition another 128,000 bought one hundred or more shares, 40,000 purchased less than one hundred shares and almost 5,000 purchased the maximum of 5,000 shares. The issue raised a total of $487.5 million for the company. The distribution of the shares was handled through the banks, investment dealers, credit unions and trust companies. The total cost was approximately $40 million - the underwriting costs were about $10.00 a share and the give away costs about $7.00. The distribution was completed in June of 1979 and since the original issuance, the shares have traded on the market from a low of $4.00 to a high of $9.25. There are a total of 96.5 million shares outstanding - largely in the hands of citizens of the province of British Columbia.

The government of British Columbia still holds five per cent of the shares. All shareholders with more than one hundred shares are qualified to vote at annual meetings. All directors are elected by the shareholders - the government has no privileged position.[29]

BRIC is a concrete example of successful privatization. The ownership of four Crown corporations was transferred to the private sector ... the assests of the corporations "are now widely held, free from government control and directed at profit maximization"[30] The future for BRIC appears to be positive. The company has bought into the rich British Columbia coal industry through the acquisition of Kaiser Resources Limited - the largest, most modern, efficient coal producer in Canada. BRIC is now the eleventh largest timber producer in North America, has two pulp mills and sizable interests in oil and gas. At the end of 1983 the net asset value of BRIC was about $10 per share and shares were trading at about &4.50. The increase in share value will come with increased earning, which in turn will appear when there is increased demand for commodities such as coal, timber, pulp and gas.

Privatization of public sector companies through distribution of shares to the public - even when they are distributed for free - does create some problems, particularly for the management of the new firm. Because the shares are held widely management has to be prepared to operate in the glare of publicity. There must be an extra-ordinary large degree of disclosure and, if the BRIC example is relevant, the management must be prepared for a high degree of interest from the press - interest which is not always expressed effectively or accurately.

On balance, however, the BRIC experience is an example from Canada of a completely successful privatization exercise. The ownership of four Crown corporations, which were established by the government, was successfully transferred to the private sector.

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[29] Ibid., p. 115

[30] Trebilcock and Prichard, Op. cit., p. 89.

Lessons To Be Learned From Canadian Experience

There are several lessons to be learned from both the successful and unsuccessful efforts to privatizatization in Canada:

1. There are many reasons why a decision to privatize may be wise -

   (i) the original purpose for which a Crown corporation was created may be fulfilled

   (ii) other policy instruments may be more effective in achieving the goals of policy than a Crown corporation

   (iii) the costs of controlling and managing a Crown corporation may be substantially greater than the benefits achieved from operating in the private sector.

2. When the objectives of the Crown corporation are clearly and entirely commercial the benefits of privatization - in terms of efficiency and effectiveness - are greater than the gains which may be gained from the continued monitoring of the activity.

3. Privatization, to be successful, needs a broad mandate of support from all segments of society. Imperative to getting this support is assurance that the reasons for the creation of the Crown corporation in the first place have been fulfilled, or will be fulfilled, in some other fashion.

4. Privatization must always be considered in relation to the availability of capital to finance any transfer or ownership.

5. When there is a well developed stock exchange and capital market privatization can be successfully achieved through free distribution of shares to the public.

6. It is imperative to create a special unit of government, apart from Crown corporations themselves, to assess whether or not privatization should take place.

7. The task of privatization should never be the responsibility of those who were responsible for the creation of Crown corporations in the first place.

8. Once a recommendation to privatize has been made, it is imperative that there be a specific unit of government with the task of assessing each recommendation in terms of (a) the manner in which the policy goals for which the specific corporation was created to meet are to be fulfilled, if they still exist, and (b) the costs of other policy instruments needed to meet the goals, if they still exist.

Canadian experience demonstrates that by their very nature Crown corporations are extremely difficult to manage and control. On the one hand they are expectedto fulfil some national mandate - that is why they are created. On the other, if they are operating in commercial markets they are expected to earn an appropriate rate of return on the investments. When they attempt to meet the first of their obligations it is often at the expense of the second - and vice versa. Because of the confusion of objectives and because they are once removed from government,,the responsible government minister is often tempted to leave the management of the enterprise to the officers of the corporation. At the same time members of the board of directors of crown corporations, who often come from the private sector do not feel they should second-guess management, whose mandate, it is assumed, comes clearly and directly from its shareholder - the government. Consequently, the chief operating officers of Crown corporations have a record, at least in Canada, of operating without much control, and because of their access to government funding, often without as much attention to the discipline of the market place as is the case with private sector companies.

And so while the Canadian tradition has been one of wide use of public sector enterprises to meet specific Canadian needs, it is highly probable that during the next decade: (i) activity will be in the opposite direction. Emphasis will be placed on privatization of activities which are primarily of a commercial nature so that scarce government resources can be freed up for other uses: (ii) when privatization is not possible, because of the need for a Crown corporation to meet specific policy goals, these goals will be more precisely defined, and corporation will be expected to respect the limits of their mandate; (iii) whenever possible the test of the market place will be applied to the activities of Crown corporations; and (iv) wherever possible alternative instruments of policy, that is regulatory agencies, tax credits, subsidies, etc. will be used to achieve national goals which traditionally have been met by the creation of a Crown corporation.

The period when the solution to many economic and social problems in Canada was the creation of a Crown corporation is, at least for the foreseeable future, over.

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Notes On the Subject of

Privatization of Public Enterprises: The Case of Turkey

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RESTRUCTURING OF PUBLIC ECONOMIC ENTERPRISES AND PRIVATIZATION: THE CASE OF TURKEY

I. Introduction

The purpose of this paper is to delineate the structural changes that are taking place in the Turkish Public Economic Enterprise system, and to point out a related issue, namely privatization. The nature of the proposed study commits it to be descriptive rather than analytical.

In the first part of the paper a general survey on some aspects of the Turkish economy will be briefly supplied in order to furnish the reader with the necessary background information on the relationship between the change in development/economic strategy and concomittant issues of restructuring of the Public Economic Enterprise system.[1]

Following this section external negative effects and internal structural problems of the PEEs will be elaborated upon as they lead to structural changes-new measures, including privatization, are referred to as reorganization of the PEEs. Present situation of and views on the privatization of the public owned industry will be delineated with emphasis on the former privatization efforts in Turkey. A description of the present day privatization efforts will be briefly accounted.

In the third part of the paper future success of the privatization measures will be depicted and some conclusions will be drawn.

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[1] From here on Public Economic Enterprises will be referred to as PEE.

II. <u>Some Aspects of the Turkish Economy</u>

The Turkish economy at the end of 1978 declared <u>moratorium</u>. She was one of the first new industrializing countries that could not meet her ever increasing foreign depts. Three terms best describes the economic situation im the beginning of 1980s.

i) severe inflation

ii) recession

iii) acute foreign exchange shortage.

