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COUNTRY CASE-STUDY

KENYA

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TABLE OF CONTENTS

		PAGE
I	THE INDUSTRIAL SECTOR BEFORE THE ADJUSTMENT PROCESS	I - 2
II	ADJUSTMENT POLICIES IN CONTEXT	2 - 13
III	THE BEHAVIOUS OF ACTORS IN THE INDUSTRIAL SYSTEM	13 - 28
IV	THE RECORD OF INDUSTRIAL ADJUSTMENT	28 - 30
V	CONCLUSIONS AND MAIN FINDINGS	30 - 33

TABLES:

1	Kenya. Economic Indicators 1984-8	34
2	GDP Structure 1984, 1986, 1988	34
3.1	Direction of Trade 1987, 1988	35
3.2	Trade Quantum Changes 1984, 1986, 1988	35
3.3	Trade Structures 1984, 1986, 1988 (%)	36
4	Main Foreign-Exchange Rates 1984, 1986, 1988	36
5	Nominal Tariffs 1978, 1984 (% ad valorem)	37
6	Balance-of-Payments Changes 1986-8	37
7	Loans by KCB 1985-8 to Priority Sectors	37
8	Approved Industrial Investment (1986-8) by Government-owned Financial Agencies	38
9	Manufacturing Sub-sectors' Import Content of Output	38
10	Gross Fixed Investment in Manufacturing. 1985-8	38
11	Labour Cost and Producivity in Manufacturing 1980-1988 (% Annual Charge)	39
12	Average Capacity Utilisation	39
	CHART 1 - Average Unweighted Tariffs - 1978	40
	CHART 2 - Average Unweighted Tariffs - 1984	40
	REFERENCES	41
	ENDNOTES (1 - 30)	42 - 45

I. THE INDUSTRIAL SECTOR BEFORE THE ADJUSTMENT PROCESS'

Kenya has a higher share of industry (18%) and of manufacturing (13%) in GDP than Sub-Saharan Africa as a whole, and between 1965 and 1985 the improvement in both its investment and domestic saving ratios to GDP was relatively high. The economy is comparatively open, with the share of exports of goods and non-factor services in GDP higher than average for low-income countries. Its share of manufactures exported to developing countries is also much higher than the average for Sub-Saharan Africa, as is its general share of merchandise exports, reflecting its relative importance as a regional manufacturing centre, a characteristic originating from the colonial period.

Kenya's first balance of payments problems arose during the 'oil shock' of 1974. The late 1970s saw a mixture of initially improved terms of trade and later substantial external borrowing which eased the foreign-exchange constraint. The 1980s, following the second oil price shock and the world recession, was a period of crisis and relatively poor performance, with a deceleration of GDP growth. The investment/GDP ratio rose from under 20% in the late 1960s to over 25% in the 1970s and reached more than 30% in the early 1980s before the crisis hit hard in macroeconomic terms. Saving rates initially rose from the 1960s into the early 1970s but by the mid-1980s were no higher than a decade earlier. This trend represents an increase in the capital costs of achieving increased output, or a decline in the productivity of new investment, and suggests a need to pay greater attention to the efficiency with which investment is used.

In sectoral terms, despite its relatively high rate of growth in international comparative terms agriculture's share of GDP declined from 44% to 39% over the period 1965-85. The manufacturing sector, on the other hand, increased its share, rising consistently from 10% in the late 1960s to 13% in the early 1980s. The public sector's share of GDP also increased over the period, reflecting the relatively rapid growth of government expenditure. Until 1982, employment growth in manufacturing was significantly higher than in other sectors but not as rapid as the growth of real manufacturing GDP, reflecting increased productivity.

In terms of national policy, there has always been some ambivalence about the extent to which Kenya wished to pursue promotion of manufactured exports or relatively highly protected import substitution. Statements of policy in a series of sessional papers from the early 1970s spoke of the need to reduce protection for domestic sectors in order to encourage efficiency. In practice, however, there was a consistent rise in the average level of scheduled tariffs after 1971 when import licensing became an important element, with a considerably higher rate of effective protection for foreign private firms, and especially parastatal enterprises, than for local firms.

II. ADJUSTMENT POLICIES IN CONTEXT

A. The Macroeconomic Context

Steady and significant expansion has characterised the economy during the past five years 1984-8, propelled by three years of good harvests and a booming services sector. Per capita income has risen in real terms at an annual average rate of 1.2%, despite a high population growth rate. For the second consecutive year tourism has displaced coffee as the country's main earner of foreign exchange. A substantial proportion of the official debt has been waived and further external assistance - on concessional terms - pledged for the 1989-93 plan period[7]. The economy's principal weakness lies in the relative stagnation of the investment/GDP ratio (19.7% in 1988). Basic statistics are set out in Tables 1 and 2.

