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The IMF and Africa: Kenya

by Steven Wisman

Kenya's experience with the International Monetary Fund in the 1980s provides a pertinent case study from which to attempt to draw some general conclusions about a model relationship between the IMF and a country with an economy and balance-of-payments problems that cannot be described as typical but are not unique in Africa. First, Kenya suffered from government deficit financing that diverted the domestic banking system's funds away from the private sector. Second, the national currency (Kenyan shilling) was overvalued, inhibiting export growth. Third (as has been true for the majority of the world's nonoil developing countries), the international economy's high interest rates, depressed demand for primary commodities, and high oil import prices combined to worsen Kenya's terms of trade. If one uses 1976 as a base period (1976 = 100), the country's terms of trade deteriorated 31.1 percent between 1978 and 1982.

Kenya's financial officials recognized that the payments imbalances increasingly evident in the late 1970s required immediate attention if they were not to impede seriously the country's future economic development. The move toward the IMF falls into three phases: (1) Kenya took advantage of its relatively good credit standing in the international financial market and borrowed $200 million at an interest rate of 1.5 percent above the London Interbank Offered Rate (LIBOR) to be repaid over seven years. Other African states which are or have been in a position to resort to such financial assistance include Cameroon, Gabon, Ivory Coast, Malawi, Sudan, and Zaire. (2) Next, Kenya negotiated with the World Bank in 1980 for a $70 million structural adjustment loan (SAL). A SAL differs from an IMF stand-by loan in that its conditions pertain to agreed policy measures (not necessarily quantitative ceilings), and its focus is on longer-term results. In a sense, these qualities free the Bank from the oft-heard criticisms of the Fund's staff for placing too strong an emphasis on monetarist variables at the expense of other factors, and demanding that sweeping changes be accomplished within a short time. (3) Kenya approached the IMF with a request for a stand-by credit agreement. The arrangement, concluded in October 1980, was for SDR 241.5 million over two years, representing 350 percent of the country's quota.

An unbudgeted 30 percent wage increase, food shortages due to drought, and unmonitored spending on the part of certain ministries led to a violation of the deficit borrowing ceiling (in effect, abrogation of the 1980 stand-by credit agreement) in mid-1981. A second stand-by credit based on the same monetarist variables but under stricter terms of conditionality was signed in January 1982. The arrangement was for SDR 151.5 million (the unused balance from the first agreement) over one year, or 147 percent of Kenya's quota, with the largest part of the loan to be made available near the end of the arrangement period if IMF conditions were met. This new agreement broke down in mid-1982 when Kenya again proved unable to meet the Fund's performance criteria. The failure on these two stand-by credits gives rise to the following questions:

- What do these difficulties suggest about the utility of the IMF-Kenya relationship for each party?
- Were Kenya's problems with the Fund's conditionality a reflection of weak economic management by the Kenyan government or of misguided IMF policy recommendations?
- Finally, and most important, what is this particular case's relevance for other troubled African economies?

Consideration of these questions must begin with a careful look at the dynamics of the negotiations.

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Basic IMF Negotiating Guidelines

The IMF was created in 1945 by the Bretton Woods conference participants to ensure that the postwar period's international economic system functioned free of the unstable investment climate, protectionist trade policies, and beggar-thy-neighbor exchange rate devaluations of the 1930s. Its six initial objectives—contained in the first Article of Agreement—still underlie this institution's current policies. These are:

- to enhance cooperation and consultation on monetary issues among members;
- to facilitate the smooth exercise of international trade so that its benefits are realized on a general basis;
- to promote exchange rate stability;
- to advocate the creation of a system that allows for the uninhibited flow of payments and transactions;
- to provide financial resources on a temporary basis to members experiencing payments difficulties; and
- to act to reduce the size and longevity of balance of payments imbalances.

The breakdown of the Bretton Woods system of fixed exchange rates in the early 1970s and the consequences of that decade's immense accumulation of external debt on the part of many developing countries have led to an IMF focus on the latter two objectives.