Since the beginning of 1950s Turkish economy had done well in terms of meeting the desired growth rates and realized the planned structural changes up to 1978. Sustained growth rates of an avarage of 6.5% to 7 % per annum had been attained since 1950 and a per capita income of 1300 dollars had been attained in 1978. The share of industry had reached 24.2% of the GNP and the yearly growth rate of industry of approximately 1%.

There are a few characteristics of the Turkish economy that will be briefly mentioned here that are pertinent to the explanation of the issues at hand. They are as follows:

1-Since the foundation of the republic in 1923, Turkey has adopted an inward oriented, import substitution development strategy. Growth accounting studies indicate that 80% of the sustained growth rates were attributed to the growth of the domestic market. At the beginning of 1980 development strategies have been drastically changed. Stabilization policy in the

IMF-World Bank tradition and export-led development strategy have been adopted.

2-Turkish economy is highly protected against foreign competition. Furthermore, competitive pressures lack in the domestic market. Along with outward oriented development policy, a liberal import regime is also being adopted in these days. Protection of the industry is gradually being abolished. Turkish private and public industry are gradually facing competition from foreign suppliers for the first time.

3-Development strategy is based on mixed economy principle in which private and state enterprises both play a significant part. SEE play a key role in the manufacturing industry. Government owns approximately [illegible]% of the industry. Government is also very active in agricultural purchases and in banking and insurance. New government investment policy concentrates state investments to energy sector and transportation/communication projects.

4-Private industry mainly manufactures durable consumer goods with foreign partners or on royalty agreements. It is widely believed that (and there is evidence) Turkish entreupreneurs have reached to a certain maturity level, and thus the economy may develop with the private sector's initiatives. The state should not crowd out the investment market any more and should concentrate in sectors where private profitability is low.

5-Another aspect of the present economic policy is to liberate the financial market from repression and to determine the value of the Turkish currency according to the market value. In the past interest rates and foreign currency value of the Turkish money has not reflected the market prices. Interest rates were fixed below the inflation rate (negative interest rates) and the Turkish Lira was overvalued. A sudden change in the interest rates and pegging policy has adversely affected the financial structures and competitive position of the private and public manufacturing enterprises.

6-One aspect of the new policy is tight monetary policy and lifting of the price control. Tight monetary policy compels the government to pursue balanced budget policy and this in return diminishes the possibility of financing PEEs balance sheet losses. Therefore, PEEs resort to contunious price increases in order to cover their operating losses. High import prices, high cost of finacing (65% per annum) lead to lower capacity utilization due to shortage of operating funds. This in return causes unit prices to increase. Rising prices when matches with a stagnant market compels companies to liquidate their assets or they turn over their equity to financial intstitutions. Insolvent private companies are bought over by state owned banks. At one hand government policy is to privatize PEEs while on the other hand new economic measures lead to defacto nationalization of private enterprises.

III. Turkish Public Economic Enterprise System

The role of the state as regards to function and organization of state owned companies varies considerably from one country to another. Turkey has adopted in early 1930s a medium way between a real entrepreneurial position with full and rigid state engagement and a system where the role of the state is limited to a catalyst function for industrial activities. The genesis of public economic enterprises has been from a combination of factors; an important motive has been the ideology of "etatism" where state is assigned the responsibility of entrepreneurship along with the private sector. It could be asserted that in Turkey the roles of public, private and foreign industry are more clearly enunciated than several other countries. The responsibility of the state as an entrepreneur has undergone significant fluctuations with changes in government. At some stage every important facit of the economy has come to be dominated by the public sector which the private sector was assigned an ever diminishing role, except for small and medium industries. After 1978 crisis, the government propounded a rapid expansion and assigned a dominant role to the private sector and curtailment of the public sector was sought. However, mixed public and private industry environment continues.

The Turkish PEE system is a very complex machinery. It is very extensive as it comprises virtually every sector of the economy. There are three distinct types of state ownership:

i) State Economic Formations (SEF)

ii) Public Economic Establishments

iii) Joint Partnerships or subsidiaries

The above classification shows the reorganization of the PEE system in 1983.

SEFs are the most important of all the above three. Their main characteristic is that their capital is fully owned by the state. They are formed in joint stock companies and their purpose is to operate on profitability. On the other hand, Public Economic Establishments are formed for public services and for the production of public goods. Their function is to operate towards meeting the economic and social needs of the public. These establishments aim at production and marketing of basic goods and services. In general they are monopolies of the state and their capital is fully owned by the treasury.

Joint partnerships are groups of joint stock companies in partnership with indigenuous private companies and multi-nationals. More than fifty percent of their equity capital is owned by SEF or Public Economic Establishments.

The PEE system in Turkey is undergoing a rapid restructuring or reorganization. Up to now majority of the changes have been of organizational nature. These changes are mostry concerned with concentration and merging process of the subsidiaries in order to obtain strengthening of their productive and administrative capacities. Another substantial change is that the PEEs are free to determine their own sale prices which were previously subject to central government approval.

At the present State Economic Formations and Public Economic Establishments have similar organizational structure as in private sector joint stock companies. The deeds and responsibilities of the board and management are subject to Commercial Laws. The management bodies consist of the Board of Directors and the General Directorate. The Board consists of president and four members, three of which are appointed by the related ministrate and the fourth is appointed by the Minister of Finance. These are all political appointments but subject to the approval of the President of the Republic. In accordance with a recent change, in order to avoid political tendencies in appointments, the two members of top management are appointed as board members in subsidiaries. Nevertheless, political considerations still play part to a certain extent in the appointments of top management.

IV. Underlying Factors for Restructuring and Privatization of PEEs

Privatization besides its original meaning has come to mean i) sale of "revenue rights" of infrastructure investments;i.e.a, sale of toll bridge revenues whilst state retains the ownership, or sale of revenue rights of electricity generating dams, and the like,

ii) lifting the barriers of entry to state monopoly sectors, such as granting tea production permission, cigarette manufacturing permission to the private sector.

Present privatization efforts are concentrated on the above mentioned types. The sale of ownership of PEEs is confined to State Economic Formations and subsidiaries. Marketing of shares of Public Economic Establishments which predominantly produce public goods and services is not planned. The shares of SEFs and subsidiaries, operating in key sectors will not be marketed.

In the past a policy option to former Turkish governments prior to privatization was reorganization of the PEEs. Earlier reorganizational efforts showed positive results and at the present majority of the public economic formations and subsidiaries operate profitably. The government views privatization as an integral part of reorganization of PEE system.

Privatization of PEEs takes place among the companies which have been profitable domestically and competitive in international markets. Priority is given to the marketing of the shares of state owned fertilizer, mining and textile companies. Attempts are made to market these shares in foreign countries. Lack of an organized Turkish capital market severely hampers the sale of these shares. Non-convertibility of the

Turkish currency discourages the foreign buyers from acquiring shares of PEEs.

There are several underlying causes that lead to restructuring and privatization of the PEEs in Turkey. These influencing factors may be broadly classified as,

i) external negative effects

ii) internal structural problems of PEEs.

