Why Governments Won't Comply

A Kenyan Case Study of Non-Compliance in IMF Programs

Jackline Melisa Makena

Submitted to the Department of Economics of Amherst College
in partial fulfillment of the requirements for the degree of Bachelor of Arts with Honors

Advisor: Professor Adam Honig

Acknowledgements

I would like to thank Professors Woglom and Reyes for starting me off on this journey; Professor Rivkin for the occassional pep-talk; and Professor Honig for enduring a good amount of my confusion.

Thanks mum and Ken for keeping up-to-date from seven thousand miles away. Thanks uncle Ikiara and the team at KIPPRA for helping me find information. Thanks also to my other uncle Ikiara for great pointers.

To the knights of the Morrow table—Linh, Marybeth and Jean— ‘Let us do this again, sometime’. Tosin, *mwaah*!! Chido and Thuzar, your grace in handling your thesis work was inspirational. Karen, you always had a new strategy. Sam, what would I be without your editing skills. Finally, thanks to all my friends who did not ask about my thesis although they were tempted to and who attempted that foiled apperance at my first thesis presentation.

Abstract

When a country requests a loan from the International Monetary Fund, it agrees to undertake a number of reforms collectively known as conditionality. Continued funding from the IMF depends on the country's compliance with its program conditionality. Studies by Mussa and Savastano (2000) and Ivanova *et al*. (2003) show that, overall, government compliance with IMF conditionality has been poor. The IMF attributes this trend to a lack of political commitment or "ownership" to programs by borrower governments. However, the concept of ownership fails to explain why commitment is lacking—that is, what factors influence compliance—or why governments enter these agreements to begin with (Bird, 1998). In this paper, I examine recent IMF programs in Kenya within the context of a conceptual framework of costs and benefits developed in Bird (2006), and find that government non-compliance occurs when actual costs and benefits of compliance differ from expected costs and benefits. Changes in costs and benefits arose due to domestic political economy factors, program design factors and external economic environment factors.

1. Introduction

The International Monetary Fund (IMF or the Fund) was established in 1944-45 together with the World Bank to oversee the Bretton Woods system of fixed exchange rate regimes. The Fund's mandate was to provide short term lending to allow its members "to correct maladjustments in their balance-of payments without resulting to measures destructive of national and international prosperity" (IMF, 1944). The Fund lost its original mandate in the early 1970s when advanced economies abandoned the fixed exchange rate regime for floating exchange rates. However, the Third World Debt crisis of the 1980s brought the IMF back into prominence with a new set of borrowers: middle- and low-income countries in Latin America and Africa (Bird, 2007)

The debt crisis had its roots in the oil shocks of the 1970s when many oil-importing and developing countries borrowed loans at variable interest rates from Western commercial banks to finance oil importation. When interest rates rose in the late 1970s, their debt burdens swelled. At the same time world prices for their exports fell due to recession in industrial countries and therefore they could not pay their debts (IMF website). The problems of external shocks were compounded by years of economic mismanagement (IMF, 1999), which led to distortions in the structure of production and resource allocation within the economy (Spooner and Smith, 1991). The Fund recognized that these deep-seated problems would take a longer time to correct and set-up lending facilities to provide low-income countries with longer-term concessional funding (IEO, 2002): the Structural Adjusment Facility in 1985 replaced by the Extended Structural Adjustment Facility in 1986. ESAF loans carried an annual interest rate of 0.5% and repayments were to be made semi-annually within 5½ years to 10 years of disbursement

(IMF, 2004). This facility was renamed the Poverty Reduction and Growth Facility (PRGF) in 1999.

The IMF envisaged these facilities as one-off operations with a less demanding adjustment requirement than other short-term Fund facilities. However, arrangements under these facilities have often been characterized by *recidivism* or the frequent and prolonged use of IMF resources through a sequence of IMF programs (Bird, 2007). The IMF's Independent Evaluation Office found that 22 of 44 countries classified as prolonged users between 1971 and 2000 were PRGF-eligible (IEO, 2002). Between 1973 and 1999, eleven African countries had nine or more sequential programs with the IMF and of this group Kenya and Senegal had the highest number of programs (Mussa and Savastano, 1999). Recidivism is likely to occur if a) one program is not sufficient to complete the adjustment process (Easterly, 2005); b) the country is under threat of external shocks that may eliminate gains made in the previous program (Mussa and Savastano, 1999); or c) the country requires the 'IMF's seal of approval' to gain debt relief, additional financing from donors including the World Bank, or private capital (Bird, 2007).

For all IMF lending facilities, the disbursement of IMF funds is conditional on the borrower government's compliance with an agreed upon program of reforms known as conditionality. Mussa and Savastano (1999), using the ratio of fund disbursements to fund commitments, find that for the period 1973-1997, only 35% of IMF arrangements were fully disbursed. This result suggests that the majority of programs were permanently interrupted for non-compliance with conditionality[1]. Ivanova *et al.* (2003: table 1), using

[1] This could also reflect economic improvement that makes IMF financing no longer necessary (Bird, 2006)

the MONA database[2], determine that between 1992 and 1998, 44% of ESAF and PRGF programs experienced an irreversible interruption and 70% experienced a major or minor interruption. Compliance with program conditionality has therefore been poor.

The IMF has traditionally attributed non-compliance to a lack of political commitment or "ownership"[3] by the borrowing governments. In 2001, the Fund began a process of streamlining its conditionality—limiting the scope of structural conditionality[4] to only those areas that were critical to the achievement of macroeconomic objectives (IMF 2001b: box 3). Streamlining would also eradicate de facto cross-conditionality between the World Bank and the IMF (Killick, 2006). This move came after a long duration of criticism that conditionality was excessive, ineffective, intrusive, and in areas outside the IMF's area of expertise (see Goldstein, 2000) and thus, hampering compliance. The Fund hoped that streamlining would promote ownership and strengthen compliance.

However, as some authors have pointed out, ownership is too vague a concept. It fails to explain why commitment is lacking—that is, what factors influence compliance—or why governments enter into these arrangements to begin with (Joyce, 2006; Bird, 1998). Dollar and Svensson (2000) and Ivanova *et al.* (2003)[5] argue that the implementation of conditionality depends on the borrower country's domestic political economy, including such factors as the efficiency of bureaucracy, political cohesion and

[2] The monitoring of IMF arrangements MONA database is maintained by the IMF's Policy Development and Review Department and details the extent to which conditions stipulated within programs have been implemented since 1992.
[3] Ownership here refers to the borrower government's willing assumption of responsibility for a program of policies because the government feels that these policies are its own and in the interest of the country (IMF 2001b)
[4] A type of conditionality. See Section 2b for details.
[5] Dollar and Svensson (2000) examine 220 World Bank programs for the period 1980-95 and Ivanova *et al* .(2003) examine IMF programs.

stability, and the power of special interest groups. Their empirical results show that factors such as the extent and structure of conditionality, which are under the control of the World Bank or IMF, are significant only when taken as exogenous. However, since these factors are determined endogenously, they do not influence implementation once this endogeneity is taken into account. Initial country conditions and external factors also do not influence implementation.

Mosley *et al.* (2003)[6] disagree with the above findings. They argue that implementation of conditionality depends not only on domestic political-economy variables but also on program design factors, such as the size of IFI financial support and the sequencing of reforms, and other factors such as the external economic environment. They argue that the regressions used in Dollar and Svensson (2000) and Ivanova *et al.* (2003) suffer from significant endogeneity bias as both studies fail to recognize that some of the domestic political economy variables they treat as exogenous—for example, political instability during the program and special-interests-group opposition to reform—are in fact affected by the degree and outcomes of implementation.

The empirical analysis in Mosley *et al*. is, however, limited. Like Dollar and Svensson and Ivanova *et al.*, they face challenges in designing a suitable measure of implementation. Also, their sample size is small and restricted to Sub-Saharan countries. Furthermore, all the above authors only answer the question "what factors influence compliance?". A closely related and significant question is why governments sign-up for IMF programs to begin with and then fail to comply? Bird (2006), using a conceptual framework of costs and benefits of compliance, argues that governments fail to comply

[6] Mosley *et al* (2003) use data from the 1997 World Bank report on adjustment lending in Sub-Saharan Africa.

with conditionality either because they only intended to comply up to a certain level, or because, while the government intended to comply, the actual costs and benefits of continuing a program differ from the expected costs and benefits.

In this paper, I consider both of the questions raised above: why do governments sign-up for IMF programs then fail to comply? And what factors influence compliance? I employ a modified version of Bird's conceptual framework to study governemnt non-compliance in Kenya's IMF programs. Kenya has entered approximately sixteen arrangements with the IMF[7]. The first IMF-Kenya arrangement, an Extended Fund Facility loan, occurred in 1975 following the oil crisis of the 1970s (Ikiara and Ndung'u, 1999). The IMF extended loans to Kenya through three main lending windows: the Stand-By arrangement, the Extended Structural Adjustment Facility (ESAF) and the Poverty Reduction and Growth Facility (PRGF). This paper will focus on two recent PRGF programs—2000-2003 and 2003-2007. The first program was undertaken in the last years of Daniel Moi's twenty-four year regime. It went off-track within a few months of its inception. The second program was undertaken under the Mwai Kibaki coalition government and was successfully implemented, although it was completed a year behind schedule.

An evaluation of these Kenyan programs reveals that in most cases, non-compliance with conditionality occurred because the actual costs and benefits of complying differed from the expected costs and benefits. Changes in costs and benefits arose due to domestic political economy factors, program design factors and external economic environment factors. Most changes in costs and benefits were fuelled by domestic political economy factors. In both programs the IMF increased its financing to

[7] This number may not include several shadow programs in the 1980s and 1990s.

counter costs changes due to external economic environment and thus, these factors did not lead to non-compliance. In one case, non-compliance occurred because, although costs and benefits of compliance did not change, the government did not intend to fully comply with conditionality.

The rest of this paper proceeds as follows: section 2 gives an overview of how IMF programs work; section 3 lays out the modified conceptual framework; section 4 examines IMF programs in Kenya in the period 2000-2007; section 5 concludes.

2. An Overview of IMF Programs

Each member country of the IMF is assigned an initial quota determined by use of a formula (see IMF, 2010). This quota, denominated in the IMF's currency, SDR, determines the member's subscription to the Fund, its voting rights, and its access limit to IMF financing.

2a. *Lending Process*

The lending process begins when a member country makes a formal request to the IMF for funding. The country's authorities then enter into negotiations with Fund staff on the conditionality to be attached to the loan. When they reach an agreement, the country authorities write a formal letter to the IMF detailing all the measures they have agreed to undertake during the program. This letter is known as Letter of Intent. IMF staff then present the program proposal to the Fund's Executive Board, which decides whether or not to approve the program. Approval triggers the first disbursement of the IMF loan. A typical IMF program is divided into several *tranches* (French for portions or sections);

the release of other loan disbursements depends on how well a country implements the conditionality attached to each tranche.