The performance of the manufacturing sector has been less than spectacular, edging up to an annual average growth of 5.5% (1984-8) but which promises to be exceeded in 1989. This would conform with the medium-term plan target rate announced in Sessional Paper No. 1 of 1986, for manufacturing value added (MVA) of 6.4% p.a. - significantly above the 3.6% expected annual rise in the sector's labour absorption rate The underlying assumption is that labour productivity should improve, on average, at 2.7%. It is also hoped that new incentives will reverse the recent decline in manufacturing investment. The export of non-traditional products - i.e. other than beverages, cement and refined petroleum products - has expanded

by an average of 14% p.a. in value during the period, led by semi-processed industrial goods, horticultural items and manufactures (see Tables 3.1 - 3.3). The terms of trade for all items, including petroleum products, have not regained their average 1982-4 level. On the positive side, unit export prices of machinery and transport equipment tripled since 1982, those of miscellaneous manufactured articles rose by over 80%, and chemicals by more than 60%. But these improvements failed to offset the broader-based increases in import prices.

In the monetary field, the rate of domestic inflation has been brought down somewhat, from a 1980-3 average of 12.5% p.a. to 10.6% in 1988. But it is likely to rise again in 1989 as imports become dearer from the continued depreciation of the Kshilling (see Table 4) and as domestic liquidity eases from new Treasury Bond sales. The real rate of interest has been kept positive for several years. Although there has been a slight but welcome shift in credit allocation in favour of productive parastatals and private firms during recent months, the government's share of credit still remains high (36% in 1988/9).

Both the internal and external structural imbalances have been met through inflows of foreign savings. The domestic savings/investment gap came to over 8% of GNP in 1988 and is expected to rise further. The external gap, with a merchandise (fob) deficit approaching Ksh 700 million (77% of export earnings), amounted in 1988 to 10.6% of GDP. But Kenya has succeeded in attracting increasing amounts of external finance on concessional terms, which should not unduly aggravate the current debt-service ratio of about one-third of foreign-exchange earnings.

Without doubt the economy is opening up to external competition. This course had been charted in several official plan and budget documents from the early 1980s. The latest five-year plan (1989-93) takes a longer step in this regard and gives substance to the medium-term structural objectives set out in the 1986 Sessional Paper. Measures relating to the selective freeing of imports, decontrol of domestic prices, the promotion of a capital market, and additional incentives to investment and exports were announced for immediate implementation during the submission of the 1989/90 budget. The concatenation of these adjustment measures is discussed in the

following section.

B. Policy Reforms

The economy at the start of the 1980s was burdened by widening external and internal deficits and faced recessionary trade and investment trends worldwide The development strategy required radical revision and the charting of a recovery programme. These were tackled in Sessional Paper No.4 (1980), which spelled out the government's commitment to structural adjustment and laid the ground for its first World Bank structural adjustment loan (SAL).[3] Seven categories of measures were announced: (i) reduction of the more onerous quantitative and administrative import controls and their gradual replacement by tariffs with equivalent protective effect; (ii) avoidance of excessive interest charges on foreign commercial loans and the search for concessional terms of official aid; (iii) cuts in public recurrent and development expenditure, along with tighter control over money supply and credit creation; (iv) strict control over increases in wages and prices; (v) orienting production to export markets through export credit guarantees and prompt compensation payments; (vi) scarcity pricing of energy and incentives to reduce dependence on imported petroleum; (vii) improved allocation of foreign exchange.

Two adverse years elapsed, during which the principal adjustment action was the elimination of no-objection certification by local manufacturers to allow the importation of competing goods. A fresh Stand-by agreement was agreed in January 1982 with the IMF with the usual focus on curbing external borrowing and deficit spending, credit ceilings, positive real rates of interest and a 'realistic' exchange rate. As a condition for a second SAL, the 1980 adjustment package was given a new lease of life in the 1982 Sessional Paper No 4, which also a acknowledged the general problem of administrative inefficiency and the consequent drain on public resources.[4]

Kenya has the reputation of performing best with policies amenable to alteration by decree rather than when institutional changes have to be made. The fact that in 1989 many of the above-mentioned adjustment measures had only begun to be implemented bears out this view. Observers

have noted that decrees are regularly issued, only to be re-issued because the agencies concerned either ignore them or procrastinate in their execution. Following the 1983 budget, tariff reductions were selectively made and further cuts were effected the following year. But the freeing of the trade regime encountered serious obstacles in recurring foreign-exchange shortages - as during the 1982 recession - and opposition by influential groups loath to see their protective shields dismantled. To quote Walter Hecox[5]:

> There are two types of interests arrayed against the removal of administrative controls: commercial and industrial entities favoured by the historic allocation of import privileges under quantitative restrictions, and government agencies with important roles in determining the mix and distribution of production ... Studies of inefficient industrial sectors ... were continuously delayed by administrative inertia and lack of commitment.
>
> ... Those in favour of structural reform include government officials concerned with maintaining access to donor assistance flows, ... small new producers in agriculture and industry who would benefit from movement closer to price- and efficiency-based rewards for domestic and foreign sales ... Those against structural reform include government officials concerned that (it) would levy too high a price in disrupting social and political balances, ... as well as those who do not believe in an open-economy approach to stimulating growth in Kenya ... In Kenya's case both internal opposition and adverse conditions contributed to delays in compliance (with donor conditionality regarding structural reform).