The external negative effects have been mentioned briefly in section II of this paper. They will not be elaborated upon in order not to be repetitive.

a) International economic environment:

The PEE system, especially the industrial sector has been mostly affected by the successive oil shocks and world-wide depression, since basic industries belong to the most vulnerable industries. After 1974 up to 1979 huge state subsidies were necessary to prevent PEEs from partial or total economic collapse. These SEPs and subsidiaries were given support by directs subsidies or by transforming former loans into equity. For example, in 1977 36% of the central government's budget was allocated to financing the losses of the PEEs.

Changes in the international economic environment also affect the availability of supplier (or buyer) credits. Import substituting PEEs, operating mainly for the domestic market were deprived of importing raw materials. The worsening of the credit worthiness of the Turkish economy put additional strain on PEEs.

The Turkish economy made a quick recovery to balance her external payments; though PEEs do not easily have access to international credit facilities directly. They are heavily dependent on central government's foreign exchange funds and their strict regulations.

b) Technological changes:

The negative effects of new technologies, such as electronic, laser, gene, etc., on PEEs have been very severe in respect to their domestic and international competitive positions. Private sector firms with younger vintage capital and embodied technical change have higher productivity levels than PEEs in manufacturing industry. Iron and steel, textiles, some areas of mining sector are good examples of competition from the private sector because of their technological advancement. Within the last years several PEEs attempted to adapt their production program in view of processing higher value added products and also by integrating single products into a larger system accompanied by complementary consulting, operational, managerial, marketing and after sales services. This development requires a thorough transformation of the companies organization, new investment outlays and training of labor. This dynamism, however, meets difficulties in the technical, economic, financial and managerial fronts. Furthermore, the management and labor do not have the necessary incentives to adopt themselves to new competitive environment.

Internal structural problems of PEEs: Due to space limitations a feww of the internal structural problems of PEEs are treated here. Only three important underlying topics are discussed.

a) PEE and government relations

b) management performance

c) burden of financing PEEs

PEE and government relations: There are different organizational patterns regarding the government and PEE relations. In Turkey there is a tight link between government and economic state formations and public economic establishments. Government also exerts direct control on subsidiaries or indirect control through state owned financial intermediaries. This tight link results in administrative and political influences on PEEs. The present organizational pattern aims at an undisturbed work of top management. Political interference is tried to be kept at a minimum level by granting juridical and financial autonomy to the subsidiaries. However, Public Economic Establishments are still subject to extensive ministarial administration. Day to day political interference is not practiced but policy formulations are subject to heavy government scrunity. It is well understood in Turkey that minimal administrative and political interference is necessary for successful PEE operations.

Management performance in PEE system is a crucial issue that has to be solved in Turkey. Executives of PEEs are part of the state bureucratic apparatus and subject to the same civil service pay scale and regulations as any other civil servant. Subsidiaries are not part of this system, where exist a wide discrepancy between wage levels in PEE and private sector. PEE system has difficulty in meeting wage demands of professional management. PEE system continuously loses well trained high level mangers to the private sector. For young professionals PEE employment is considered as human capital investment. Unfortunately this situation is not under change and the importance of highly qualified managers is not understood.

Burden of financing PEEs: The need for funding of PEEs is immense. The reasons for this increasing capital demand are listed below:

i) PEEs are engaged in most capital intensive sectors and new investments are necessary for the rationalization(expansion, new technology acquisitions, etc.) require considerable financial resources.

ii) State Investment Bank, another PEE, is not well equipped financially to serve the present and future capital needs. Presently, investable funds are channelled to working capital needs of the enterprises. Continuous depreciation of the currency (40-45%) and hisgh inflation rates necessitate the companies to increase their working capital funds and therefore, the possibi;ity of financing physical capital outlays are very limited.

iii) PEEs have been used as an instrument of government policy to foster economic development-especially industrialisation. Each PEE served as the growth pole in their own industrial sector.

The PEE, especially in steel, aluminum, coal, energy and fertilizer enterprises had to follow a siecial price policy which kept the domestic prices below the costs. Or, as in some cases, domestic prices are kept below international export prices. The pricing policy have had detrimental effects on the companies' own financing capabilities. Balance losses are subsidiezed and/or financed from the general public budget. PEEs have very low equity capital around 5-10%, whereas ordinarily at least 30% is required. This situation adversely affects the profit and loss accounts.

The state of the national economy does not permit the public economy to undertake new investments in the areas where PEEs are already concentrated. In these sectors private sector also competes with PEEs, and the productivity in private sector is higher.

Turkish experience in privatization is very recent. It permits to draw only inconclusive results. There are two principles that have to be considered for the success of privatization process. First, privatization should increase capital accumulation. Second, privatization process should not upset the stability of social structure.

If Turkish experience is viewed in the light of these two principles, the future success of the exercise is limited due to prevailing conditions of the Turkish economy. It is estimated that profitable operation of the PEEs in the near future requires substantial investment. The present five year development plan gives priority to heavy infrastructural investments in energy and communication and transportation sectors. The funds that will be obtained from privatization are designed to abe allocated to the projects mentioned above.

At the present the Turkish government is very active in money and capital markets in order to raise funds for budgetary purposes. Marketing of PEE shares in the capital market will further crowd out the small Turkish capital market. As noted formerly, short term deposit rates fluctuates around 50 % per annum. Government bonds yield not above 40 %. Given the interest rate structure, it is not possible for the PEEs to to provide returns competitive with government bonds. It must be noted that contribution of privatization to capital accumulation depends upon how the sale of PEE shares are financed and by whom these shares are purchased. When the transfer of shares to private business is considered, three alternative fundings are possible;

i) Funds may be financed by the existing savings of the private business.

ii) It could be financed by credits from the banking system.

iii) Credits could be supplied by governments,i.e., shares could be sold to private business on installments.

In the first case privatization process is a mere transfer of ownership from public to private sector, and do not readily contribute to capital accumulations since it will be shifting already existing investible funds from one project to another. In the second case, if private business insists on privatization to be financed by an equal amound of bank credits-which is the actual situation in Turkey-than the inflationary impact of bank financing should be considered.

In an inflationary economy, incremental increases in money supply, however defined, result in price increases. It is feared in Turkey that privatization, if financed in this manner, will further contribute to inflationary pressures. The social cost of forced savings in order to create funds for privatization is very high, especially to the fixed income groups.

THE DEVELOPMENT OF PRIVATIZATION AND DIVESTITURE

THE CASE OF KENYA

By

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THE DEVELOPMENT OF PRIVATISATION AND DIVESTITURE:
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1. Introduction

This Paper reviews efforts to divest and privatize State Owned Enterprises (SOE's) or Parastatals in Kenya. An analysis of the political and economic constraints which inhibit the activities of the state owned enterprises from being undertaken by the private sector is reviewed for the period 1963 to 1986 or from independence to today . An initial perception of the rise of parastatals is undertaken before the analysis of the constraints is discussed. The study will look at three case studies which represent the efforts of the Government of Kenya to divest itself from the management and ownership of parastatals. The discussions which follow on is partially determined by the reviewed cases. I must however point out that the question of divestiture is still on the whole a novel and to some extent a sensitive subject by and to the Government of Kenya. For this reason some of the case studies do not contain enough information on such key areas as financial returns and details of loans borrowed locally or insights into the procedures the Government adopted in implementing certain projects or choosing of the management or the Board of Directors.