2b. *Conditionality*

IMF conditionality is aimed at two main areas: macroeconomic stabilization and structural adjustment. Macroeconomic stabilization conditionality is aimed at the management of aggregate demand (Joyce, 2006) and includes such measures as budget deficit cuts and exchange rate devaluation. Goldstein (2000:4) defines structural adjustment conditionality as "...policies aimed...at either improving the efficiency of resource use and/ or increasing the economy's productive capacity". The IMF (2001c) further divides structural reforms into two groups: those that are designed to support macroeconomic stabilization by enhancing the functioning of macroeconomic policy instruments (such as public expenditure management) and those that are aimed at improving the economy's efficiency and flexibility to foster growth and facilitate adjustment to exogenous shocks (such as trade liberalization and changes in financial regulation).

Primarily, conditionality is necessary to assure members that Fund resources are available to them if they comply with agreed upon policies and to give the IMF assurance that the country will repay its loan (IEO, 2007). Conditionality, however, also serves other functions: first, it induces governments to change their economic behaviour; second, it helps the IMF ration its limited funds; third, it signals donors and private investors on the borrower country's economic environment and thus catalyzes donor and private inflows—a phenomenon known as the *catalytic effect* of IMF programs (Collier *et al.,* 1997).

The catalytic effect of IMF programs is an important component of the IMF approach to stabilization. Since the IMF has limited resources, it sequences and paces program reforms so as to restore donor and investor confidence in a country as soon possible (Mussa and Savastano, 2000). In fact, the Fund's converted the ESAF into the PRGF to provide a longer-term framework for donor-support to low-income countries through the Poverty Reduction Strategy Papers (PRSPs)[8]. In turn, donors, investors and creditors (such as the Paris Club) rely on the IMF to provide "certification regarding the soundness of macroeconomic policies" (IEO, 2002) in borrower countries, what is know as the 'IMF's seal of approval'.

The IMF uses four main tools to monitor compliance with conditionality: first, *prior actions* **(PA)** which the borrower country must accomplish before the IMF disburses any funds; second, *performance criteria* **(PC)—**quantitative targets for specified financial aggregates such as net international reserves and structural measures such as subsidy cuts; third, *structural benchmarks* **(SB)—**qualitative indicators used to gauge a country's compliance with structural policy commitments; fourth, *program reviews* which assess the progress of implementation and whether a program needs to be altered (Goldstein, 2000; Khan and Sharma, 2003).

Borrowers must comply with performance criteria **(PC)** to complete program reviews and trigger subsequent disbursements of the IMF loan. However, failure to meet structural benchmarks **(SB)** should not lend to IMF to withhold funds. If the government

[8] The PRGF is framed around Poverty Reduction Strategy Papers (PRSPs). Each borrower government prepares a PRSP in conjunction with the civil society and other development partners.

fails to implement performance criteria, the IMF may waiver the condition. Otherwise, non-compliance will lead to a temporary interruption of the program. If the government and the IMF cannot come for an agreement on how to get the program back on track, the program experiences permanent interruption.

Since governments negotiate with the IMF on program conditionality before signing off on a program, their failure to comply with this conditionality later in the program is puzzling. The conceptual framework below provides a theoretical context for analysing a) why governements enter into IMF arrangements and then fail to comply and b) what factors influencing this change in compliance.

3. Conceptual Framework

3a. General Discussion

In his 2006 paper, Bird sets up a conceptual framework for analysing government compliance with IMF conditionality. He argues that once an IMF program is initiated, government compliance with program conditionality will depend on the government's perceived costs and benefits of continuing the program. A government will rationally discontinue a program when marginal costs of the program exceed marginal benefits. Therefore, non-compliance occurs when a) the program's actual costs and benefits turn out different from the government's perceived costs and benefits or b) the government's calculations of costs and benefits match before and after the initiation of the program, but the government had no intention of fully implementing the program (see discussion in section 3d).

Bird assumes that the government's main objective is to retain power; therefore, any sharp declines in standards of living threaten its incumbency. The government turns to the IMF when the economy is facing an unsustainable balance-of-payments (BOP) because the country has limited access to capital markets and the country's reserves are declining rapidly. Without external financing, the government's corrective policies would lead to a sharp decline in standards of living. This is likely to threaten the government's political stability. IMF financing cushions the economy as the government pursues corrective policies. The IMF's involvement also catalyzes the inflow other funds because it boost donor and investor confidence in the government.

However, not all countries turn to the IMF because of BOP problems. Countries like Kenya that have been prolonged users of IMF resources are more likely to seek the IMF's 'seal of approval' or funds to consolidate reforms undertaken in previous programs. In the sections below I will lay out Bird's conceptual framework and modify it in several areas[9] to make it more useful for the analysis of long-term IMF resource users like Kenya.

3b. Benefits of Compliance

In Bird's framework, the benefits of compliance are derived from the continued access to IMF financing and other financial resources that allow the government to correct external imbalances. However, since prolonged users of IMF resources turn to the IMF for its 'seal of approval' or funding for sustaining gains made in previous program, accessing IMF financing and other related resources allows the government to improve economic performance. Prolonged users will therefore turn to the IMF if 1) the government believes the program will produce improved economic performance during

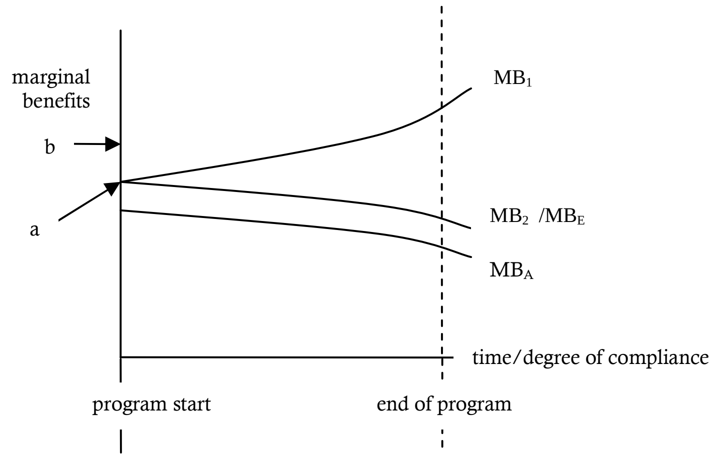
[9] All the figures in this section are also modified versions of Bird's work.

its tenure; and 2) improved economic performance is explicitly part of its political agenda. In the rest of this section, I lay out Bird's construction of the marginal benefit (MB) schedule and highlight areas where I have modified the framework to suit the analysis of IMF programs with prolonged users.

Bird identifies two important characteristics of the marginal benefit (MB) schedule: the starting point of the schedule on the vertical axis and the shape of the schedule. The starting point of the curve depends on the value that the government places on access to IMF financing. Bird shows that this depends on the availability and cost of alternative sources of finance in the absence of the program. Since the first disbursement of the IMF loan occurs upon the approval of the program, the MB schedule starts above the horizontal axis (point a on figure 1). If the announcement of an IMF program also triggers private capital inflows, the MB schedule starts even higher on the vertical axis

Bird states that the shape of the curve depends on how the marginal benefit of the

Figure 1

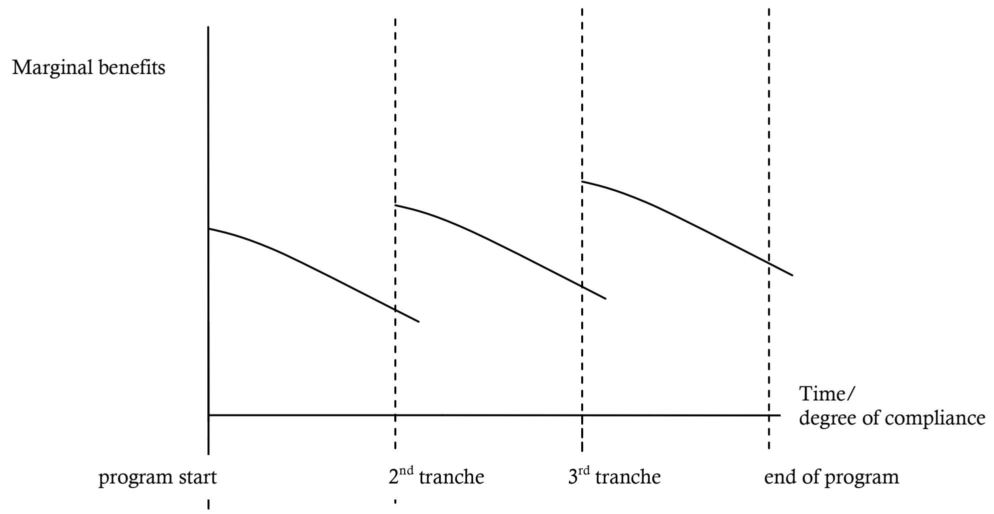


program changes over time and with the degree of compliance. For prolonged users, Bird's analysis of the *size of the catalytic effect* of IMF programs is most relevant. Donor aid and private capital inflows provide capital for economic growth. The evolution of a program's marginal benefits will therefore depend on the catalytic effect of the program. If compliance with conditionality, rather than the announcement of a program, triggers the catalytic effect, then marginal benefits will increase with program implementation and the MB schedule will be flat or upward sloping (MB_1). If the catalytic effect is absent or depends only on the announcement of a program, benefits of the program are gained from its inception rather than its implementation and the MB schedule slopes downwards (MB_2).

However, I think it is important to factor the nature of IMF programs into Bird's analysis. IMF loans are disbursed in instalments; therefore the MB schedule should have discontinuities (see figure 2). Donors and investors rely on the IMF for information about the program and only receive information on the program when the IMF announces the inception of the program or subsequent tranche approvals. In which case, the distinction between the announcement and implementation effects on donor response may not be important. In both cases, the MB schedule is more likely to be downward sloping, and its starting point on the vertical axis and for each new tranche will depend on the value the government places on IMF financing and triggered private and donor inflows.

Finally, Bird shows that once the program is underway, the actual benefits of the program may differ from the ex-ante expectations. The actual MB schedule (MB_A) therefore lies at a different position than the expected MB schedule (MB_E) (see figure1).

Figure 2



3c. Costs of Compliance

In Bird's framework, costs of program implementation arise due to conditionality because conditionality implies a "discrepancy between the policies preferred by the government and those preferred by the IMF" (Bird, 2006: 21). The cost of conditionality will depend on the size of the gap between the policy preference of the government and that of the IMF. While I agree with Bird, I find his discussion of the policy preference gap vague. Therefore, in the paragraph below, I will attempt to expound further on the implications of the preference gap between the government and the IMF.