Officials in the Ministry of Planning informed the author that two basic studies of Kenya's comparative advantage came up with conflicting results, which an on-going exercise will, hopefully, resolve. Implementation was also delayed by the conjunction of a worsening political climate with the August 1982 attempted coup and the 1984 drought. Budgetary revenues shrank and retarded the introduction of population control measures promised in the 1982 Sessional Paper. Staff weaknesses also became more apparent as margins of manoeuvrability narrowed. Yet the prudent management of interest rates did encourage savings and improved the private sector's access to credit somewhat during this period.

The changes that were then made in the level and structure of nominal tariffs deserve a closer look. A comparison of their frequency distribution pre-adjustment and after the second SAL depicts not so much a drop in the average <u>unweighted</u> level, but rather a pronounced modal shift

towards higher duties (see Table 5 and Charts 1 and 2) and considerably higher _effective_ levels of protection for the value added component of the goods concerned.[4] A 1987 World Bank study reproduced calculations on a sample of 46 enterprises in 1986, which concluded that their VA, on average, was 51% higher than it would have been in the absence of tariffs and quantitative restrictions on competing imports. Over the years the shares of exports in the output of manufactures declined while the level of protection increased, suggesting a generalised deterioration in competitiveness.

The economic constraints then obtaining precluded the easing of import licensing. Four grades of controls were in place: automatic authorisations for 801 products under Schedule 1A; annual Kshilling allotments for the 'open' importing of 958 products (Sch.1B); 92 products requiring ministerial approval and importable by authorised agents only (Sch. 2A and 2AS); and 832 tariff items quota-bound for listed eligible importers (Sch. 2B). Foreign exchange allocations for the last category were very parsimonious, equivalent to a mere 3.3% of the 1984/5 import value (Sharpley and Lewis, 1988, p.61). This licensing regime worked particularly against the interests of export-oriented firms. The classic example is the prohibited import of high-quality packing and packaging materials to encourage the manufacture of local substitutes. Their usually lower quality reportedly foreclosed promising foreign outlets for several Kenyan exportables (_Ibid._ p.65).

Ten years earlier in 1974 the Export Compensation Scheme had been introduced to bolster export competitiveness by offsetting the cost-raising effects of tariffs and sales taxes on inputs. In 1984 the basic cash compensatory rate was raised from a mere 10% of the value of eligible exports in 1982 to 20%. The incentive effect was not substantial, however, because in practice few firms - mostly multinationals - succeeded in receiving payments which, in total, represented only 4% of the value of manufactured exports in 1984. Delays in payments are said to have been as long as 40 weeks (_Ibid._). Anti-exporting bias also resulted from the Sales Tax insofar as refunds of the tax paid on imported intermediate goods could be claimed only upon proof of the export of the corresponding finished goods. Not only was the exporters' working capital diminished thereby, but

again very long delays occurred in reimbursement.

Sessional Paper No 1 Of 1986 produced a medium-term policy outline which became the framework for the current development plan (1989-93). During the preceding two years several new policy instruments had been approved, notably manufacturing in bond and a green channel for exporters' administrative procedures. But the first of these measures generated a skimpy response because of the vagueness of its operation and the delay in ensuring adequate customs controls. The second also took time to become operational and effectively reduce bureaucratic procedures and procrastination.

The 1986 Sessional Paper postponed intended establishment of an export credit guarantee scheme - on the pretext of the government's continuing financial difficulties - until 'commercial banks and other credit institutions pool their export credit portfolios .. and thereby provide credit insurance privately'. Nor was there any mention of Export Processing Zones. The fiscal premium on investment in rural areas was reinforced with the tax deduction raised from 20 to 50%, - estimated to represent a subsidy equivalent to about 10% of the initial cost of similar investment in urban areas. The potential contribution that small-scale and Jua Kali enterprises could make to employment generation was also highlighted.