For purposes of definition this Paper assumes the World Bank's definition of State Owned Enterprises as indicated in the World Development Report of 1983. State Owned Enterprises are industrial and commercial firms, mines, utilities and transport companies as well as financial intermediaries. State Owned Enterprises are distinguished from the rest of the Government because their revenues come from the sale of goods and services and because they are self accounting and have separate legal identity. The term parastatals is also considered is this Paper to be synonymous with State Owned Enterprises. (Privatization and Divestiture is defined as the transfer of a function, activity or organization from the public to the private sector).

Since independence parastatals have played a growing and to some degree a pervasive role in the Kenya economy. This position stems in part from Kenya's colonial experience during the British administration of the economy. At independence in 1963 the state domination of the economy was accepted more or less automatically. Many of Kenya's economic planners at that time and to some degree today viewed Government control as the only way to maintain economic independent in the face of the neo-colonialist threat. A deep seated suspicion of the private sector, partially derived from the earlier foreign domination of Kenya's industrial development by British companies and the general resentment toward the Asian minority who controlled, at independence the distributive trade, encouraged Kenya's Government to implement additional Government control. As

Government control gathered momentum in the mid sixties and early seventies practical reasons arose for reliance and expansion of parastatals. The Government faced with a large bureaucracy found it increasingly difficult to implement certain statutory obligations that it set out to do, parastatals became the quickest and reliable way to improve efficiency at national level rather than Government department. The Government subsequently went to parliament and set up a chain of parastatals through legal procedures. In banking and insurance, agriculture, transport, industry and service were formed. There were other reasons, soon after independence the Government was eager to form new international alliances with various sovereign states. Some of the bilateral negotiations were with the Eastern Block countries, the need to have efficient organizations within Kenya which could handle the bilateral Government to Government trade with the Eastern Block countries were primary to the formation of parastatals. The parastatals in this instance became instruments of international cooperation which a private company would not necessarily find to be profitable. The Government's desire to control the economy also meant that participation in the most important sectors of the economy became mandatory, giving rise to the formation of commodity parastatals like the Coffee Board of Kenya and the Tea Board of Kenya to represent the two major primary crops for Kenya. Participation in finance and banking followed with the acquisition of shares in such banks as the National Grindlays Bank and the formation of Kenya Commercial Bank. Participation in the industrial output area led to the formation of the Industrial and Commercial Development Corporation and the Kenya Industrial Estates. The Government's concern and emphasis for african and Kenyan participation in the distributive trade led to the formation of parastatals like the Kenya National Trading Corporation with specific duties to assist africans to enter into the distributive trade. The reasons for parastatal formation varied from one organization to the other. Other reasons less easy to define or describe included personal factors motivated by profit by influential individuals or departmental managers with the ability to influence the turning of a department into a parastatal. In the mid sixties Kenya was also inunduated with investors looking for joint ventures some spurred with the capitalist political leaning of the Government while some spurred on by the eagerness and to some extent the inexperience of the economic planners of the new nation.

In 1982 when the Government performed some form of a head count there were parastatals in transport and communications, commodities, finance, insurance investment, food processing, livestock, textile and fibers, rubber and plastic, beverages, engineering, fishing, chemicals and pharmaceuticals, retail, tourism, mining, wood and paper, housing and construction, motor assembly and energy. The total number of parastatals and statutory bodies reached 323.

Statutory Boards	147
Wholly Owned Companies	47
Majority Shareholding Companies	36
Minority Shareholding Companies	93
Total Government Involvement	323

Source: Report of the Working Party on Government Expenditure 1982 Government Printer Nairobi

The growth of parastatals mushroomed even though their performance was increasingly called into question by the public at large and by the Government who set up several working parties to look into parastatals. In 1979 the President of Kenya appointed a committee to review Statutory Boards from both the private sector and the public sector. The President noted in the Terms of Reference that the Statutory Boards and other parastatal organizations had vastly grown and it was necessary to ensure efficiency and support for Government planned programmes. The review did not halt to a sizeable degree the formation of additional parastatals nor the level of resources transferred to parastatals till another committee was formed in 1982.

the table below shows Government transfers to parastatals as percent of the Total Development Expenditure 1976 to 1985.

Table 1
Financial Transfer to the Parastatals as Percent of Total Development Expenditure

Year	Financial Transfers to the Parastatals (Kenya Pounds)	Total Development Expenditure	Percent of Transfers to Development Expenditure
1976	52085000	74254000	70.14
1977	38651000	86034000	44.93
1978	75137000	115142000	65.26
1979	75960000	146547000	51.83
1980	63038000	171916000	36.67
1981	81776000	218485000	37.43
1982	78037000	186002000	41.95
1983	37144000	273028000	13.60
1984	37811000	273028000	13.85
1985	21655000	335361000	6.46

Source: The Annual Statistical Abstract
Central Bureau of Statistics NRB

Approximately 99 percent of resources transferred to the parastatals is effected through the Development Expenditure vote. The table shows the sharp decline in the resources transferred to the parastatals after 1982 when the second committee looking into Government expenditure made their report, before that period the financial transfers were over 36 percent.

The 1979 parastatal review did indicate the fact that several of the parastatals had taken on a bewildering array of organizational forms, financing and management including gross diversification into areas that were not in he original legislative documents during formation consequently creating managerial difficulties. Management and performance have been cited by experts as important constraints to the efforts of Governments to privatize. Many parastatals in Kenya suffer large losses partly attributable to management. Some of the managerial failures include practical realities connected with the initial investment which may not have been a good idea in the first place. Decisions could have been made on bases not linked to economic rationales and the non-availability of proper planning which needs to take into account detailed evaluation of the market and the constraints likely to face the organization. The choice of product lines and the choice of marketing strategies were sometimes not compatible with the challenges facing the company and with the demands of its customers who often require an efficient and low cost product or service. Inefficient managers were a trait of many parastatals and to some degree this still persists even today, due to the system sometimes deployed for the selection of chief executives. Soon after independence, Kenya did not possess the management expertise in great numbers that could be deployed to manage all the parastatals; and it was inevitable that some parastatals would be landed with technically unable managers for the large public complexes. The system of selection sometimes based on the political connection of the individuals have not necessarily helped matters as has been exemplified by the subsequent selection of decisions strongly influenced by political options.