The debilitating effects of the 1973-1974 and 1979-1980 oil price rises on the balance of payments of nonoil developing countries—as well as on the industrialized economies—impelled IMF member countries to look outward for external capital resources to help alleviate the financial consequences of high oil import costs. Throughout most of the decade, private commercial banks replete with OPEC surplus deposits fulfilled most of these needs. International lending rose from \$33 billion in 1973 to \$160 billion in 1980, an increase of 385 percent. When U.S. monetary policy officials decided in 1979 to concentrate on money growth instead of interest rates in controlling inflation, the consequent unstable rise in interest rates made private external financing to cover payments imbalances too expensive for many developing countries. To maintain their creditworthiness in the world market and/or to reschedule debt service payments, more and more finance officials turned to the Fund and its stand-by credit facilities to draw in excess of their reserve tranches.

How Stand-by Arrangements Evolved

The IMF created stand-by credit facilities to assist members whose balance-of-payments difficulties and consequent resource needs exceed the credit available in their first credit tranches. Higher tranche loans differ from the first tranche in that they are granted only on a conditional basis. Stand-bys are normally for one year—a period which the Fund considers short enough to permit a reliable economic forecast and long enough for observation of changes in selected economic data.

The concept of stand-by credit allocation evolved over time. In 1956, the utilization of phased periodic payments in place of granting total agreed credit in one package was perceived as a way of encouraging compliance with IMF performance criteria. Binding performance criteria were introduced two years later. Finally, via a 1969 amendment to the Articles of Agreement, performance criteria were formally adopted as a policy option.

As the world economy suffered from simultaneous recession and inflation during the mid to late 1970s, developing countries increasingly borrowed from the IMF sums in excess of their first credit tranches. Whereas during the three years previous to 1979 only 19 such stand-by or extended arrangements, totalling SDR 7.5 billion, were negotiated between the IMF and member countries, 73 such agreements, totalling SDR 23.7 billion, were signed between 1979 and 1981.

Establishing a stand-by arrangement requires seven steps. (1) The member country's finance officials contact the IMF during the Article IV consultations (ostensibly on exchange rate management) or simply during a visit. (2) The actual request for assistance is formally or informally declared. (3) The real work commences when members of the Fund's staff prepare a comprehensive briefing paper that reviews the state's economic problems, considers possible adjustment policies, and proposes final recommendations. Final approval is granted by the IMF's Executive Board after the report is reviewed by the Managing Director. (4) The Fund's negotiating team is formed. The team is usually composed of a senior economist and several colleagues from the Exchange and Trade Relations Department and the Fiscal Affairs Department. One or two staff members familiar with the country's particular predicament complete the negotiating team. (5) The actual economic negotiations last two to three weeks. It is important to note that the IMF staff cannot strike a bargain on its own; approval of the final terms must await consideration by the Fund management back in Washington. The staff's degree of latitude and flexibility varies according to the management's faith in the team leader, the staff's overall experience, and the general progress of the negotiations. (6) If there is no breakdown in the negotiations, the country's finance minister prepares a "letter of intent" that formally requests the stand-by credit and states explicitly the economic policy adjustments to be made. (7) The Fund's Executive Board makes any necessary changes and then grants final approval.

The potentially most controversial aspect of this process is the nature of IMF staff policy advice in the preparation of the letter of intent. To what extent were the performance criteria perceived as imposed by the Fund? Where should the line be drawn between the country's acknowledgment that certain austerity measures are indeed necessary and IMF staff pressures to ensure that the country (which may have no other viable option for external finance) implements particular policies that local officials oppose (usually because of domestic political implications)? Kenya's case involved the first of these issues more than the second. Kenya's economic policymakers agreed with the Fund on the thrust of the stand-by packages. Differences arose on several points but—quite unlike Tanzania's case—were not so great as to result in the termination of the negotiations.

The Conditionality Controversy

The principle of conditionality on the provision of credits beyond the first tranche also developed through a series of piecemeal policy changes. Conditionality was nonetheless as controversial before the creation of the Fund—when Keynes and others debated the utility of qualified versus automatic access to the IMF's reserves—as it is today. The Fund's critics argue about whether this institution has the right:

- to impose programs that require short-term results from developing countries known to have serious difficulties with quick resource-distribution measures;
- to utilize a monetarist approach in place of one focusing on other perhaps more applicable variables;
- to disregard the sociopolitical ramifications of its decisions for often fragile Third World polities; and
- to rely too much on exchange rate adjustments whose effectiveness is not beyond reproach.