Restrictions on local borrowing by foreign-owned firms were eased. An executive department was established in support of a Commission set up to oversee price controls and the exercise by local firms of monopoly power. The retention of pric controls was grounded in foreign exchange and import shortages, on the one hand, and the need to contain the tendency of 'natural monopolies' to charge what the market can bear, on the other. Approved prices of controlled articles were henceforth to take full account of all cost-raising production items, some of which had been excluded previously. It became possible for some industries to shift their price structure from a cost of production to an import parity (tariff-inclusive) base.

The 1986 Sessional Paper also indicated the government's intention to

divest its interests in all industrial parastatals. Stringent budgeting and evaluation procedures had already been instituted to ensure stricter supervision and improved accountability for all parastatals and development finance institutions, and a Task Force on divestiture had been set up in 1984. But the government has moved slowly in this area, though progress was reported in 1988 with the sale of a major food-processing firm and the flotation of 20% of the Kenya Commercial Bank shares on the Nairobi Stock Exchange.

Little transpired in the matter of adjustment in the course of the next two years of relative prosperity following the coffee mini-boom. Of significance, however, was the reduction (from 2000 to 700) of products eligible for export compensation. In the 1988 Budget Speech industrial policy measures were introduced by a frank recognition of the low growth of industrial output and of the relative decline of industrial exports since the inception of adjustment, as well as of the decline in the sector's efficiency.[7] Reliance was to continue to be placed on competitively adjusting (downward) the national currency. To compensate for a certain liberalisation of import licences, tariffs on competing products were to rise, and the spread between imported inputs and final products was widened for some goods. The tariff structure was to be further rationalised by the reduction of categories (from 25 to 17) - abolishing eight in the higher range. Enabling legislation with respect to restrictive business practices and price controls was finally passed - 2 years after its announcement as active policy.

Thus it was only in 1986 and thereafter that the greater part of the adjustment measures proclaimed as policy in the early 1980s began to bite - the major exceptions being currency depreciation and interest-rate management. On the whole, the protection enjoyed by Kenyan industry had not been reduced to any significant degree since the start of the decade. It is against this backdrop that we turn to a closer examination of the interaction of adjustment measures and industrial activity during these years.

C. Industrial Dimensions of Adjustment

The operational aspects of adjustment in Kenya to date have consisted principally of exchange and interest rate management, and only recently of investment-cum-exporting incentives. A fixed exchange-rate policy was maintained during most of the post-Independence period, with the currency gradually becoming overvalued. Exchange controls have been in place throughout and the Kenyan shilling has never been freely convertible. Interest rates have also been controlled, at negative rates during the 1970s and into the 1980s. Together with the large volume of involuntary lending to the government and parastatals and the consequent crowding out of the private sector, particularly during the occasional ceilings on bank lending, these controls created severe disincentives to the development of the financial sector, and hence of the industrial sector. In recent years there has been a substantial liberalisation of monetary policy. It has become stated government policy to move towards market-determined interest rates in the early 1990s. Since the early 1980s they have been positive in real terms, and in the face of unsatisfied private sector demand for credit are likely to continue to rise. This upward movement is not expected to have much effect on the domestic saving rate, but is likely to have a negative effect on the level of investment, though with higher productivity from the investment that is undertaken. There has also been an important change to a policy of exchange-rate flexibility in the period 1984-8, with a 66% depreciation of the nominal trade-weighted exchange rate (see Table 4). The 1989-93 Development Plan announced the government's intention to move to 'market-based programmes as a means of rationing (foreign exchange) while gradually reducing the use of (import) controls and licensing'. A managed floating exchange rate is to be the major instrument for regulating imports in the long term, and in this context the national currency must be maintained 'at realistic levels'. Such an exchange-rate policy is seen as benefitting domestic exporters and also the tourist industry.

These two policy instruments fall within the exclusive domain of the Central Bank and are under close IMF surveillance, in line with normal stand-by conditionality. Decision-taking is conducted by small inter-ministerial committees to which neither representatives of industrial parastatals nor private industrialists have access. At best their views are taken into account when the periodic submissions by industrial associations (the Kenya Association of Manufacturers and the Chamber of

Commerce and Industry) to line ministries filter through to the Central Bank and the Treasury. Although until quite recently the most binding constraint on industrial activity was the availability of foreign exchange, changes in its sectoral allocation cannot legitimately be taken as an adjustment parameter in the narrow sense. Indeed, in the Kenyan context, it could be argued that allocations are less a function of policy than of political/financial leverage.[8] Publicised criteria for foreign exchange allocation have not been respected consistently, as evidenced by the legal importation of large quantities of competing goods and luxuries. Widely reported delays in the issuance of import authorisations have encouraged uneconomic stockpiling of inputs and a consequential increase in working capital requirements. An added, though more generalised, problem encountered by entrepreneurs stems from an inadequate appreciation (if not understanding) of industries' problems by decision-makers in government.[9]