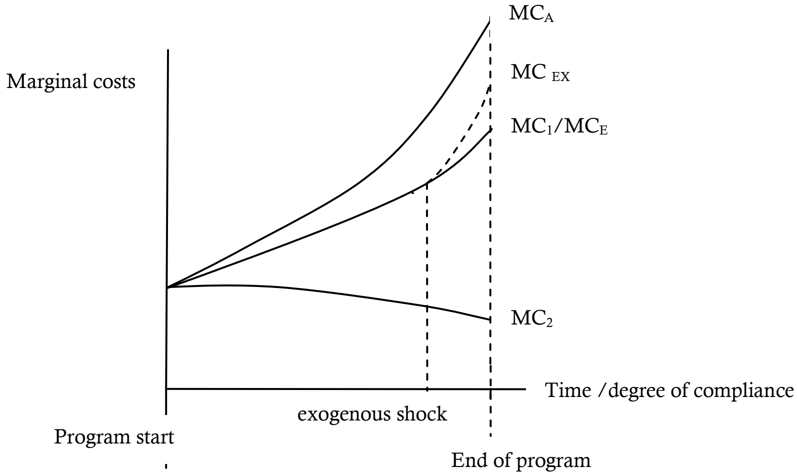
The government pursues policies that the IMF deems unsuitable for two main reasons: a) an ideological divergence with the IMF or b) factors that constrain its behaviour. In the first case, IMF engagement leads to a loss of sovereignty over economic policy formulation. In the second case, the constraining factors facing the governemnt determine the government's perceived costs. One constraining factor could be the government's capacity. When the government engages in an IMF program it faces the opportunity cost of shifting its capacity away from service provision to program reforms. Another constraining factor is vested interests in the country that may oppose reforms. Conditionality forces the government to act in a manner that ignores its constraints and in so doing increases the risk of opposition from a discontented population or segements of the population. This opposition may threaten the government's incumbency.

The above expansion notwithstanding, Bird's analysis of the MC schedule remains relevant. He highlights two characteristics of the MC schedule: its starting point on the vertical axis and its shape. The starting point of the MC schedule depends on the government's perceived costs of implementing prior actions **(PA)** before IMF approval of the program as well as the government's perceived loss of sovereignty over policy formulation. The MC schedule will therefore start above the horizontal axis (Figure 3).

The shape of the MC schedule depends on how costs change over time and with the degree of implementation of conditionality**.** Assuming sovereignty costs do not change, the MC schedule is upward sloping if it becomes progressively harder to implement the later stages of the program. For example, if opposition to the government increases with every additional measure implemented (because, for example, conditonality sequences and paces reforms such that it forces the government to ignore more and more of its constraints over time), the MC curve will slope upwards (MC_1). Conversely, if opposition to the government decreases with every additional measure implemented, the MC curve will slope downwards (MC_2).

Finally, Bird argues that actual costs may differ from ex ante costs. For example, if political opposition to the program policies (and therefore the government) turns out to greater than expected, the actual MC schedule (MC_A) will have a steeper slope than the expected MC schedule (MC_E). Exogenous shocks could also cause actual costs to differ from ex-ante costs. For example, a negative exogenous shock will make the MC curve steeper after it occurs (MC_{EX}).

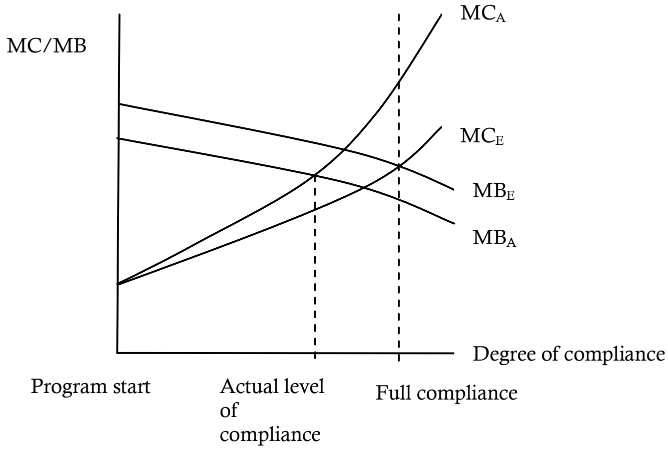
Figure 3



3d. Marginal Benefits & Marginal Costs

Figure 4 shows the expected MB and MC schedules plotted together. Governments

Figure 4

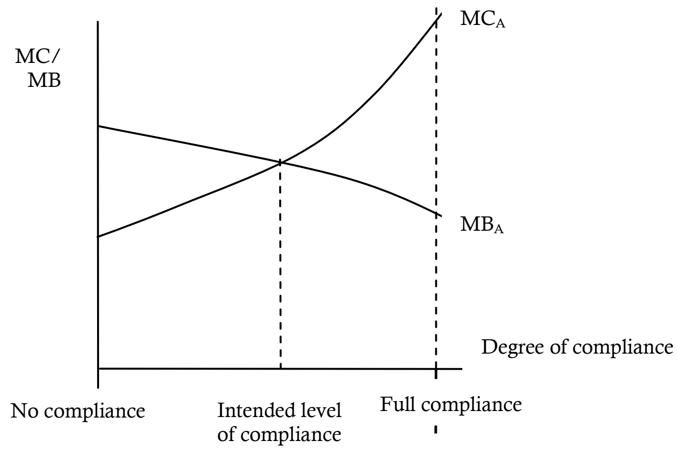


will initiate IMF programs if the value of the benefits of the first instalment of IMF financing and any capital inflows that arise from the announcement of the program is greater than the costs of prior conditions and the loss of sovereignty in policy formulation from the point of view of the government.

Afterwards, government compliance with conditionality will depend on how the costs and benefits of the program evolve. Actual costs and benefits are likely to differ from *ex ante* expectations. Therefore, ex-post, a government may be unable to comply fully with conditionality it intended to comply with ex ante. The point of intersection between the actual MB curve and the actual MC curve gives the actual level of government compliance. One example of a situation where actual costs and benefits differ from ex ante costs and benefits is when donor and investor response to the inception of an IMF program is less than expected. On the marginal benefits side, the actual MB schedule lies below the expected MB schedule. Costs of implementation increase because external financing is inadequate to relax the constraints the government faces in enacting reforms. The actual marginal costs increase faster than expected. Overall, the level of compliance is lower than expected.

As mentioned in section 3a, non-compliance is also possible when a government has no intention of fully complying from the inception of the program. It chooses to comply only up to a certain level where marginal costs exceed marginal benefits (Figure 5) but is able promise more reforms than it intended to undertake. Joyce (2006) argues that this is possible because there is an information asymmetry between the IMF and the government.

Figure 5



4. A Case Study of Kenya

4a. *Introduction to Kenya*

In a 2002 report, the IMF's Independent Evaluation Office classified Kenya among the Fund's prolonged users; that is, countries that have spent 7 years out of 10 under an IMF arrangement over the period 1971-2000. Between 1975 and 2000, Kenya had 13 IMF programs, a total engagement of 19.2 years (IEO, 2002).

Kenya is the largest economy in East Africa; in 2007, its gross domestic product was $27billion, almost twice the size of Tanzania's economy and three times the size of Uganda's economy. GDP growth averaged 2.26% for the period 1997-2002 and 5.35% for the period 2002-2007 (see figure 6 in the appendix). The current account deficit was below 5% throughout 1997-2007, with a high of 4.1% in 2007(figure 8). This suggests that Kenya did not experience balance-of-payment problems during this period; the government more likely turned to the IMF for the reasons highlighted in section 1. IMF macroeconomic conditionality for the programs under study focused on reducing government domestic debt, increasing reserves, streamlining budgetary spending and cutting external debt (tables 1, 3, 5 and 7). The IMF included conditionality on the fiscal deficit only in the 2000-03 program although the deficit had declined between 1997 and 2000. The budget deficit rose sharply in 2001 and 2002 perhaps due to campaign spending prior to the 2002 elections. The next deficit expansion (2005/2006) coincided with the referendum on the Kenya's new constitution in late 2005 (figure 7). Over this period, total reserves rose from 1.32 import months to almost 4 import months (figure 10), while total external debt fell from above 48% of GDP to about 27% (figure 9).

Ikiara and Ndung'u (1999) characterize Kenya's compliance with conditionality in the 1980s as poor. Program implementation accelerated in 1993-1994 when the government rapidly liberalized the economy, but slowed down again. Most of Kenya's IMF programs occurred under the Daniel Moi regime (1978-2002) and were characterized by a 'stop-go' government strategy. Despite this pattern of compliance, the IMF remained engaged in Kenya because of fears that collapse of the Kenyan economy would greatly affect neighbouring economies (FT[10], 1997).

The first program under study, PRGF 2000-03, came after a three-year hiatus of IMF involvement in Kenya and a donor aid freeze. Kenya's previous program, the 1996-9 ESAF, went off-track in July 1997 when the High Court ruled that the prosecution of perpetrators of Kenyan's largest corruption scandal, Goldenberg, could not proceed on procedural grounds. The Goldenberg scheme had been uncovered in 1993. It had involved the payment of about $600 million from the Ministry of Finance and the Central Bank of Kenya (CBK) for fraudulent gold exports under an export scheme. Donors

[10] The Financial Times

became reluctant to lend to Kenya and in their subsequent programs with Kenya, both the World Bank and the IMF focused heavily on governance issues. The program expired in April 1999 without completion.

4b. *Poverty Reduction and Growth Facility program 2000-2003*

4b.i. *Background*

Kenya made its next request for an IMF program in late 1999. At the time, the country was facing its worst drought ever, insecurity in the northern part of the country, tension within the military, a looming energy crisis and the rampant spread of HIV/AIDS. Figure 6 shows that annual GDP growth has been declining since 1999 while inflation had been rising (figure 8). This volatile economic and social situation was coupled with Opposition demands for an overhaul of the constitution and wrangles within the ruling party over the succession of Moi in the upcoming general elections. While Moi did not need votes, his successor would fare better if the economy was doing well. Also, the governement might have seen the IMF program as a direct source of campaign money through IMF funding and related funds, or an indirect source through the facilitation of debt rescheduling from the Paris Club[11].

Negotiations for the 2000-03 program began after President Moi appointed Dr. Richard Leakey, a leading Opposition figure, as the head of the civil service in July 1999. Dr. Leakey also headed a small team of technocrats, the Dream Team, drawn from large private companies, the World Bank and other international financial institutions to take

[11] The Paris Club is a group of bilateral lenders including Austria, Belgium, Canada, Denmark , Finland, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, the U.K. and U.S. In November 2000, the Paris Club rescheduled principle and interest arrears worth ($24 million) and debt-service maturities worth ($275million) over a period of 20 years with a 10-year grace period. The rescheduling allowed gross official reserves to increase to 3 months import cover from 1.1 months import cover (IMF, 2002).

charge of various key ministries like Finance and Agriculture. These appointments were the result of pressure on the government from the IMF to adopt “a more comprehensive approach to addressing corruption in Kenya” (IMF, 2008). The World Bank, the UNDP and other donors advanced Kenya funds to remunerate these technocrats (Murunga, 2007).