The Fund's response is to underline its commitment to the entire membership. Without conditionality, it is argued, the IMF's resources would be depleted so rapidly that no member could be sure that enough would be available in its own time of dire need. In addition, conditionality ensures that financial assistance fostering the return of a viable balance-of-payments position is complemented by policy adjustments that address the problems responsible for the payments imbalance. The Fund claims, furthermore, that its staff members do not impose their opinions on what the letter of intent's specific measures should be. In principle, this position allows the IMF to maintain a certain distance from the consequences of the difficult political and economic decisions deemed necessary to stabilize a country's economy. The Fund also asserts that its monetarist approach enables it to gather economic data more quickly to gauge a program's impact.

The Fund's application of its conditionality policy has not been consistent. The creation in the mid-1970s of the Oil Subsidy and the Trust Fund suggested a policy of mild conditionality as the IMF sought to help the nonoil developing countries alleviate the financial burdens imposed on them by the 1973-1974 energy crisis. This contrasts with the present situation in which the recession-induced relative shortage of Fund resources and the economic conservatism of the leading member countries dictates stricter terms. The IMF responds that its current policy is not static—"it is not fixed, and a prevailing balance may be modified in terms of milder conditionality if circumstances make this change advisable." In Kenya's case, the second stand-by's performance criteria invoked stronger conditionality than the first.

While IMF structural adjustment programs focus primarily on demand management, other measures may also be involved. A new emphasis on supply-side tactics reflects the Fund's belief that balance-of-payments deficits can be attacked through an efficient allocation of resources that will stimulate wise project investments and so result in new export earnings flows that will improve the trade balance. Exchange rate devaluations are seen as another means of improving the current account's position by making imports more expensive in the domestic market and exportable goods and services less expensive in the world market. Finally, periodic checks ("program monitorization") ensure that agreed monetary and fiscal targets are being met.

All of the above policy approaches represent potential obstacles to a negotiated economic agreement between the IMF and a member in need of credit, but it is demand management that is both the most controversial aspect of stand-by credit negotiations and a key aspect of the two IMF-Kenyan agreements analyzed here.

Demand management measures seek to influence the extent of liquidity in an economy suffering from a payments imbalance. Limits are placed on money and credit growth rates to put them in line with desired inflation, economic growth, and balance-of-payments targets. Monetary policy measures usually include changes in domestic bank interest rates, money supply growth, and net public and private sector borrowing. Fiscal policy adjustments include enhanced revenue collection via taxation and customs policies, reductions in expenditures, and the placement of limitations on the accumulation of external public debt.

Kenya's Negotiating Posture

The reliance on coffee and tea exports to earn essential foreign exchange, and on imported energy to facilitate economic growth, left Kenya very exposed to the negative consequences of the post-1979 world recession. Lowered international primary commodity prices and increased petroleum costs combined to weaken the country's balance-of-payments position. Between 1980 and 1981 the value of coffee exports decreased 17.1 percent and the value of tea exports decreased 13.1 percent. Energy import costs rose 92 percent from $389 million in 1979 to $747 million in 1980 and peaked at $792 million in 1981 before falling somewhat in 1982. Gross foreign reserves correspondingly decreased 24.1 percent in 1980 and 50.4 percent in 1981.

Kenya's GDP is based on agriculture (32 percent), industry (21 percent), and services (47 percent). Total GDP grew at an average annual rate of 5.9 percent in 1960-1970 and 5.8 percent in 1970-1981; both rates were above the World Bank's weighted average for the category of "lower-middle income countries" of which Kenya is a part. GDP rose 5.5 percent in 1981 but only 3.3 percent in 1982. The lower rate reflected the onset of a difficult economic period for Kenya's population of 17.4 million, whose growth rate is an uncomfortably high 3.9 percent a year.

Sectoral analysis sheds further light on the country's problems. After the debilitating 1979-1980 drought, agricultural growth went from 6.2 percent in 1981 to 4.4 percent in 1982. The effect on the economy was serious because this sector employs 78 percent of Kenya's work force and, as noted earlier, generates 32 percent of GDP.