In respect of credit availability and its cost to industry, the main problem has been public sector borrowing taking precedence over private sector requirements. While manufacturing parastatals could meet most of their credit requirements through government sponsorship at home or abroad, only the transnationals and a few 'natural monopolies' among private firms had adequate access to credit and could pay the going interest rate without undue hardship. With the easing of the foreign-exchange constraint in 1986, inflation became a cause for concern and measures were taken by the Central Bank to reduce the previously accepted annual increases in money supply. The resulting credit squeeze not only narrowed firms' room for manoeuvre; it also made renewal of equipment and expansion more difficult. This situation illustrates the difficult trade-off between investment promotion objectives and tight monetary policy, directed by fears of uncontainable inflation.[10]

The third policy instrument - investment and export incentives - lies in the hands of the Ministries of Industry, Commerce and Finance. Prior to its abolition in mid-1985 the New Projects Committee, grouping representatives of line ministries and development financing institutions, was charged with regulating the flow of new industrial investment. An analysis of its activities disclosed that it lacked technical support to appraise projects adequately and was too susceptible to political

interference.[11] Its functions were taken over by an Investment Advisory Centre which has begun to receive substantial material and technical support from bilateral aid agencies. By mid-1989, as the Investment Promotion Centre, it had not only acquired considerable autonomy, professional expertise, data processing capacity and enhanced authority by virtue of being vested with 'one-stop' investment processing functions, but was also put in the hands of a leading African entrepreneur. Expeditious treatment of investment proposals, in addition to the 'green channel' processing of exporters' requests for importing inputs, should give a welcome fillip to manufacturing output and investment and allow the targets set out in the 1989-93 Development Plan to be attained.

It goes without saying that these targets are based on optimistic assumptions in respect of foreign-exchange availability throughout the plan period. Since commodity and invisible export earnings, as envisaged realistically by the planners, will fall considerably short of the projected import requirements, Kenya will continue to rely on external support for its balance of payments. And such aid will have to be on concessional terms for the country not to get caught in the notorious debt-servicing-low-growth trap.

Although the assumption that the country's largest sector - agriculture - will grow on average and in real terms at an historically high rate of 4.5% p.a. seems over-sanguine, the investment target ratio of 20% of GDP as the average for the 1989-93 period should not be out of reach on present policies. The same goes for the plan targets of 6.4% average growth for the manufacturing sector and 4.5% growth for building and construction. Chief among the instruments underpinning these two objectives is the World Bank's sectoral adjustment credit of US$ 112 million, initiated in May 1988. Its aims mark no innovation in the Bank's recipe for African industrial development and have generated scepticism as to their appropriateness among Kenyan high-level civil servants and some politicians. Their reservations have found fresh support in the new proposals of the Executive Secretary of the UN Economic Commission for Africa to cope with African under-development.[12]

The industrial reform package agreed with the Bank continues to use trade

policy as the linch-pin of industrial adjustment. in line with the rational (not optimal) use of resources based on market-clearing prices. To that end no new instruments or institutions are to be established but existing ones are to be considerably strengthened:

i. Import licensing: By mid-1989, 76% of all tariff items - covering 95% of the average value of imports - are to benefit from 'unrestricted' import authorisation. The government remains committed to removing all quantitative restrictions by 1990-1 and to reducing protection for industry in 1991-3. The Sixth Development Plan, however, contains a reservation concerning licensing to the effect that 'strategic local products and those requiring longer periods of adjustment will continue to receive non-tariff protection'.

ii. Tariffs: Further rationalisation will be based on the findings of the on-going study of Kenya's comparative advantage, with the objective of more uniform rates of effective protection, and a reduction in the total number of tariff categories from 17 to 12.

iii. Export orientation: the current Export Compensation facility is to be replaced by an import duty compensation scheme. Complementary external finance for establishing two Export Processing Zones is to be sought.

iv. All price controls are to be dismantled by 1991.[11]

v. Parastatals: the equity portfolios of Development Finance Instutitions (DFIs) - e.g. the Industrial and Commercial Development Corporation, the Development Finance Company, the Industrial Development Bank - are to be rationalised through privatisation (partial or complete).

It will therefore have taken Kenya no less than a decade, supported by three World Bank adjustment programmes and several IMF Stand-by agreements, to complete putting in place and honing the instruments required for its policy objectives. Yet this will have occurred at a time when authoritative African voices are beginning to urge a more subtle, inward-oriented approach to development problems, including environmental and

cultural protection, as well as job creation. In this connection it must be recalled that the Kenyan plan warns that by its final year (1993) two million more people will be seeking employment. If the manufacturing growth target is met, formal wage employment in the sector as a whole will have absorbed a little more than one-tenth of this increment. Hence the emphasis now placed on providing institutional support for small-scale informal - rural and urban - industrial activities. By mid-1989 the Ministry of Planning had elaborated guidelines for locating 8 Rural Trade and Production Centres where promotional support will be given to agricultural processing and to such service facilities as repair workshops and tourist-oriented crafts. Moreover, efforts will be made to involve these centres in sub-contracting work for larger firms nearby.