Dr. Leakey and his team undertook radical reforms in the civil service, such as the retrenchment of civil servants and the clean up of corporations, for example, Kenya Ports Authority and Kenya Revenue Authority (KRA). These reforms signalled to the IMF that the government was at last committed to reform. The Dream Team therefore played a key role in the approval of the 2000-3 PRGF program on August 4th 2000(DN[12], 2000d). The program was approved just a month before the IMF issued its guidance note on the streamlining of conditionality. In the governance area alone, it featured 19 structural conditions and another 70 anti-corruption measures in the Memorandum of Economic and Financial Policies[13].

The IMF agreed to lend Kenya SDR 150 million (55% of Kenya’s quota). Upon approval of the program, Kenya received the first disbursement of the program worth SDR 33.6 million. Program reviews were to be completed bi-annually. The program expired in 2003 without the completion of a single program review.

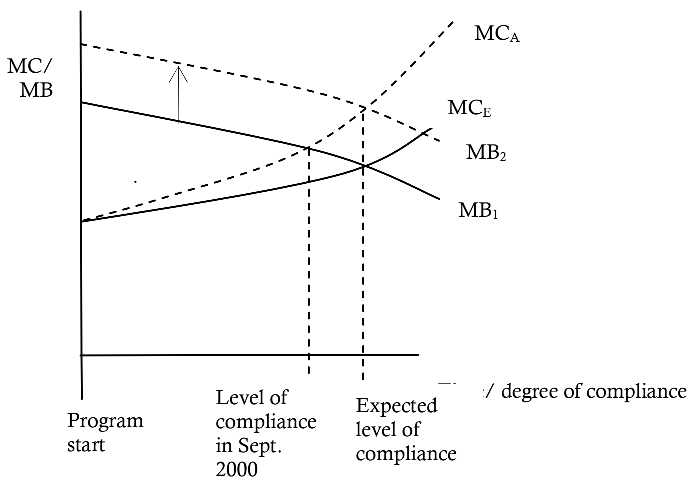
4b.ii. *Non-compliance (2000-01)*

The government failed to meet several conditions attached to the first tranche of the 2000-03 program. First, it exceeded the ceiling on the fiscal deficit in December

[12] The Daily Nation Newspaper, including Sunday Nation and Daily Nation supplements
[13] This document accompanies the Letter of Intent and gives definitions of the various terms and conditions included in the Letter of Intent.

2000(Table 1). In the context of the conceptual framework, an increase in spending on drought relief would lead to an increase in the costs of complaince and a rise in marginal costs (Figure 11). This would result in a lower level of compliance than expected. However, the IMF augmented Kenya's loan amount to SDR 190 million from SDR 150 million in October 2000 to take into account government spending on drought and famine relief (IMF, 2008). It is unclear whether the government gained access to these extra funds immediately; however, an augmentantion of IMF financing would shift the governement's MB schedule out. This could explain the governement's return to compliance in March 2001.

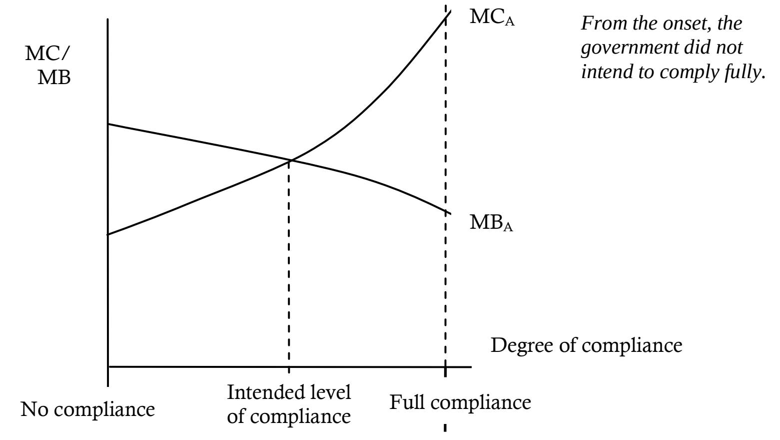
Figure 11



Second, the government failed to set up an independent Kenya Anti-Corruption Authority. Non-compliance occured because the government did not fully intend to comply. From the start, the push for an anti-corruption organization had come from the donor community (IEO, 2007). Under the 2000-03 program the IMF wanted to make the KACA independent and empowered to prosecute corrupt individuals. The program included two conditions to this end (Table 2). The first condition was a prior action (PA) requiring the establishment of a fully effective KACA. The second condition, a performance criterion (PC), required the publication of an Anti-Corruption and Economic Crimes Bill to give the KACA independence from the other arms of government (DN, 2000c).

The Bill was to be similar to one annexed to the *Kombo Report*, a document written by the Parliament Anti-Corruption Committee. The report contained a list of names of corrupt government officials and politically-connected individuals. It had been up for discussion in Parliament in May 2000 (two months before the approval of the IMF program) and had faced strong opposition from the government side. By including the Anti-Corruption and Economic Crimes Bill as a PC, the IMF tried to force the government to adopt proposals it had already rejected (DN, 2000b). This was an unrealistic goal. Parliament postponed discussion of the Bill and in December 2000, the High Court ruled that the KACA was unconstitutional because it appropriated the Attorney General's powers to prosecute cases (DN, 2000h). The government had actually drafted a faulty bill back in 1997 which suggests that the government had not intended to comply with conditionality. An information asymmetry between the government and the IMF allowed the government to promise more reforms than it had intended to undertake. This led to non-compliance once the government had maximized perceived benefits of the program (in this case, the rescheduling of debt).

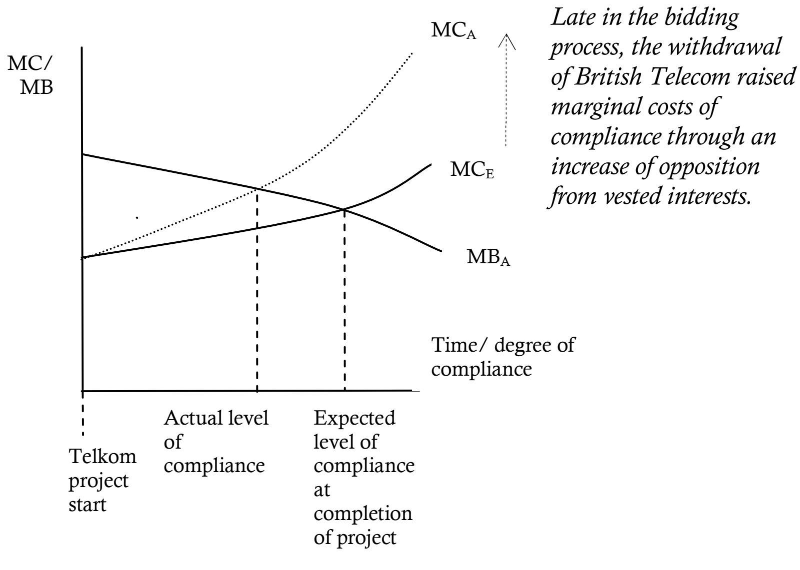
Figure 12



Third, the government failed to privatize Kenya's telecommunications monopoly, Telkom, through the sale of its 49% stake to a strategic partner. Although this was aWorld Bank program conditionality, non-compliance affected the IMF program because proceeds from the sale had been factored into the budget. This led to "…a severely limited cash expenditure, while the overall deficit exceeded the program deficit by 1% of GDP" and a "…recourse to arrears accumulation…brought about an escalation of new claims of pending bills on the budget" (IMF, 2002). The government thus failed to meet IMF conditionality on the non-accumulation of pending bills (see Table 1 in the appendix).

The sale of Telkom stalled in December 2000 after President Moi announced that the government would not bow to pressure to sell the parastatal at a throw-away price (DN, 2000e). On the contrary, the World Bank claimed that the largest bid, by Mount Kenya Consortium, had been suitable given the size of Telkom's market (DN, 2000f). However, a few weeks before Moi announcement, British Telecom had withdrawn from the bidding process leaving the Mount Kenya Consortium as the highest bidder. A *Daily Nation* article suggests that the government felt that the members of the consortium did not have adequate expertise and technological capacity to benefit Kenya (DN, 2000g). The article also points out that at the time Telkom was implementing a multi-million-dollar expansion and modernization of its networks which stood to benefit various vested interests. Developments with British Telecom and the Mount Kenya consortium raised marginal costs of complying with World Bank conditionality by increasing opposition from vested-interests to a sale that was seen as unfavourable (see figure 13). This affected the IMF program because of cross-conditionality between the IMF and World Bank programs.

Figure 13



Finally, the government failed to satisfactorily meet conditionality on the financial sector (see Table 2). One condition involved the submission to Parliament of amendments of the Banking and Building Society Acts to give the Central Bank (CBK) authority over all institutions involved in banking activities. While the government had sumitted the Bill to Parliament, the legislative body had also amended the Central Bank of Kenya Act (through a bill known as the Donde Bill) to give the CBK power to limit for deposit and lending rates at three percent above the Treasury bill rate. The Donde Bill had been proposed by a member of parliament from the Opposition. In fact, the Opposition had been against the resumption of IMF funding to Kenya. On 4th January 2000, eight Opposition members had formed a lobby group, Stakeholders Support Group, and demanded that the IMF prove that the government had undertaken significant and sustained efforts to curb corruption as per IMF conditionality under the lapsed 1996-9 program (DN, 2000a). The likely reason for this protest was the Opposition's fear that the government would use IMF funds for its campaign in the 2002 elections and therefore have an unfair advantage. When the IMF resumed funding, the Opposition decided to fight the government in Parliament. The Donde Bill, for example, aimed at curbing high interest rates and was touted as a pro-people bill. The government-majority Parliament could not afford to reject it. Its passage made the government reluctant to comply with the conditionality to sell its 26% stake in Kenya Commercial Bank as it would receive a lower price (DN, 2001). Here, domestic political economic factors raised the costs of implementing program conditionality and led to lower than expected compliance (see figure 13).

4c. *Poverty Reduction and Growth Facility 2003-2007*

4c.i. *Background*

Kenya's next program occurred under a new government elected in the December 2002 elections. The National Rainbow Coalition (NaRC) government promised to introduce free primary education, to eradicate corruption within government, to create half-a-million jobs within its first year in government and to pass a new constitution in six months after its inauguration. The NaRC was made up of NAK, a coalition of ex-Opposition parties led by President Mwai Kibaki, and LDP, a faction of the ex-ruling party under Minister Raila Odinga.