However not all parastatal failures are to be blamed on the management, frequently the parent ministries interfered unnecessarily to an extent that the management was unable to make decisions that are in the best interests of the organization. The system of transferring civil servants to head and run parastatals persists not only in Kenya but in many developing nations. The major results of this has not been in keeping with the commercial practices required in a competitive field. The challenges of parastatal management also lie with the institutional building capacity it requires from its managers. Often the manager must start an organization from scratch or one with only a few years of existence with little or no management systems that can be developed over time.

The specific talents required are often on institutional development or the ability to formulate practicable development objective and meet them while making full use of the available human, financial, and other resources. The capabilities required include those for policy development, planning, organizational design, financial management (including programming and budgeting) procurement, personnel management, training, and management coordination. While many of the Kenya parastatal managers have considerable achievement to show, institutional and managerial problems continue to be the most pervasive on programme implementation.

2. <u>History of Divestiture Development In Kenya</u>

There is no clear cut reasons as to why there was a final countdown towards divestiture in Kenya but there are a series of events from 1979 which indicate protracted efforts of the GOK to slow down the rate of investment in parastatals included among these are:

1. Continued poor performance of parastatals inspite of the large Government investment over the years.

2. Decentralization policies of the MOI era emphasizing district level budgeting rather than management by the Central Government.

3. Adverse economic circumstances facing the economy.

The Government's first efforts toward divestiture is evidenced by the formation of the Ndegwa commission on February 8, 1979 of a 16 member committee to review the urgent financial, administrative and operational problems facing important parastatals and to set some guidelines for appointments and control. The Terms of Reference in part identified managerial weaknesses as a major weakness of parastatals.

The Commission made their report after three months recommending various ways for improving parastatals in the economy. Among the major recommendations were that the Parastatal Board chairman should not have day to day executive powers and that Board members should be competent to participate effectively in the business of the Board. Special attention sho ld be paid to business acumen, technical ability, relevant experience, judgement and personal integrity and direct involvement of the parent ministry should be kept small. To correct anomalies in financial management the review recommended training and the development of uniform schemes for budgeting procedures and procurement. To rationalize on Government investment in parastatals the Review recommended the development of an investment division in the Ministry of Finance with specific responsibilities for identifying the status of all existing Government investment, follow-ups of Government investments for recoveries of capital and interest, to identify priorities for investment, appraise management contracts and the financial guarantees to the parastatals.

The Review classified parastatals into four areas:

1. Parastatals in serious financial difficulties like the Kenya Cooperative Creameries, Kenya Meat Commission, The Wheat Board, the Maize and Produce Board and the Kenya Airways.

2. Parastatals showing poor return on investments or having problems other than financial ones arising from over expansion, and diversification spurred on by lack of clear policy guideline like the Industrial and Commercial Develoroment Corporation, the Kenya Tourist Development Corporation, the Horticultural Crops Development Authority, the University Halls of Residence and the Kenya National Trade Corporation.

3. Parastatals which have outlived their usefulness such as the Central Agricultural Board, Mombasa Pipeline Board, Pig Industry Board and Canning Crops Board.

4. Other parastatals tottering along due to other problems.

The Review presented their report in May, 1979 and it received a good reception by the Government some of its recommendations were soon implemented like having parastatal Board Chairmen as non executive.

The turning point for divestiture however seems to have come about as a result of economic factors rather than a change in Government Policy in 1982.

In 1982 the Government of Kenya faced a financial crisis that required both an immediate response and longer term measures to prevent a recurrence in the future. the crisis had two roots. The weaker but well known root was international economic stagnation in the early eighties which reduced the rate of economic growth and consequently the growth of Government revenue. The stronger but less well perceived root was the profligation of commercial activities the Government had undertaken which had diverted scarce management talent away from the central duties of the Government into areas the Government should not be involved in. The Government required a solution that would ensure that a similar financial crisis does not occur that nearly prevented the GOK from meeting its obligations for essential services.

The magnitude of the Governments financial crisis can be best reflected by the Government's revenue and expenditure at the end of 1981:

Table II

Revenues and Expenditures as Per Cent of GDP at Market Prices

	1976/77	1977/78	1978/79	1979/80	1980/81
Total Expenditure	24.7	30.1	32.2	31.6	35.5
Current Revenue (excluding foreign grants)	19.3	24.1	23.6	25.1	25 6
Deficit	5.4	6.0	8.6	6.5	9.9
Foreign Grants	0.7	0.5	0.6	0.8	1.3
Required Borrowing	4.7	5.5	8.0	5.7	8.6

Source: Various government reports and statistics.

The table reveals that while the Government had done remarkedly well in revenue collection the Government expenditures had even grown faster. The Government had as a result been surviving by heavy borrowing of funds. The heavy financial borrowing placed heavy financial burden as interest rates grew rapidly. The position of the debt burden and Government revenue is best shown by the table below which showed the relative increases including the GDP.

TABLE III

Composition of Deficits as at 1981

	1976/77	1977/78	1978/79	1979/80	1980/81	1976/77-1980/81 Percent Increase
	-------(KL Million)-------					
Current Revenue (including grants)	331.1	481.2	528.9	630.9	738.3	123
Consolidated Fund Services	42.6	67.8	73.7	87.9	132.0	210
Debt Service (Inter)	(21.5)	(29.4)	(34.2)	(36.9)	(51.2)	138
Debt Service (Exter)	(14.8)	(31.2)	(31.2)	(41.9)	(67.4)	355
Revenues Available to Ministries	288.5	413.4	450.2	543.0	606.3	110
Overall Deficit	78.7	109.2	173.7	137.5	236.7	201
Domestic Finance	([illegible].9)	(66.0)	(112.4)	(62.7)	(88.7)	81
External Finance	(29.8)	(43.2)	(61.3)	(74.8)	(148.0)	397
GDP [illegible]rket Price	1656.7	19[illegible]9.0	2167.4	2435.4	2757.1	66

Source: Vari[illegible]

While the GDP rose by 66 percent and the current revenue rose by 123 percent the consolidated fund used to pay interest rates rose by 210 percent. As domestic savings were not enough more external borrowing was required with the resultant increase of 397 percent.

The sharp rise in debt servicing reflects a borrowing history that dates back to 1971 and is still a major issue with the Government in 1986. During the 1960s annual deficits averaged about 4 percent of the GDP at market prices. Public debt was growing as a percentage of GDP but debt service was growing more slowly due to the prevailing interest rates at that time and the long grace periods which postponed loans for several years. But from 1971 the deficit was 5.1 percent and generally stayed that way for the next 13 years till 1984 when the GOK managed to reduce it to under 5 percent. The exception was during the coffee boom years of 1976/77. The estimated debt service in 1985 was as high as 30 percent. Because of the realization that the economy was approaching its borrowing limit the only immediate option for the Government was to reduce Government expenditures.

The high deficits also affected the economy as they increased imports and capital outflows that contributed to the negative balance of payment position; and the Government's heavy borrowing drained the potential credit for the private sector.