Thanks to the infusion of World Bank credit, there is every reason to expect the activation of the long-heralded export credit insurance and guarantee facility under the aegis of the Kenya Commercial Bank. Its operation will be patterned on that of the World Bank's Multilateral Investment Guarantee Agency, to which Kenya is a signatory, and should meet the widespread needs of incipient exporters.

III. THE BEHAVIOUR OF ACTORS IN THE INDUSTRIAL SYSTEM

A. Formulation and Implementation of Adjustment

As might be expected, government officials eschewed making personal assessments of the efficacy of the policy instruments within their fields of responsibility and tended to ascribe almost all inaction and delays in implementing adjustment either to macroeconomic difficulties (such as periodic foreign-exchange shortages), or to the need to combat disloyal action by economic agents (over/under invoicing and monopolistic pricing). The explanation advanced by a Ministry of Finance official for the disappointing record of the Manufacture in Bond facility - after 12 applications has been made originally, only one firm was operating the facility in mid 1989 - in no way related to problems of customs control. Rather, it was alleged that the other 11 firms had been too optimistic about securing market outlets for their goods in the first place.

However, some mismanagement and technical weakness was admitted. In addition to scarce expertise, there is a fundamental dearth of reliable communication between ministries and subordinate agencies. As an example, the inspectorate of the Ministries of Commerce and of Industry is called upon to advise inter-ministerial organisations on the approval/rejection of requests for importing inputs and receiving foreign exchange allocations. Yet it has no ex officio access to firms' accounts in order to vet actual procurement practices and needs. Indeed, line ministries 'have to beg for data from the Central Statistical Office, the Ministry of Finance and the Customs', to quote one high-ranking official. Yet basic economic and financial data have been computerised. A uniform system of recording trade data is in place and could allow the relevant government departments not only to trace imports from time of authorisation to their final destination, but also to compile import price data and permit more accurate customs valuation.

There are also surprising blanks in information that should be available to the public, such as the number and sectoral distribution of business failures. Specific authorisation from the Office of the President is required for what is an objective index of a country's business climate. Annual reports of parastatal companies are not readily available and those of banks and DFIs take about two years to become public. Thus, much remains to be done in developing the flow of economic and financial information, particularly with the planned extension of open market trading and the divestment of government equity holdings. The current introduction of data processing equipment in line ministries and DFIs should alleviate this problem in the not too distant future.

B. Changes in the relationship between firms and their environment

Enquiries about the extent of dialogue between industrialists and government decision makers showed that both found that the existing channel of communication via the Joint Industrial Committee and periodic submissions on policy issues by the KAM and CCI is satisfactory. It was even pointed out in the Treasury that the 1989 Budget Speech generated praise from the KAM, to the extent that it took account of several of its caveats and grievances. Likewise, the original draft Bill on Restrictive

Trade Practices, Monopolies and Price Control had been 'drastically' amended as the result of KAM's representations. In a recent welcome development, the Ministry of Commerce agreed to receive import licence applications from KAM members en bloc and to inform KAM of the outcome within 10 days. The KAM is also used by its members to put pressure on the fiscal authorities to reduce inordinate delays in settling Sales Tax refund claims and bills for services rendered.

For the time being, the CCI is not as well-equipped as the KAM for interacting with government on the technical level. However, it too is beginning to receive external assistance, both technical and material. In the view of both organisations adjustment as a programme has met with a mixed reaction on the part of the business community, since importers are satisfied with the easier access and producers concerned about the higher prices of imports, credit, etc.

There was consensus among entrepreneurs about both the need to open up the economy to competition and the objectives of individual adjustment measures, particularly in view of the fact that these followed the break-up in 1977 of the East African Community in which Kenya's industry enjoyed a comfortable predominance.

Early in the adjustment process the KAM submitted proposals calling for the reduction of high duties on inputs so as to allow existing firms to achieve better price competitiveness. Later, it pointed out the inadequacy of the revised 20% rate of Export Compensation, given the high costs of breaking into new markets, for which leading competitors are known to receive large subsidies. The high opportunity costs of foreign exchange would have justified investing public funds in such an operation.[14] On the whole industry seemed to be adapting smoothly to the gradual rationalisation of customs tariffs, at times with some advice from the KAM, for example in explaining certain economic concepts, such as effective rates of protection (ERPs), direct resource cost (DRCs) and their use as analytical tools.