The government sought a new IMF program after the expiration of the 2000-03 program. Its main motivation seems to have been the restoration of donor and investor confidence in Kenya since it needed financing to meet its election promises (Kelley, 2003). The NaRC government was under pressure to produce short term results that would pave way for more long-term reforms. As fulfilment of prior actions to the resumption of IMF funding, Parliament quickly passed the Anti-Corruption and Economic Crimes Bill and the amendment to the Public Ethics Bill. It is important to note that the passing of the Anti-Corruption and Economic Crimes Bill was possible due to the relaxation on the part of the IMF of its demand that the anti-corruption body (now renamed Kenya Anti-Corruption Commission, KACC) be independent from other arms of government and empowered to prosecute corruption cases. The new KACC would investigate cases and pass them on to the Attorney General for prosecution. It is important to also note that the new program occured after the IMF had began streamlining its conditionality; therefore, conditionality should have focussed on the IMF'S area of expertise and structural conditionality should have directly been linked to the achievement of macroeconomic stability.

The new program was approved on 21st November 2003 for the period 2003-2006. The original end date for the arrangement was 20th November 2006 but at the request of the government, the IMF extended the program twice. The IMF agreed to lend Kenya

SDR 175 million (64% of Kenya's quota). Program reviews were to be completed bi-annually.

4.c.ii. *Non-Compliance (2003-4)*

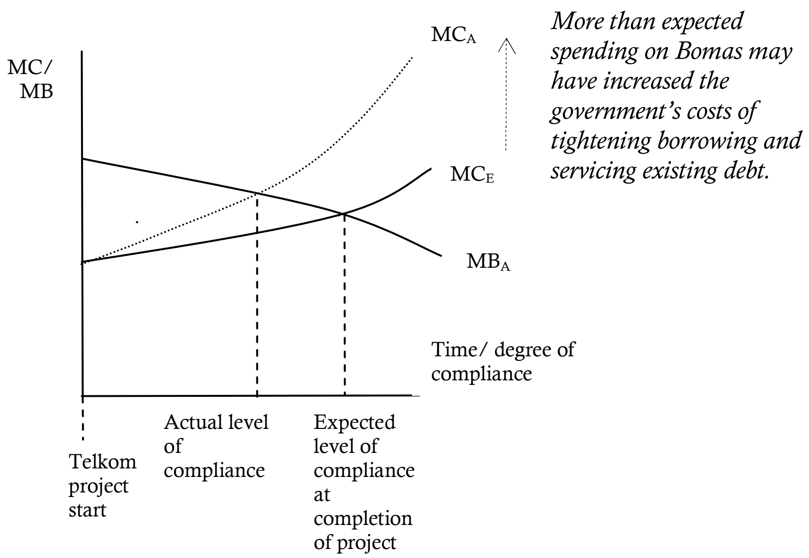
Kenya completed its first program review in December 2004. The review was delayed by six months and the Fund granted Kenya waivers for five of Performance Criteria missed: two macroeconomic conditions on the contracting or guaranteeing of non-concessional external long-term debt and on the accumulation of external payment arrears (see table 4 appendix) and three structural conditions on an audit of the National Social Security Fund (NSSF), on the submission to parliament of a Banking Act amendment and on the audit of pending bills (see table 5).

Non-compliance with macroeconomic conditionality might have been due to the Constitutional Review process. The government, in its election campaign, had promised to give the country a new constitution[14] in six months after its inauguration. Shortly before the 2002 elections, a Constitution of Kenya Review Commission had produced a draft constitution. Only three stages remained in the process: discussion of the draft by a National Constitutional Conference (commonly known as Bomas) made up of politicians and representatives from interest groups; approval by Parliament; and finally presidential assent. Certain sections of the draft constitution, for example, the section on the triming of presidential powers, faced heated debate. It is likely that heavy expenditure associated with popularizing the government's pro-presidential view at Bomas left it cash-strapped (DN, 2006a). This could have led increased the cost of implementing the macroeconomic

[14] The push for an overhaul of Kenya's constitution had begun during Moi's last term in office. As Moi was a de facto dictator, the then Opposition sought to trim his powers. The Nark Coalition took up constitutional issue to distinguish itself from the long-time ruling party.

conditionality on the accumulation of external arrears and therefore to non-compliance (figure 14).

Figure 14



The government also failed to meet the condition on new wage setting mechanisms for public employees but the IMF moved this condition to the second period of the program. The objective of this condition was to reduce the share of the wage bill in total expenditure. To fulfil this condition the government had to restart a stalled retrenchment program began under the Moi regime. However, one of the government's election promises had been the creation of half a million jobs in its first year. Retrenchment would have faced strong opposition. In fact, soon after the program's approval civil servants began demanding pay increases (DN, 2003a). The IMF seems to have anticipated that domestic opposition would lead to an increase of marginal costs for the government and non-compliance, hence, the removal of this condition.

4c. iii *Second Period of the PRGF program (Jan 2005-April 2007)*

a. Background

Kenya's Opposition was not satified with the IMF's approval of the second program tranche. Members of Parliament from the Opposition argued that non-compliance had exceeded the two conditions highlighted above (DN, 2004b). The IMF seemed to have ignored the April 2004 discovery of Kenya's second large corruption scheme. The scandal known as Anglo-Leasing (after the non-existent firm to which the monies were paid) involved the 18 fraudulent or flawed security contracts worth $750 million for goods that were either overpriced or not delivered. Although 12 of the contracts had been signed under the Moi regime, six (worth $300 million) involved the Kibaki government (IMF, 2008).

Foreign envoys from all the major donor countries reacted to the Anglo-Leasing scandal with a threat to freeze aid if the government failed to investigate and prosecute all civil servants and politicians involved. In July 2004, The E.U. actually suspended budgetary support of Kshs. 12.5 billion in July; Kshs. 4.7 billion had already factored into the budget (DN, 2004a). This, however, did not seem to influence the IMF in contrast to its reaction to the Goldenberg scandal of 1993. The Fund's reaction to Anglo-leasing was to ensure adequate resources to KACC to investigate the case and to push for evidence of prosecutions in significant corruption cases (IMF, 2008). The government had immediately fired and prosecuted the Permanent Secretaries[15] in the ministries of Finance and Home Affairs and the Financial Secretary at the Treasury, and recovered some of the funds paid to Anglo-leasing. The new KACC and the PS for Governance and Ethics,

[15] The Permanent Secretary is the administrative head of a government ministry. The Minister is the political head.

John Githongo, were also actively engaged in investigating the Anglo-Leasing scandal. The IMF's positive rating of Kenya suggests that the Fund was satisfied with these government efforts and chose to stick to its guidance note on the streamlining of conditionality. However, by October 2005, the IMF seems to have reconsidered its position.

b. *Non-compliance (2004-07)*

Kenya completed its second review 22 months behind schedule, in April 2007. This delay was due to an IMF decision not to approve the third loan disbursement on 10th March 2006. This decision, however, did not involve government failure to meet any of the program conditions (see table 5 and 6). Non-complaince could have been due to either program design factors or domestic political economy factors.

A *Financial Times* article suggests that program disruption occurred because the IMF's Executive Board was concerned about high-level corruption in the Kenya (FT, 2006). An IMF official stated that donor support had dissipated and "the critical mass of support was no longer there". Intense donor focus on corruption began in February 2005 when the British High Commissioner, Sir Edward Clay, publicly accused the NaRC government of large-scale graft and handed over a dossier of 20 new corruption scandals to the president (DN, 2005). A week later, on 7th February 2005 the Permanent Secretary of Governance and Ethics, John Githongo, the central man in the fight against corruption, resigned and went into self-exile in United Kingdom (Gaitho, 2005). He alleged that the government was trying to cover up the Anglo-leasing scandal by shielding the politicians involved. At the end of February 2005, Germany became the second donor after the E.U.

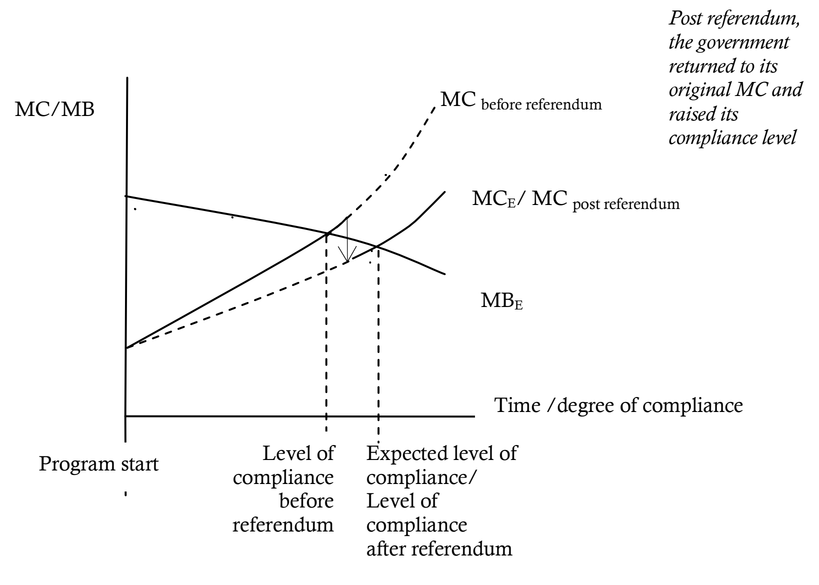
to withhold budgetary support. By June 2005, the U.S. was also withholding funds. The World Bank also suspended budgetary support some time after June 2005 following the arrival of Paul Wolfowitz as president (IMF, 2008).

President Kibaki's immediate action after Githongo's resignation was to move one of the ministers implicated in the scandal, Chris Murungaru, from the Ministry of National Security to the Ministry of Transport. The President was, however, reluctant to fire Murungaru—although this would give credibility to his war against corruption—because the minister was one of his closest allies in NaRC. The country was soon to vote in a referendum whether to accept or reject the draft constitution. Kibaki's faction in NaRC supported the draft constitution while LDP, the faction led by his main rival, Raila Odinga, was against it. The referendum therefore doubled as a vote of confidence for or against the government. Kibaki could not afford to lose his close allies in NaRC.

The situation changed when the government side lost the referendum on 21st November 2005. Kibaki immediately sacked his entire cabinet and reconstituted it without Murungaru and members of LDP. Later, on 8th January 2006, when the British Broadcasting Corporation (BBC) aired a secret tape made by John Githongo that implicated the ministers of Justice and Finance, Kiraitu Murungi and David Mwiraria, in an attempted cover up of the scandal (DN, 2006b), Kibaki quickly forced both ministers to resign.