The financial crisis led to the formation of the Working Party on Government Expenditures in January 12, 1982. The working party comprised of 6 senior Government of Kenya officials. The Terms of Reference was to recommend urgent and practical measures to contain Government expenditures within the level of limited Government revenue receipts. In doing so the Working Party was to recommend ways and means of improving efficiency in resources used within the Government, paying particular attention to the following:

(i) Articulation of Development and Recurrent expenditures overall and by Ministry.
(ii) Management systems for budgeting, expenditure control and reporting.
(iii) Mobilization and utilization of external aid and technical assistance.
(iv) Processes for monitoring implementation of policies, projects and programmes and for introducing remedial measures.

(v) Personnel management, including numbers employed, composition, deployment of staff and matching of qualifications with job requirements.
(vi) Organization and management of transport and equipment including procurement, composition, replacement, repair and maintenance, and rational use of vehicles and equipment.
(vii) Consolidation or elimination of duplicated. functions and facilities.

The Working Party was to report to His Excellency the President by 30the April, 1982. The Working Party made several recommendations for reducing Government expenditures but for the purposes of this Paper a detailed review of their findings in regard to the Parastatal sector will be given because the recommendations effectively were the turning point in Divestiture in Kenya. The next several sections is devoted to the findings of the Party.

3. The Management of Government Investments and Parastatals

The Working Party noted that since independence the Government had deliberately pursued a policy of participation in directly productive activities in order to decolonialize the economy, promote development and regional balance, increase citizen participation in the economy and ensure greater public control of the economy. This policy direction had been stated in a number of Government documents, including the Sessional Paper No. 10 of 1965 on African Socialism and Its Application to Planning in Kenya and the various Development Plans. In order to achieve these goals the Government set out to strengthen the parastatal sector by reorganizing the parastatals inherited at the time of independence and by creating new parastatals to perform specific functions in the economy. In a number of instances, the Government sought to stimulate the diversification of economic activity through direct investments in private companies and corporations entering new fields.

The Working Party confirmed that the Government had by and large, been successful in pursuing these objectives. However, with regard to Government investments there was a need for review because the participation had grown beyond the original intentions. First, some parastatals had exceeded their original mandates and made investments in commercial and industrial activities that should have been left entirely to the private sector. Second, private investors had purposefully sought Government participation and guarantees as means of safeguarding their own share and loan capital. As a result of these factors, the Government was too widely and deeply involved in activities which would have been more appropriately and efficiently conducted without Government participation.

The Working Party noted the extensive involvement in the form of equity participation, loans, grants, subsidies and guarantees in largely unprofitable enterprises which had imposed an onerous financial and management burden on the Government. As a result, the Government's attention and resources had been diverted from more important matters of policy innovation, formulation and direction. Equally important, was the fact that Government involvement in commercial ventures had tended to tarnish the image of the Government because the parastatals and other ventures which are expected to be viable had not been profitable. Moreover, in some cases, minority share ownership by Government had served to strengthen foreign ownership and control thus leading to some de-Kenyanization of the economy, which was not the original intent. By 1982 for example, cumulative investments by Government, including guaranteed debt of parastatals, exceeded KL900 million. At a rate of return of 10 percent, Government should have been realizing KL90 million per annum in dividends. Instead in 1978/79 dividends paid to the Exchequer amounted to only KL2.2 million and were paid by only six parastatals. As an example, the Working Party cited the Industrial and Commercial Development Corporation which between 1964 and 1977 received dividends totalling KL4.5 million from it's subsidiaries but as at the end of 1977 had not paid any surplus to Government. Almost 75 percent of the above sum was paid by only six out of total portfolio of fifty-one companies. In the same period only twenty-six companies paid dividends while thirty-three (i.e. 56 percent) did not pay any dividends at all. The defaulting companies were not in their formative stage, since fifteen of them had been in operation for between five and ten years.

It was the view of the Working Party that the Government of Kenya should no longer continue to respond without question to requests for new funds from parastatals. rather the enterprises were to serve the Government and the people by providing goods and services and paying dividends and taxes.

To avoid such situations the Government would have to reduce its own exposure to risks which the private sector can and should assume without Government intervention. In particular new investment should be reduced to a minimum, some existing investments should be disposed of and those parastatals and other investments considered essential must be operated efficiently and more effectively administered by

Government. The Committee further found the investments by Government were largely at the initiative of the private promoters with the Government being brought in as an indispensable partner or to undertake rescue measures. "By its nature (the Committee observed) this process had led to large injections of Government funds coupled with subsidies and concessions of one kind or another, often in enterprises which would otherwise not meet normal viability or profitability criteria...it was quite obvious (therefore), that Government investments had not measured up to acceptable standards."

Examples of unsound and poorly controlled investments were readily found in such areas of activity as fertilizer, sugar, textiles, and power alcohol. The amounts involved were of such a magnitude that if they had been directed toward the development of essential rural infrastructure, several districts could have been radically transformed in the terms of both production and employment. In many of these cases Government participation on the open ended scale provided was not essential to the establishment of the enterprise but rather a profitable convenience for the promoters and in many cases, despite its financial participation, often of majority ownership, the Government was not involved in the actual management of the projects.

The Working Party noted that most of the investments were not strategic in any sense of the word and in most cases ownership and/or management control was with foreigners and Kenyans held very few shares and very few management posts. The form of Government involvement was neither effective Kenyanization nor a means of effective regulation. It was for the most part a means of underwriting with Government money risks which should be borne by private investors. In addition, few of the investments were paying dividends and many sought additional finance from Government whenever they encountered difficulties in the market place.

The Working Party noted that it was convinced that Government participation in commercial enterprise had been carried well beyond the original conceptions and had reached the point where such participation was inhibiting rather than promoting development by Kenyans themselves. The Working Party stated that it was a matter of high priority for the Government to revers the trend by working out a viable programme for divesting itself of some of its investments to Kenyan investors who are prepared to take the risks of enterprise in pursuit of the profits that can be earned.

The Government implemented several of the Working Party recommendations on controlling Government expenditure. The recommendation for Divestiture for example, led to the formation of A Task Force in March 1983 to review Government investment in parastatals with the following Terms of Reference: To determine:

(i) those parastatals whose retention as Government agencies or enterprises is essential to accelerated and equitable national development and the regulation of the private sector;

(ii) those whose objectives have been achieved and which should be discontinued;

(iii) those whose functions could be absorbed by parent ministries; and,

(iv) those whose functions would be more efficiently performed by the private sector.

With respect to divestiture the Task Force is to design an effective strategy and appropriate mechanisms for the divestiture of shares or assets taking into account those:

(i) currently profitable and whose shares can easily be disposed of;

(ii) currently unprofitable but which can be made profitable before the disposition of shares; and

(iii) currently unprofitable and without promise, and should be wound up through the sale of assets and dissolution.

The Task Force is yet to make its final submissions as at the time the author was putting final touches of this paper in June 1986.

Since the formation of the Task Force in 1983 several parastatals have gone up for sale; it is not very clear whether they had direct linkages to the Task Force activities but it reflects the change in economic-political thinking after 1983. The three parastatals are the Kenya National Transport Company (KENATCO), the Kenya Fishing Industries and the Uplands Bacon Factory.