In regard to industry's assessment of the stance of distributors (traders) in the course of adjustment, the KAM recommended that its members try persuading their agents and wholesalers to reduce their profit margins as

costs of production rise, so as not to cut into demand. In the view of the CCI, there was an imbalance between the low profit margins realisable on controlled products and the high ones on freely priced goods.

As to industry's reaction to the credit policy pursued by both the commercial banks and non-banking institutions (house mortgage funds and insurance trusts), the cost of borrowing was seen as too high and the collateral requirements as too exacting. Foreign supplier credit was accessible only for the larger, better known enterprises.

The industrial economic environment in recent years was characterised as 'fairly stable' and certainly not 'turbulent'. KAM members, on the whole, have managed to cope with adjustment. Failure of industrial investment to pick up was ascribed to the slow implementation of the incentives policy. Potential foreign investors were discouraged by delays of up to 18 months experienced by even the old-established firms in repatriating their permitted profits.

There was consensus on the relative absence of problems for management in arriving at acceptable wage settlements, in large part due to the common practice of tapping the ever-growing pool of non-unionised 'casuals'.

Views also coincided about the export potential of the Preferential Trade Area which has recently added to its common list some products of direct export interest to Kenya. However, the strict rules of origin requirements are blocking the PTA market for several large Kenyan assembly-cum-packaging firms. On the general need for market intelligence and export promotion, it was suggested that the Kenya Export Trade Agency should be allowed to and function as an autonomous body.

C. Firms' adjustment stategies

Although 13 firms were selected for interview and alerted officially, only 9 became accessible to the author, 3 of them being small-scale enterprises - workshops in European terms. Their output profiles do not span all the required input source/output market criteria. The conclusions drawn from such a sample cannot be viewed as representative nor be

generalised across industrial sub-sectors.

Three enterprises in category A (processing mostly local inputs mainly for the domestic market) responded to the UNIDO questionnaire: Firm Aa - a large-scale parastatal weaving, dyeing and finishing synthetic and blended fabrics; Firm Ab - a large-scale manufacturer (under foreign licence) of biscuits, pasta, breakfast foods and confectionery; Firm Ac - a small-scale producer of leather articles.

The parastatal textile manager considered that opening up the industrial sector to external competition, when it had not developed historically along lines of comparative advantage, might be timely but was bound to be costly in social and financial terms.[15] Policy dialogue is mainly with the holding corporation (ICDC) and only incidentally with the KAM. Direct communications with ministerial departments has not been easy or fruitful. The firm was never effectively protected by against competing imports because of the notorious permeability of the customs cordon. Hence the proposed replacement of quantitative restrictions by tariffs would not change its competitive stance significantly. As a parastatal, it had to purchase its raw materials from other parastatal producers, at prices much higher than world prices. It was doubtful that adjustment would extend to the abrogation of this contractual linkage. The firm's profitability during the first quarter of 1989 was not as good as in the preceding year. The easing of the foreign exchange constraint on importing locally unavailable inputs (chemicals, dyes and spares) left intact the problem of their higher Kshilling cost. The credit squeeze left the firm with 40% of its overdraft requirements unsatisfied and its working capital at 65% of what it should be. 'Banking in Kenya is unresponsive to the development needs of the manufacturing sector.'

The manager of the large foodstuffs firm likewise reported deterioration in profitability, due principally to supply shortfalls in local sugar and flour, as well as the need to extend to its distributors - who are illiquid because of the credit squeeze - 4 to 5 months' grace for settling their bills. His view of adjustment was that it was an additional hardship to live with. There was no lack of understanding of its

purpose, nor any need for additional interaction with public authorities on that score. Import liberalisation was welcomed, as was the Kshilling's depreciation, since it has made the firm's products more competitive on foreign markets. The firm has been stimulated to substitute the importation of certain inputs (e.g. edible oil) with its own production, thus expanding its output vertically.

For the owner/manager of the leather workshop (Ac), the most recent quarter saw a significant rise in orders, but this was more the result of the firm overcoming its 'teething problems' than of any improvement in the business climate traceable to adjustment. As the firm was the only one producing luxury leather articles, it did not fear competition - legal or fraudulent. It too had to extend up to 45 days its settlement terms for its clients and retailers, while having to pay spot cash for the quality leather it needs. Adjustment mainly meant tight bank credit and high interest rates. Since the firm's import dependency was only about 5%, the easing of licences and foreign exchange allocations did not represent a significant improvement.