On one hand, it is possible to argue that the IMF, by bowing to donor pressure, had changed conditionality attached to the program and increased costs of compliance for the government as illustrated in figure 14. Changes in costs had led to non-compliance. On the other hand, although the investigation and prosecution of top officials involved in corruption had not been an explicit part of IMF program conditionality, the IMF could have taken John Githongo's resignation as a signal that the government had failed to meet the condition of establishing an independent and effective Kenya Anti-Corruption Commission (KACC)—a prior action for the resumption of aid to Kenya in 2003. The Fund was therefore justified in withholding funding. Before the November 2005 referendum, the prosecution of high level officials threatened the political stability of the government. After the referendum, such prosecutions became possible and even a favourable tool for showing government commitment to reform. Non-compliance before the referendum occurred due to an increase in costs as demands for tougher measures against corrupt officials increased. In the post-referendum period, costs fell and the MC curve became less steep. Government compliance therefore increased.

Figure 15



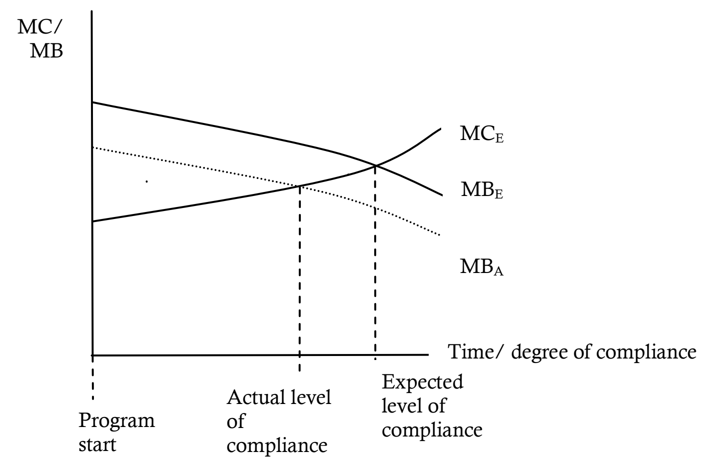
4c. iv. *Non-compliance (April 2007-November 2007)*

Kenya completed its third program review on 16th November 2007 within seven months of the second review. The IMF granted Kenya waivers for the non-observance of four performance criteria (see table 7 and 8). One missed PC was the submission to cabinet of a strategy to initiate the sale of government and NSSF shares in the National Bank of Kenya. Also missed was a related structural benchmark (SB) on the establishment of the Privatization Commission.

The Privatization Commission was to replace the Investment Secretariat in the Ministry of Finance and undertake transparent and orderly divestiture of government shareholding in state corporations. However, after Parliament passed the Privatization Bill and the president gave it assent in November 2005, the Minister of Finance failed to gazette it. A bill cannot become operational in Kenya unless it is published in the government gazette (Opondo, 2007). The minister said he could not publish the Bill before he set up all the structures needed to make it operational. Opondo points out that the law required the bill's publication before any such structures could be established. The government was intentionally stalling the bill.

In fact, the president had been slow to give assent to the bill back in 2005 and had only signed the bill into law because of a European Union threat to withhold funding if assent was not given by October 2005 (Munene, 2005). One explanation for this reluctance could be that the government preferred to revive and strengthen parastatals to privatizing them. In fact, in December 2003, donors questioned the government's move to revive institutions such as the Kenya Meat Commission and the Horticultural Development Authority. They expressed concern that the government has not made a major shift in issues of privatization one year after its inauguration (DN, 2003b). The National Bank of Kenya (NBK), one of the parastatals the World Bank wanted privatized, returned to profitability in November 2003. The revived parastatals may have promised greater benefits to the government in terms of revenue and employment creation than complying with IMF conditionality. This reduced the marginal benefit of the IMF program and made the government reluctant to comply with conditionality (figure 16).

Figure 16



5. Conclusions

It is possible to draw several conclusions from the above analysis of Kenya's most recent PRGF programs with the IMF. First, as argued in the case of the Kenya Anti-Corruption Authority under the 2000-03 program, a government can agree to conditionality it does not intend to comply with. In this case, the government seeks an IMF program not for its long-term benefits of boosting donor and investor confidence or of strengthening gains made in previous programs, but for short term benefits such as immediate IMF lending and bilateral debt rescheduling made possible by the presence of an IMF program.

Second, when a government seeks an IMF program for its longer-term benefits, it may fail to comply fully with conditionality if the benefits or costs of continuing the program change. During Kenya's programs, non-compliance often occurred due to an increase in costs. The actual MC schedule rose more steeply than the expected MC schedule and this led to lower than expected compliance. In one examined case, the privatization of strategic parastatals, the benefits of complying with program conditionality fell; the actual MB schedule lay below the expected MB schedule and actual compliance was lower than expected.

Changes in costs and benefits occurred due to program design factors, domestic political economy factors, and exogenous factors. Some examples of program design factors that affected compliance include cross-conditionality between IMF and World Bank programs in the 2000-03 program. Government non-compliance with World Bank conditionality directly affected the IMF program by made it difficult for the government to meet its macroeconomic conditionality. Another example is the interruption of the 2003-07 program during its second tranche. One explanation of this interruption is Fund augmentation of conditionality in the course of the program (or the 'shifting of goalposts') due to pressure from donors over perceived high-level corruption in the government. New conditions threatened the government's political standing and increased the costs of compliance. Another explanation could be that IMF program failed to capture elements that would signal government commitment to donors and investors. Therefore, while the government had agreed to one set of conditions, donors and investors required the fulfilment of more conditions. This made implementation costs higher than expected and led to non-compliance.

The 2003-07 interruption may also be explained in terms of domestic political factors. One can argue that interruption occurred because the IMF discovered government failure to fully comply with conditionality attached to the previous tranche on the establishment of an independent and effective anti-corruption body. The government failed to prosecute high-level officials involved in corruption because this move would threaten its stability. Again, implementation costs were higher than expected but due to domestic political economy factors.

Exogenous shocks such as drought and famine and increases in oil prices raised costs of compliance in both program periods. However, their effect on program implementation was eradicated by the IMF's quick augmentation of lending from SDR 150 million to SDR 190 million in October 2000 and from SDR 175 million to SDR 225 million in November 2004.

The above results support findings in Mosley *et al.* (2003) that implementation depends not only on domestic political-economy variables but also on program design factors such as structure of conditionality and other factors such as the external economic environment.

References

Bird, G. 2007. "The IMF: A Bird's Eye View of Its Role and Operations" Journal of Economic Surveys, 21(4): 683-745.

_____2006. "The Implementation of IMF Programs: A Conceptual Framework" Department of Economics Discussion Papers 15/06, Department of Economics, University of Surrey.

_____1998. " The Effectiveness of Conditionality and the Political Economy of Policy Reform: is it Simply a Matter Political Will?" Journal of Economic Policy Reform, 2 (1): 89-113.

Collier, P., & Gunning, J. W. 1999. "The IMF's Role in Structural Adjustment." The Economic Journal, 109(459), 634-651.

Collier P., Guillaumont P., Guillaumont S., & J. W. Gunning. 1997. "Redesigning Conditionality." World Development, 25(9), 1399-1407.

Daily Nation. 2006a. "Exclusive: the Anglo Leasing Truth." January 22.On Access World News Database.

_____2006b "Githongo's Secret Tape on Kiraitu Aired by BBC." February 9. On Access World News Database.

_____2005. "British Envoy Raps Kenyan Government over New Graft Cases." February 2. On Access World News Database.

_____2004a. "Envoys Give Kibaki Seven Key Demands." July 22. On Access World News Database.

_____2004b. "KANU Faults IMF on Positive Rating on Reforms." September 28. On Access World News Database.

_____2003a. "Lending Rules Will Hurt Our Workers, Says Union's Boss." December 1st. On Access World News.

_____2003b. "Donors Query Policy Shifts." December 2. On Access World News Database.

_____2001 "Donors Demand Action on Anti-corruption Authority." January 23. On Access World News Database.

_____2000a. "Opposition Blames British High Commission for Aid Resumption." January 4. On Access World News Database.

_____2000b. "IMF Sets Tough New Conditions for Aid Deal." July 31. On Access World News Database.

_____2000c "IMF Deal May Mean that MPs Vet Appointments to Public Office." August 1. On Access World News Database.

_____2000d "Kenya: State May Review Leakey Team's Hefty Pay Package—Finance Minister." October 15. On Access World News Database.

_____2000e "State Indecision over Sale of Telecommunications Firm Causing Anxiety." December 15. On Access World News Database.

_____2000f. "World Bank Reacts to President Moy's Decision not to Sell Telecom Firm." December 15. On Access World News Database.

_____2000g "Paper Says Deal On State Telecoms Company 'Still Remote'." December 26. On Access World News Database.

_____2000h "Anti-corruption Body May Continue Operation Despite Court Ban." December 27. On Access World News Database.

Dollar, D. and J. Svensson. 2000. "What Explains the Success or Failure of Bank-Supported Adjustment Programs" Economic Journal, 110 (446): 894-917.

Easterly, W. (2005). "What Did Structural Adjustment Adjust? The Association of Policies and Growth with Repeated IMF and World Bank Adjustment Loans." Journal of Development Economics, 76(1), 1-22.

England, A. 2006, March 10th. "IMF Delays Loan to Kenya." Financial Times, 3.

Gaitho, M. 2005 "Anti-Graft Czar Was on a Mission Impossible." Daily Nation on Access World News Database. February 8.

Goldstein, M. 2001. "IMF Structural Conditionality: How Much Is Too Much?" Institute for International Economics, Working Paper No. 01/04.

Government of Kenya. 2000. Letter of Intent. Washington, D.C.: IMF

Ikiara, G. and N. Ndun'gu. 1999. "Employment and Labor Markets during Adjustment" in Van Der Geest, W. and R. Van Der Hoeven (eds.), Adjustment, Employment and Missing Institutions in Africa: The Experience in Eastern and Southern Africa. (Geneva: International Labor Office), pp 73-114.

Independent Evaluation Office of the IMF. 2007. "Structural Conditionality in IMF-supported Programs: Background Documents." Washington, D.C: IMF.

_____2002. "Evaluation of Prolonged Use of IMF Facilities." Washington, D.C: IMF.

IMF. 2010. "IMF Quotas". Factsheet. IMF website

_____2009a. "Kenya: Third Review under the Poverty Reduction and Growth Facility Arrangement and Request for Waivers and Nonobservance of Performance Criteria". IMF Country Report 09/18.

_____2009b. "Kenya: 2006 Article IV Consultation and Second Review under the Three-Year Arrangement under the Poverty Reduction and Growth Facility, and Requests for Extension and Rephasing of the Arrangement, Reduction in Access, and Waiver of Performance Criteria". IMF Country Report 09/137.

_____2009c. "Kenya: 2004 Article IV Consultation, First Review under the Poverty Reduction and Growth Facility, and Requests for Augmentation of Access, Rephasing of the Arrangement, and Waiver of Performance Criteria". IMF Country Report 09/225.