The next three sections is devoted to the analysis of the case histories of the companies in order to gain some onsite analysis.

In mid 1985 the GOK implemented a decision to sell
nya National Transport Company (KENATCO), a state owned
nsport enterprise. This was a significant decision as it
the first time in Kenya's history that a wholly owned state
erprise was to be sold. The sale was also seen some
nomists as marking the beginning of the implementation of
of the recommendations made by the Committee on
estiture of Parastatals formed by the GOK in June 1983.

The GOK has had problems of trying to assure state
ed enterprise efficiency. The major reasons mentioned in
r sections broadly lie in conflicting objectives,
ufficient autonomy, inadequate measures for judging
formance, lack of incentives linked to performance, and
eacratic rather than commercial management styles. Some of
e reasons were responsible for the failure of Kenatco and
other parastatal, which have "disguised" failure in so far
entral Government support is necessary for their survival
equally there were external issues. The attempts of the
to instill internal improvements in KENATCO like better
ancial management, more careful inventory control and a
nced scheduling of transport vehicles did not succeeded;
rnally the collapse of the major market in Uganda, Tanzania
Zambia following the collapse of the East africa Community
977 spelled its death in just a matter of time.

Brief History of Kenatco

Kenya National Tranporters Company (KENATCO) was
ed in 1969 with the purpose of establishing a national
sport company to promote Kenyan participation in the
port sector and to promote intra-trade within the
nboring countries. The company operates under the Company
Kenya Laws Cap 486, its shares are owned by the Government
enya (96.5%) and a taxi cooperative in Nairobi (3.5%). In
the company added a limousine taxi service that has
fited from the various international conferences held in
obi including the IMF Governors meeting held in Nairobi in
and the O.A.U. summit meeting and the 1985 Women's Decade
erence.

The size of the company can be indicated by the assets
ontrolled, by 1976 the company owned 70 long distance
age trucks and leased a further 60 that were servicing
ness from the strategic port of Mombasa to Rwanda, Burundi,
da, Tanzania and Zambia. Kenya exporters were also regular
of Kenatco transport to the neighboring countries
cially Zambia and Uganda, the major markets for
factured Kenyan exports. The taxi limousines were close to
Other assets included garage networks, buildings and
ing lots.

The problems of KENATCO started to surface actively in 1978 following the closure of the Tanzania border and the subsequent breakdown of the East African Community. The long distance markets for the company's trucks in Zambia and Tanzania were sealed off, and the neighboring Uganda then troubled with flaring violence during Idi Amin's rule declined in importance as a market. With the closure of the border Kenatco's management decided on the long route through Uganda, Rwanda and Burundi to reach the lucrative markets in Zambia. However forced to increase their rates due to summounting costs the company became uncompetitive, in addition drivers were reluctant to pass through Uganda. Zambia also decided to channel most of their imports through Dar-es-Salaam and Beira. Gradually but firmly the company started losing money with reported losses in 1978, 1979, 1980,1981, 1982 and 1983. Management also lost financial control as revenues diminished with loss of morale and accountability. For example, malpractices became rampant among drivers with frequent failures to meet deadlines due to several "go slows", by drivers. Occassionally mis-use of vehicles occurred through haulage of unauthorized loads, and through embezzlement of petrol and key spare parts. The company even failed to implement key requirements like planned maintenance on the vehicles a necessity due to the poor condition of Kenyan roads in the 1970s. By 1981 trucks were coming off the road permanently for minor defects, sometimes leading to complete failure to deliver goods. The GOK intevened in 1980 and changed the Chief Executive to try and put the company back on its feet, but it was too late. In 1981, the company failed to meet its debts and a court proceeding was requested by creditors. The GOK bailed the company and replaced the Chief Executive again. In 1982 there were further problems when staff failed to receive their salary and went on strike - grounding the company, the GOK once again moved in and bailed the company out and changed the Chief Executive again. In 1983 the Mombasa based staff went on strike due to lack of salaries. In June 1983 creditors filed a court proceeding and the company was put in receivership, it remained in receivership till the Government decided to sell in August 1985.

As recent as May 1985 the GOK maintained that the company would <u>not</u> be wound up as a bailing out programme was being worked out with all parties. On August 30th, 1985 the Inspectorate of Parastatals, the Government body in charge of state owned enterprises, confirmed that the sale of KENATCO'S assets was given the go ahead by the Cabinet. The Receivers subsequently advertised the assets of the company in the local papers.

The Transport Sector in Kenya and East Africa is generally lucrative in view of the key position the port of Mombasa commands and the improved relations between Kenya and Tanzania which may expand the market soon. There are local entrepreneurs with cash to buy the Enterprise, but none have come forward as of June 1986 inspite of the Government's efforts to sell individual trucks and taxis.

The other more recent Government intention towards divestiture is a proposed sale of Uplands Bacon Factory which processes pig meat for the local market.

5. History of Uplands Bacon Factory

The company was set up by white settler farmers in 1906 with the objective of processing bacon and pork products for the Kenya market. The farmers slaughtered the pigs and sold the carcases to the factory for processing. The factory generally functioned along these lines till 1946 when a slaughter unit was installed and a sausage making unit was inaugurated. On the achievement of independence, in 1963 the company was taken over by the GOK (it is not clear from the records whether compensation was paid to the white farmers many of whom left soon after independence, an analysis of post independence British grants to Kenya reveals that large amount of funds were devoted to compensating farmers in the white settler areas and presssumably the pig farmers who supplied pigs to Upland Bacon Factory must have fallen in this group.) As african pig farmers were almost none existent in the early years of independence the GOK held the company in trust till cohesive farmer groups could emerge like cooperatives. The trust was managed by the Standard Bank, a British Bank with branches in Kenya.

In the 1970s the company gradually expanded adding additional product lines including building a capacity for 2000 pigs. During this period the GOK exercised formal control of the company and generally became the de facto managers through various appointments of the Chairman and other management staff who were usually seconded from the Department of Livestock Development. From 1975 serious managerial problems were becoming evident as the company repeatedly failed to pay the farmers on time, usually two days after the slaughter. The delay gradually increased from the two days to nearly six months by 1978. This subsequently led to a severe reduction of pigs delivered by the farmers and the spiralling effect of the idle capacity exacerbated the managerial problems of the company. The factory had a capacity for 2000 pigs but it was receiving only 200 pigs per week, much less than the breakeven capacity of 450 pigs per week.