Industrial growth also suffered in this period. The reasons for this were fivefold: (1) foreign exchange shortages hurt the ability of entrepreneurs to import necessary capital materials; (2) energy costs exhausted funds for other needs; (3) political-economic problems in neighboring Uganda and Tanzania virtually closed their markets to Kenyan imports; (4) surcharges on import items increased their costs; and (5) payments from the government's export compensation fund were distributed in an erratic manner.

The public external debt accumulated to finance the government's deficit spending was $1.7 billion in 1980 (disbursed only). It increased 29 percent to $2.2 billion in 1981 and then steadied at $2.3 billion in 1982. The World Bank expects the debt to continue rising until 1986. Total debt service payments in the 1980-1982 period were $227 million, $269 million, and $379 million. Finally, the ratio of total debt service to export earnings was 20.6 percent in 1981 and 22.7 percent in 1982.

In 1979, the recognition that these problems represented more than a temporary inconvenience prompted Kenyan officials to contact the international banks, the World Bank, and the IMF for monetary assistance.

Officials from the IMF and the U.S. Department of the Treasury, not always in agreement, concur that Kenya's economic negotiators experienced little of the public pressure in working with the Fund so characteristic of several Latin American cases, notably Argentina and Brazil. Several reasons are cited: (1) Kenya's governmental structure is strong and centralized, despite the fact that a minority faction within the military attempted a coup d'etat in August 1982. (2) The country's economic approach has historically been conservative and thus many Kenyans in the public, private, and governmental sectors were relatively receptive to the Fund's monetarist recommendations. (3) The severity of the payments imbalance was not comparable to Brazil's and Argentina's.

These three factors combined to create a negotiating environment in which differences were insignificant when measured against the two sides' mutual objective of seeing the negotiations through. Kenya wanted to right its balance-of-payments imbalance and thereby improve its development prospects. The Fund, for its part, viewed the stand-by credit requests as an opportunity to influence Kenya's economic policy in a manner consistent with the country's needs and, in general terms, those of the international monetary system.

A Balance Sheet

The specifics of the October 1980 and January 1982 stand-by arrangements concentrated on Kenya's principal weakness: government deficit financing. The Fund sought in each negotiation (1) to place ceilings on the central bank's net domestic assets and net public sector borrowing; (2) to reach agreement on Kenya's exchange rate policy; and (3) to liberalize the country's restrictive import program that inhibited productive investment projects.

The Fund's critics contend that the second stand-by's stricter conditionality was unwarranted because Kenya's excessive spending after the signing of the first agreement was due to the unforeseen circumstances noted earlier—an unbudgeted civil service salary increase, large drought-induced food shortages, and over-spending on the part of non-Treasury ministries. Although it is true that the food shortages resulted from the effects of the 1979-1980 drought and were not the government's responsibility, the other two spending excesses were arguably within the control of Kenya's decision-makers. A more valid criticism of the Fund would be to ask whether so much emphasis on reducing public deficit financing was necessary. In any case, several points are clear:

- Condemnation of the Fund's monetarist approach ignores the concurrent efforts of the World Bank's SAL program, which focused on the fiscal, supply-side, and longer-term adjustments critics blamed the IMF for ignoring.
- In each instance, Kenya agreed to implement the programs' economic policy changes.
- As noted earlier, the Fund's own situation markedly changed in the early 1980s, and this affected its policy on conditionality.

Of various external factors that influenced the posture of the Fund's negotiators and the imposition of the second stand-by arrangement's stricter terms, two were the most important. Several other IMF-African agreements had recently broken down and the Fund wanted to curb this trend. Second, the negotiations for the second credit provision occurred not long after the 1981 IMF-World Bank annual meeting where Reagan administration officials took a strong position against what they perceived as excessive soft-term lending by these multilateral institutions. In conversation and in print, Fund staff members acknowledge that they must in their lending activities be cognizant of the influence their organization's largest members have on IMF policy and practice.