_____2009d. "The Poverty Reduction and Growth Facility (PRGF)". Factsheet. IMF website

_____2008. "Kenya: Ex-post Assessment of Longer-Term Program Engagement". IMF Country Report 08/338.

_____2004. "IMF Concessional Financing through the ESAF". Factsheet. IMF website.

_____2003. "Kenya: Request for a Three-Year Arrangement under the Poverty Reduction and Growth Facility". IMF Country Report 03/399.

_____2002a. "Kenya: Selected Issues and Statistical Appendix." IMF Country Report 02/84.

_____2002b. "Kenya: Article IV Consultation". IMF Country Report 02/85.

_____2001a. "Conditionality in Fund-Supported Programs: Overview" paper prepared by Policy Development and Review Department, Washington D.C.: IMF.

_____2001b. "Conditionality in Fund-Supported Programs: Policy Issues", paper prepared by Policy Development and Review Department, Washington D.C.: IMF.

_____2001c. "Structural Conditionality in Fund-Supported Programs", paper prepared by Policy Development and Review Department, Washington D.C.: IMF.

_____1944. “Articles of Agreement of the IMF, Article I. v.” Washington D.C.: IMF.
IMF website. Unknown date. “IMF History: Debt and Painful Reforms (1982-89)”.
Ivanova, A., Mayer, W., Mourmouras, A., & Anayiotos, G. (2003). “What Determines the Implementation of IMF-Supported Programs?” IMF working paper 03/8.
Joyce, J. 2006. "Promises Made, Promises Broken: A Model Of IMF Program Implementation." Economics and Politics, 18(3): 339-365.
Kelley, K. 2003. “Funds D-Day for Kenya.” Daily Nation on Access World News Database. November 21.
Khan, M. S., & Sharma, S. 2003. “IMF Conditionality and Country Ownership of Adjustment Programs. World Bank Research Observer, 18(2), 227-248.
Killick, T. 2006. “Conditionality and IMF Flexibility.” In Paolini, A. and Zanardi, M. (eds.), The IMF, World Bank and Policy Reform (London and New York: Routledge): 253-264.
Mosley, P., Noorbakhsh, F. and A. Paloni (2003) “Compliance with World Bank Conditionality: Implications for the Selectivity Approach to Policy-Based Lending and the Design of Conditionality.” CREDIT Research Paper No. 03/20. University of Nottingham.
Munene, M. 2005. “E.U. Ties Aid to New Rules on Contracts.” Daily Nation on Access World News Database. October 26.
Murunga, G. 2007 “Governance and the Politics of Structural Adjustment in Kenya” in Murunga, G. and S. Nasong’o (eds.) Kenya: The Struggle for Democracy (London and New York: Zed books): 263-300.
Mussa, M., & Savastano, M. (1999). “The IMF Approach to Economic Stabilization” NBER Macroeconomics Annual, 14:79-122
Opondo, O. 2007 “It’s a Glaring Illegality,” Daily Nation on Access World News Database. October 14.
Spooner, N. and L. Smith 1991. Structural Adjustment Policy Sequencing in Sub-Saharan Africa. Rome: Food and Agriculture Organization, Economic and Social Policy Department.
Wrong, M. 1999, Sept. 19th. “Test Case for Tough Stance: The Economic Collapse of Kenya would Spill Far Beyond National Borders”. Financial Times, 27.

Appendix

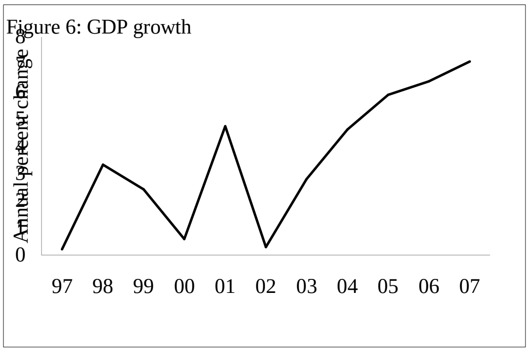


Figure 6: GDP growth

Source: World Economic Outlook, Oct. 2009

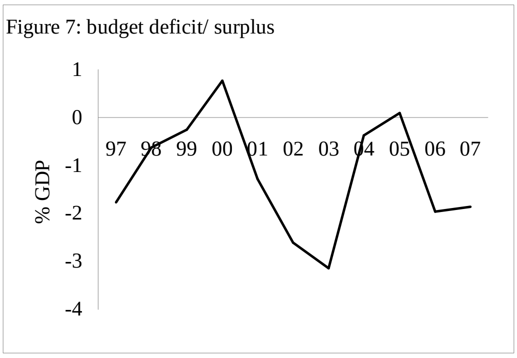


Figure 7: budget deficit/ surplus

Source: IFS (IMF), March 2010

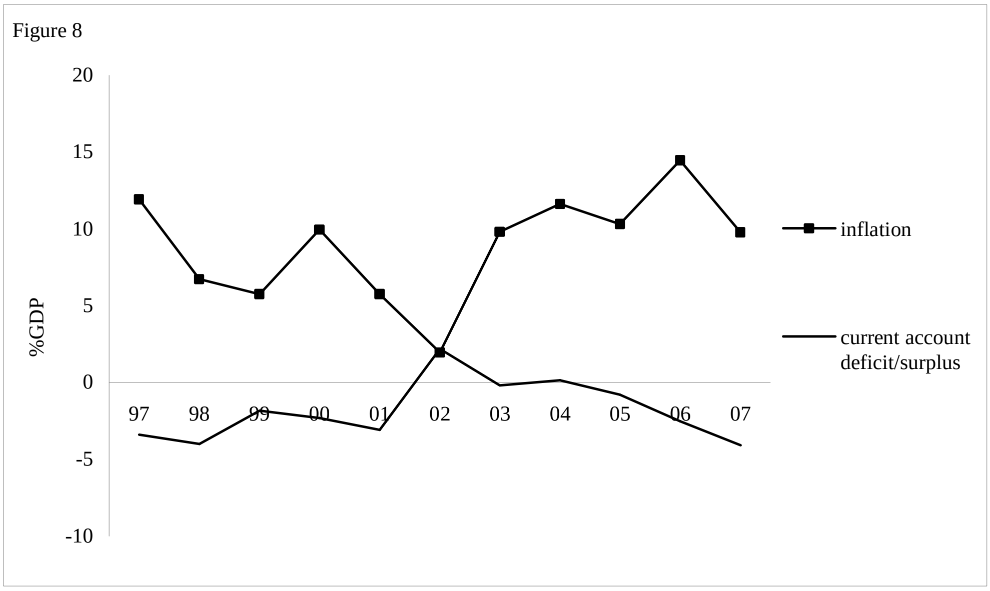


Figure 8

Sources: IFS (IMF) &WDI (World Bank) respectively

Figure 9: External Debt

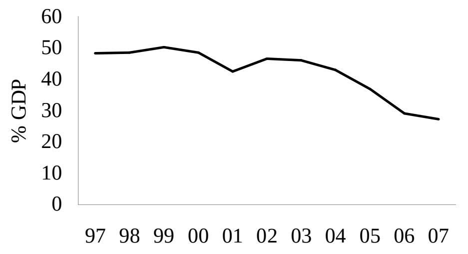
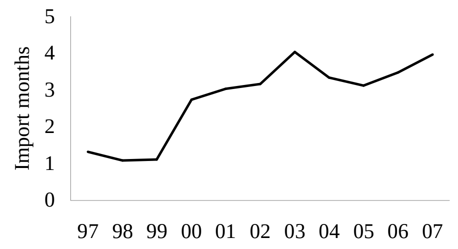


Figure 10: Official reserves



Source: WDI (World Bank)

Source: WDI (World Bank)

Table 1: summary of macroeconomic conditionality for July 2000-July 2001 in million dollars						
	March 31	Sep. 30	Dec. 31	Mar. 31	Jun. 30	Outcomes
Performance criteria						
Net domestic assets CBK (ceiling)	…	346.257	350.267	300.801	251.337	all met
Net foreign assets CBK (floor)	582.781	600.602	656.751	696.858	771.725	all met
Overall fiscal deficit (ceiling)		52.139	125.668	191.176	169.786	only sept. & march met
Stock of external arrears	100.0	35.0	0.0	0.0	0.0	only sept met
Contracting or guaranteeing nonconcessional external long-term debt		0.0	0.0	0.0	0.0	all met
Short-term external debt		0.0.	0.0	0.0	0.0	all met
Benchmarks						
Stock of pending bills		23.021	0.0	0.0	0.0	Not met in sept. & dec. Other outcomes

						unclear
Memorandum items						
Programmed external budgetary support		154.840 (79%)	447.152 (57%)	461.110 (53%)	642.019 (62%)	All targets missed. Figures in brackets show the actual amount of budgetary support received.
Notes: a. Shaded entries are actual variables. All other are program objectives. Sources: IMF, 2002; GOK 2000.						

Table 2: Summary of structural conditionality (2000/1) and outcomes	
A. Governance 1. Amendment of the draft bill containing the code of ethics for public officers by October 2000 to strengthen investigative powers of the Public Service Commission, extend the requirement of wealth declaration to include immediate family of officials **(PC).** 2. Publish in the official gazette an Anti-Corruption and Economic Crimes Bill similar to the one annexed to the Parliament Select Committee on Corruption (also known as the *Kombo Report or Bill*)**(PC)** 3. The establishment of a fully effective anti-corruption agency (Kenya Anti Corruption Agency, KACA). **(PA)**	1. Parliament rejected the code of ethics bill on the grounds that it contravened the principle of separation of powers among the Executive, judiciary and legislative branches of government (IMF 2003) 2. Parliament also postponed discussion on the Anti-Corruption and Economic Crimes Bill. 3. The government fulfilled this prior action by drafting a bill proposing an independent KACA but the Constitutional Court subsequently ruled the KACA unconstitutional.
B. Fiscal Management Conditionality was aimed at producing	

Public Expenditure Management (PEM) reforms. Measures included: 1. Transfer of the supervision of district treasury officers from the Office of the President to the Ministry of Finance. **(PC)** **2.** A plan for the elimination of pending bills (domestic arrears) by March 2001. **(SB)** 3. Strengthening the office of the Controller and Auditor General through the development of terms of service by Dec 2000 to allow competitive remuneration for the staff on terms applicable to the pay structure of KRA and KACA **(PC)**	1. Met. 2. Not Met. 3. Partially addressed.
C. Financial Sector 1. Amendments to the Banking Act and Building Society Act to give the Central Bank of Kenya (CBK) authority over all institutions involved in banking activities by March 2001. **(SB)** **2.** Sale of at least 26% of government shares in Kenya Commercial Bank (KCB) by March 2001. **(SB)**	1. Met. However, Parliament also amended the CBK Act ("Donde Bill") to set a limit for deposit and lending interest rates. 2. Not Met.
D. Trade regime 1. The government was to complete developing a tariff reform program by March 2001 to be implemented under the 2001/2 budget **(SB)**	1. Met (with a delay).
Notes: a. (SB): Structural Benchmarks; (PA): Prior Acts; (PC): Performance Criteria (PC) Sources: IMF 2002a; IMF 2002b: IMF 2003; IMF 2008; GOK 2000.	