GOK's Involvement with the Uplands Bacon Factory

When the company reached a financial crises in 1978 the Government stepped in and reshufled the management and a working capital of approximately Ksh.1,000,000 was added. In 1980 the GOK appointed another General Manager and pumped in an additional Ksh.12 million to pay off farmers arrears this money was in effect capitalized by the company. At about the same time a private company was licenced (Farmers Choice Company) to be a competitor as Uplands failed to pay off farmers and meet the market requirements as evidenced by continued importation of pork products from Europe for the tourist industry. The competition in a way spelled the doomsday for Uplands Bacon Factory as farmers flocked to the competitor leaving UBF with additional idle capacity and a dwindling market share. The financial crises of the company did not diminish and by 1984 many farmers were faced with arrears of nearly one year. The GOK once again stepped in and pumped an additional KSh.15 million but it was generally too late as the company moved from bad to worse and creditors pounced with auctioneers and the Government keeping them away by political muscle.

a. Board of Directors

The members of the Board are supposed to be 6, with a Chairman, Managing Director, 3 farmers and 1 appointed by the Standard Bank. The Chairman died in 1984 and has not been reappointed and two other Board members also died and are as yet to be formally replaced. The seconded officer from the GOK is acting as the de facto Board. With the exception of the Standard Bank appointees all Board member are appointed by the GOK.

b. Management of the Organization

The Managing Director has 6 departmental managers reporting directly to him:

Sales Manager (vacant)
Production Manager
Feeds Manager
Contracting Manager
Chief Accountant, and
Pork Products Manager

c. Operating Policies

The Company contracts for pig supply from farmers on an annual basis for a certain quantity of weekly delivery. The pigs once delivered are put into a holding house for fattening before slaughter for approximately thirty days. They are then slaughtered and processed into various product lines like bacon, sausages, hot dogs and meat cutlets. The products are then transported to various depots located in Nairobi, Mombasa, and Nakuru for distribution to hotels, institutions and retail outlets.

d. Profitability

The company has not made any profits since 1976 mainly due to the idle capacity which has sharply increased the overheads of the company. The company has for example not met the breakeven point of 450 pigs per week since 1975.

e. Financial Situation

The Company has debts due to high operating expenses totalling to over 90 million Kenya shillings,

GOK -------KSh.40 million
Bank -------KSh.10 million
Farmers------KSh.30 million
Others------KSh.10 million

f. Future Prospects

The Kenya pork products market is not fully met, there are four major producers namely: Upland Bacon, Farmers Choice, National Airport Services, and private traders. Total market requirement is approximately 5000 pigs per week. Total supply is a maximum of 2,500 pigs per week. The company has an inefficient factory and a total overhaul of machinery is required in order to cut down the overheads. The company is faced with a cripling debt and credit worthiness from farmers view and from suppliers of equipment and overdraft, it has to regain the confidence of these before it can generally have an improved future inspite of the lucrative market.

5. Divestiture

The GOK is committed to divesting the company as confirmed by the Ministry of Agriculture and Livestock Development and by the Acting Chief Executive of the company and analysis of some of the steps the GOK have undertaken so far. The GOK for example advertised the company in Europe as one of the investment opportunities available in Kenya and the Chief Executive went to Belgium in May and met with 13 potential investors from the EEC.

Serious buyers have surfaced one each from W. Germany, Ireland and England. Locally Mitchell Cotts of Kenya (better known for their shipping interests) have shown a keen interest and seem to have the backing of the GOK. Mitchell Cotts are proposing to finance the buy out with funds from the Commonwealth Development Corporation (CDC), serious negotiations are expected to commence in June/July 1986.

Originally it was proposed by the GOK that the enterprise be sold back to the farmers with shares being based on the value of delivered pigs between the years 1963 to 1984, but the debts proved too cripling for the farmers. The GOK is now looking into ways of squaring off the debts before sale.

6. Review of Kenya Fishing Industries

Not all of the divestiture progammes are as slow as the above two, the Government have managed to sell a small company, the Kenya Fishing Industries, successfully. The assets of the Kenya Fishing Industries were officially valued at KSh 45 million and the accepted highest bid was KSh 38 million, representing a nominal net loss of KSh 7 million. A profile of the company is shown below:

NAME: Kenya Fishing Industries

DATE OF FORMATION: 1972

LOCATION: Mombasa

PRODUCTS: Processed sea fish; local market 20 percent

EQUITY: From 1978 onward, GOK (thru ICDC) - 100%
From the period 1972-1978 equity was divided among three partners: Toyo Fisheries (Japan) - 34%; Maritime Company (British) - 32%; and GOK - 34%

NUMBER OF EMPLOYEES: 100

AVERAGE TURNOVER: KSh 25 million per year

NATURE OF OPERATIONS: The project was designed to be operational in two phases. The first phase was to develop the capacity of Kenyans to do inshore and deep-sea fishing. Four trawlers were bought for the inshore fishing of lobsters, shrimps, and prawns, and two ships were bought for deep sea fishing within the 200 mile limit off the coast of Kenya. The company entered the second stage in 1976 with the processing and canning of sea fish and prawns.

MAJOR PROBLEMS OF THE COMPANY: Financial mismanagement leading to failure to meet obligations to employees and creditors; inadequate marketing and pricing policies leading to loss of market; and indecision on the part of the GOK on key issues likely to improve profitability.

7. Lessons Form Kenya's Experience For A Divestiture Program

(1) The Government of Kenya has made a political commitment to divestiture. In the case of KENATCO nearly 1,000 people lost jobs following the foreclosure before sale. As evidenced the GOK tried to delay for a time taking the decision and only took a decision after repeated attempts and options had been exhausted. The delay cost the Government several million pounds.

(2) The sale of parastatals by the Government is concentrating on the loss making firms. The Government is in the initial stages willing and ready to sell the less profitable companies, less so the successful organizations.

(3) The Government, with the exception of one company, is generally finding it difficult to sell the assets of the companies because of declining value of the assets and over pricing by the valuers.

(4) Individual investors have shown interest in parts of Parastatals rather than the whole organization. In the case of KENATCO the limosine service is very profitable and has had many bidders including the employees (drivers of the vehicles).

(5) The Government left the procedures for the sale to Receiver rather than involve a department of the Government.

(6) In the case of the sale of the Kenya Fishing Industries the GOK have correctly kept a hand-off policy after the sale.

(7) Some Investors have expressed a feeling that for the large parastatals, there is no guarantee that the Government will continue its hands-off policy, hence the reluctance to purchase.

(8) Little public promotion or investment promotion were undertaken by the Government or the Receiver before sale.

(9) The Government managed to have the cooperation of the Trade Unions with respect to the loss of jobs after it committed funds to paying off the terminal benefits of the one thousand or so workers.

(10) The Government of Kenya in the period 1983-1986 has been altering the policy environment for investments and the private sector. These are seen as further commitment to Parastatal divestiture.

(11) The proposed Parastatals for sale have on the whole not been targeted for the external investor.

FOR GROUP DISCUSSIONS

Practical considerations may include:

1. What institutions should be included in the planning stage?
2. Should potential buyers be controlled?
3. Is it necessary to reorganize?
4. What are the legal, political and other road blocks?
5. The role of Management and Trade Unions
6. The timing of the sale.
7. The investment, public and organizational promotions that should be undertaken.
8. The role of Government after the sale.