Kenya's particular example provides evidence both supportive and critical of IMF policy. The IMF program had some clear successes. Stricter fiscal and monetary policies aided in reducing the central government's overall deficit from 10 percent of GDP in 1980-1981 to only 6 percent in 1982-1983. To cut into the balance-of-payments deficit, the government devalued the Kenyan shilling 5 percent in early 1981, 15 percent in September 1981, and an additional 15 percent in December 1982. Between 1981 and 1982 the current account deficit decreased from $721 million to $512 million, a 29 percent improvement. At the same time, the annual percentage change in the general price index dropped from 19.3 to 13.7 percent.

On the other hand, the program failed to lower net government borrowing from the domestic banking system. The public sector's portion grew 65.6 percent in 1981 and 67.9 percent in 1982, while the private sector's increased only 10.7 and then 10.3 percent. Furthermore, the drastic reduction in expenditures on development projects delayed ongoing efforts and hurt the productive capabilities of existing enterprises dependent on government assistance.

On balance, the program appears to have been effective. Kenya has shown a continuing commitment to the thrust of the IMF approach. In March 1983 the government of President Daniel arap Moi agreed to yet another stand-by arrangement, one whose performance criteria concentrated on essentially the same structural improvements demanded in the previous negotiations. This reflects at minimum a vote of confidence in the Fund's economic and financial remedies. Granted, a minority faction within the government criticized the Fund's conditionality on several grounds—including the usage of short-term targets instead of less stringent long-term objectives, a perceived overemphasis on quantitative monetarist ceilings, an unwillingness to reward positive policy changes or concrete efforts to improve the budgetary picture, and an "excessive" demand for documentation that prevented finance ministry manpower from attending to other, arguably more pressing, economic policy duties. The World Bank indirectly concurred on the latter point. Crisis management required too many man-hours at the expense of long-term agricultural and industrial sector policy-making.

Relevance for Other African Countries

The IMF-Kenya relationship was and is exceptional when considered in light of many other African countries' circumstances. Kenya's diversified economy, conservative economic philosophy, and perceived political stability contributed to its appeal to commercial banks and the relative ease with which it largely agreed with IMF recommendations.

Aside from Ivory Coast, Cameroon, and Malawi, few sub-Saharan countries are in a similar situation. What does this imply for the other states subject to periodic balance-of-payments problems and in need of the Fund's assistance? Will they be able or as willing to implement the IMF's strict demand management conditions given the recent negative political consequences of the attempted removal of price subsidies witnessed in Sudan, Tunisia, and Morocco?

Indeed, the sociopolitical implications of short-term economic policy adjustments in Africa represent a delicate issue for the 1980s. In relations with African officials, the IMF staff must remain aware of the problems inherent in imposing an austere monetary and fiscal program on predominantly low-income economies. An astute Fund negotiator must be cognizant of the general weak responsiveness of these economies to price incentives in the short term; the prevalence of low per capita incomes and low real urban wages; the relative inexperience of economic managers and administrators; the unreliability or virtual nonexistence of data bases; and the often limited nature of domestic political support for the regimes in power.

Is Kenya's example, given the country's distinctive characteristics, relevant to the needs of most African countries faced with the above economic shortcomings yet hesitant to approach the Fund? The answer is yes, because Kenya wisely turned to the IMF at a key moment in the evolution of its financial difficulties. Concerned about its creditworthiness in the international capital market and its growing balance-of-payments problem—in other words, the factors key to the country's future economic development—Kenya requested the IMF's advice and resources before its external public debt and debt service requirements grew to a point where it would be impossible for the country simultaneously to pay its liabilities and finance its future growth. This relatively early recourse on Kenya's part represents a positive example for other African countries in financial difficulty.

The World Bank's structural adjustment loan program has presented a viable alternative solution to the Fund's short-term approach, though admittedly the SAL program focuses on improvements in an economy's supply side. In 1982, technical assistance related to economic management changes comprised approximately 10 percent of all World Bank lending to sub-Saharan Africa. As in Kenya's case, the concurrent efforts of the IMF and the World Bank in the implementation of the structural adjustment programs is an emerging development—one that is in the interest of all parties insofar as concurrent action serves to heighten awareness of all facets of a low-income country's economic difficulties with respect to short- and long-term variables, and to monetary and fiscal policies. With 1982's total external debt for all Africa at an estimated $123.0 billion and the total debt-to-exports ratio at 143.4 percent, the continent's balance-of-payments difficulties are unlikely to disappear soon.

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