Table 3: Summary of Macroeconomic conditionality for July 2003- July 2004 in million dollars **(both PC and SB)**

	June 30	Sept 30	Dec. 31	Mar. 31	Jun. 30	Outcomes
Net domestic assets CBK		-96.441	-55.111	-171.552	-248.448	Met
Net foreign assets CBK		10.006	30.792	110.792	189.664	Met
Central govt. wages and		269.310	561.444	844.357	1182.774	Met

salaries						
contracting or guaranteeing nonconcessional long-term debt	0.0	continuous zero ceiling throughout program				breached but contracts later cancelled
short term debt	0.0	0.0	0.0	0.0	0.0	Met
accumulation of external arrears	0.0	continuous zero ceiling throughout program				breached in July 2004;
accumulation of domestic arrears	0.0	continues zero ceiling throughout program				Met
Memorandum items:						
Programmed external budgetary support	241.229	134.883	360.595	631.716	812.020	Outcome is unknown. It is not clear if these figures reflected donor pledges made in the Nov24-25 Consultative donor meeting.
Notes: a. The IMF did not factor in any privatization receipts for this period. Source: IMF 2003/399; IMF2009/225.						

Table 4: Summary of structural conditionality (2003/4) and outcomes	
Governance 1. Establishment of the Kenya Anti-Corruption Commission. **(SB)** 2. Establishment of a timetable for the completion of initial asset declarations by senior public officials (in compliance with Public Officials Ethics Act). **(SB)**	1. Met (with delay). 2. Met (with delay).
Financial Sector 1. Reach an understanding with staff on a time bound plan for	1. Met but subsequently differences arose between Fund and Bank

restructuring the NBK. **(PA)** 2. Decide on transfer financial sector regulatory functions from the Ministry of Finance to the CBK **(PA)** 3. Submission to parliament of an amendment to the Banking Act to transfer of financial sector regulatory functions from the Ministry of Finance to the CBK **(PC)**. 4. No imposition of controls by the government or the CBK on commercial bank fees, charges or interest rates (pending an amendment to the CBK Act) **(PC)**. 5. Completion of an audit of the National Social Security Fund (NSSF) **(PC)**. 6. Reaching an understanding of the fiscal implications of restructuring the NSSF **(SB)**.	programs. (specifics not given) 2. Met 3. Met (with delay). 4. This was a continuous condition. It was observed during 2003/4, but breached in 2005/6. The government insisted that despite the provisions of the law, in practice, the Ministry of Finance always approved proposed increases in bank fees and charges. 5. Met (with delay). 6. Not Met. NSSF restructuring transferred to World Bank Financial Sector Adjustment Credit (2005/6)
Fiscal Management 1. Development of an action plan and timetable for the introduction of a Commitment Control System (CCS) to minimize deviation of expenditure outcomes from targets and the build-up of arrears **(SB)**. 2. New wage setting mechanisms for public employees aimed at reducing the share of the wage bill in total expenditure. (Savings were to be directed towards social and economic services) **(SB)**. 3. Finalize an audit of the stock of pending bills and adopt measures that provide for the clearing of pending bills over a three-year period.	1. Partially completed 2. Not met and incorporated into 2004/5 program. 3. Not met. Financial audit completed but clearance plan to await conclusion of legal audit.

Privatization and Restructuring 1. The introduction of a Privatization Bill in parliament for the establishment of a Privatization Commission **(SB)**	1. Met (with delay).
Notes: Sources: IMF 2003; IMF 2009c; IMF 2009b	

Table 5: Summary of Macroeconomic conditionality for July 2004- July 2005 in million dollars.				
	Dec 2004	Mar 2005	June 2005	Outcomes
Cumulative change in the net foreign assets of the CBK(floor)	-88.942	-28.030	114.351	Met
Cumulative change in reserve money of the CBK (ceiling)	33.554	28.277	43.471	Not Met
Cumulative change net domestic financing of the central government* (ceiling).	252.894	345.180	341.761	Met
Central government wages and salaries (ceiling).	659.455	1001.849	1318.911	Met only in March. Otherwise exceeded
New contracted or guaranteed nonconcessional external medium term or long-term debt** (ceiling and continuous **PC**).	0.000	0.000	0.000	Met
New contracted or guaranteed nonconcessional	0.000	0.000	0.000	Met

external short-term debt** (ceiling).				
Accumulation of domestic budgetary arrears (ceiling and continuous **PC**).	0.000	0.000	0.000	Met
Accumulation of external arrears (ceiling and continuous **PC**).	0.000	0.000	0.000	Met in December. Not met otherwise***.
Memorandum items				
Programmed external budgetary support	0.000	60.165	151.349	No budgetary support was received
Privatization receipts	1.267	2.141	2.533	No actual privatization receipts

Notes:

a. Excluding govt. debt issued for any bank restructuring and the new securitization of expenditure arrears.
a. **by the central bank and CBK
b. *** This was mainly because Kenya continued to accumulate arrears on external security-related commercial loans/ suppliers' credit contracts; the government was disputing the validity of amounts under contracts due to governance concerns top potentially fraudulent procurements.

Sources: IMF 2009b.

Table 6: Summary of structural conditionality (2004/5) and outcomes	
Governance **1.** Agreement with government over a system of annual declarations and verification of assets by ministers, permanent secretaries, and heads of state bodies **(PA)** 2. Submit to parliament an amendment to the Public Officers Ethics Act (2003) to provide for the annual verification of asset declarations of ministers, permanent secretaries, and heads of state bodies by the KACC. **(SB)** 3. Completion of asset declarations by ministers, permanent secretaries, and heads of state bodies. **(PC)**	1. Met 2. Met 3. Not Met (in progress)
Financial Sector 1. Limit overdraft of the NBK with the CBK to end-June 2004 level. **(SB)** 2. Completion of detailed financial review of NSSF. **(SB)**	1. Met 2. Not Met
Fiscal Management 1. Completion of the Budget Outlook for 2005/6-2007/8. **(PC)** 2. Completion for the Budget Strategy Paper. **(PC)** 3. No imposition of control by the government or the CBK on bank fees, charges or interest rates (continuous **PC**) 4. Agreement with government for a revised budget for 2004/5 designed to limit domestic borrowing to below Kshs 32 billion (approximately $450 million). **(PC)** 5. Consolidate budget-management and planning functions in the Ministry of Finance. **(PC)**	1. Met 2. Met 3. Not met 4. Met 5. Met
Privatization and Restructuring **1.** Initiate detailed assessment of financial and debt positions of key parastatals.**(PC)** 2. Issuance of new guidelines for wage arbitration by the Industrial Court. **(PC)**	1. Met 2. Met (with delay)

3. Develop a time bound plan to restructure/ privatize public-sector owned banks. **(SB)** 4. Apply new wage setting mechanism for public employees **(SB)**.	3. Met 4. Met
Trade regime 1. Introduce simplified customs processing procedure for import and export. **(SB)**	1. Not Met
Notes: Sources: IMF, 2003; IMF 2009c.	

Table 7: Summary of Macroeconomic conditionality for 2007 in million dollars			
	June 2007	Sept. 2007	Outcomes
Cumulative change in the net foreign assets of the CBK(floor)	219.193	316.743	Met in June. Not met in Sept.
Cumulative change in reserve money of the CBK (ceiling)	208.406	241.622	Not met but corrective measures undertaken.
Cumulative change net domestic financing of the central government (ceiling).	399.391	802.274	Met
New contracted or guaranteed nonconcessional external medium term or long-term debt** (ceiling and continuous **PC**).	2.030	2.030	Met
New contracted or guaranteed nonconcessional external short-term debt** (ceiling).	0.000	0.000	Met
Accumulation of domestic budgetary arrears (ceiling and continuous **PC**).	0.000	0.000	Met
Accumulation of external arrears	0.000	0.000	Met (with delay)

(ceiling and continuous **PC**).			
Memorandum items:			
Programmed external budgetary support	0.271	0.271	No budgetary support received
Privatization receipts	246.697	246.697	Actual receipts well below target.
Notes: Source: IMF 2009a.			

Table 8: Summary of structural conditionality (2007) and outcomes at the end of the program	
Governance 1. Cabinet approval of the 2006/7 Governance Action Plan for Building a Prosperous Kenya***** **(PA).** 2. Web-post of information on all procurement contracts above Kshs 0.5 million that were awarded in the second and third quarters of 2005/6. **(PA)** 3. Resubmission of the Proceeds of Crime and Anti-Money Laundering Bill. **(PC)** 4. Resubmission to Parliament of Statute Law which provides for public disclosure of wealth declaration and the appointment of at least 20 new judges. **(PC)**	1. Met 2. Met 3. Met 4. Met
Fiscal management 1. Make the Public Procurement Oversight Authority fully operational under the Procurement and Disposal Act. **(PC)** 2. Publish quarterly reports based on expenditure returns data no later than 45 days after the end of each quarter (continuous **SB**) 3. Establish objective criteria for granting tax exemptions and waivers by end April (**SB**). 4. Complete the study of contingent	1. Not Met 2. Met 3. Met. 4. Not met.

liabilities of twenty-four parastatals' accounts (**SB**). 5. Present to Parliament the Auditor General's Report for 2005/06 **(SB).** 6. All procurement will continue to be subject to the transparent and competitive procedures established under the Procurement and Disposal Act **(**continuous **SB).**	5. Not met. 6. Met
Financial sector **1.** Another amendment to the Banking Act aimed at 1) the introduction of mandatory supervisory interventional and prompt corrective action for inadequately capitalized and failing banks and 2) the introduction of consolidated supervision **(SB).** 2. Submit to cabinet a strategy to initiate sale of government and NSSF shares in the NBK. **(PC)** 3. Complete a diagnostic audit of NSSF **(SB)**. 4. Finalize draft regulations necessary to implement the Proceeds of Crime and Anti-Money Laundering Bill. 5. Make the IFIMS****** operational in four spending ministries for the management of the 2007/8 budget **(PC)**	1. Not met 2. Met (with delay) 3. Not met 4. Met 5. Met
Privatization and Restructuring 1. Include in the finance bill for 2007/8 the elimination of business licenses found not to serve a useful purpose**.(PC)** 2. Establish the Privatization Commission under the Privatization Act 2005 **(SB)**	1. Met 2. Not met
Notes: a. *This was an action plan to address corruption and foster economic growth. It was created during a donor Consultative Group meeting with the government in April of 2005 following the resignation of John Githongo. b. **Integrated Financial Management Information System. Sources: IMF, 2009a	