On questions regarding change in the stance of those determining the firm's business environment via adjustment, the managements of Aa and Ab agreed about the greater readiness of government agents to give a sympathetic hearing to individual problems and, on occasion, to solicit their opinions. But adjustment had exacerbated credit-related problems (higher interest rates) and for Aa and Ac, with all their assets already mortgaged, had meant inability to raise loans for financing more efficient machinery and new production lines to profit from the improved Kshilling competitiveness in foreign markets.[16] 'Banks did not facilitate or promote industrial innovation.' Borrowing abroad was the (costly and risky) way open to the large private firm, but was foreclosed to the parastatal for lack of a government guarantee. The small workshop Ac did see its environment change with the divestment pursued by its umbrella body - Kenya Industrial Estates (KIE) - from which it had decided to purchase its premises and buy back the KIE's mortgage on its machinery on advantageous terms. This re-purchase will give it the collateral required to secure new bank credit.

None of the three A category firms complained of additional

constraints resulting from higher utility and transport costs, although these have been rising. Production costs have definitely risen in the course of adjustment, in line with inflation (which follows close on Kshilling depreciation because of the economy's high import dependence). These increases had been passed on, in full, only by the small firm Ac. For firm Ab the increase in prime costs came to about 10% over the last 2 years and was mainly due to the higher salaries of executive and administrative staff. No new taxes have had to be shouldered, but neither have any subsidies been forthcoming.

As to shifts in market shares, the parastatal had lost domestic market share over the last 8 years; the private manufacturer was quite secure on the home front and was steadily gaining ground in PTA markets and penetrating the market of the Gulf States. The Ac firm lost out to artisanal competition only in 'down-market' articles.

On the firms' adaptive capacities, the general reply was affirmative in respect of access to trained manpower, technology and market information up to the time of writing. Firms Aa and Ac had benefitted from bilateral technical assistance and knew how to get more. The large food manufacturer was quite self-sufficient in all respects.

As to the compressibility of prime costs, firm Aa could effect some economies by better planning and scheduling of its resource flows, but would first have to modernise its equipment. It had already reduced its labour force from 850 to 800 and could cut it further 'if it had a free hand'. Ab had worked out a defensive strategy as it had anticipated the effects of the adjustment policy. Its gains in market share were due to the timely improvement in the quality of its products, better packing for export (using locally manufactured tins) and widening its product mix. It had not yet changed the sourcing of its inputs, nor compressed its workforce. But more guidance/training was being given 'in-house' to cope with new, more sophisticated, production processes. Stock levels had to rise in the face of the distributors' liquidity bind. Its equipment was not in need of modernisation or reconversion and a local Operations and Management expert had been used to reorganise the plant. The small firm Ac had also carried out a change in the lay-out of its machinery. It had not

reduced its labour force nor its wage levels as it had switched to producing high-quality gift articles requiring skilled and reliable workers. Its machinery did not need replacement or modernisation, hence no new investment had been undertaken. As mentioned earlier, all firms have had to extend their settlement periods for clients' bills. In many cases this has required a threefold increase in their working capital. The owner/manager of Ac had to dispose of personal assets to widen the firm's capital base.

Finally, as to the results of the firms' own adjustments, in most cases there had been a compression of profit margins, particularly in the period 1984-8, firm Aa's capacity utilisation rate had recently averaged 85-90% in weaving yarn and 70% in dyeing and printing fabrics, but this performance could not be kept up for long with its 20 year-old equipment. Capacity utilisation in private firm Ab had risen from a 60% average in 1987 to 80% in 1988. Extra shifts had been put on, but labour productivity had not increased perceptibly. The Ac leather workshop had a full order book for the peak Christmas gift season. Its profitability rate (35% on average) had not changed in recent years.

The second category of firms agreeing to be interviewed - processing mainly imported inputs and oriented chiefly to the domestic market but with potential interest in exporting - comprised: - Ba, a large-scale subsidiary of a transnational, with a large government shareholding, assembling mainly commercial roadvehicles from knock-down kits and some locally produced (30%) accessories. Capacity utilisation in 1989, with one shift, equalled 69%; - Bb, a medium-sized, privately-owned metal products manufacturer, utilising locally rolled/shaped steel from imported ingots and billets. Capacity use in 1989 equalled 50%; - Bc, another medium-sized metal products manufacturer, part of a large foreign conglomerate owning several product-related firms in Kenya. 1989 capacity utilisation equalled 65%; - Bd and Be, two engineering workshops, privately owned and operating under KIE tutelage; - Bf, a large-scale, publicly-owned (86% Kenyan, 14% foreign) manufacturer of natural fibre products, in receivership, protection notwithstanding; currently disposing of its stock, with bleak prospects of viability unless radically restructured.

Ba's management reported that the period 1982-6 had been characterised by alternating loss-making and break-even years, with profitability improved in 1987-9. The currency depreciation, import licensing and tight foreign exchange allocation had constrained operations under adjustment, which 'had been necessitated chiefly by external circumstances'. While these had eased in 1988-9 and there was more dialogue, there was still inadequate transparency in government decision-making and insufficient prior warning given to enterprises. The firm prided itself on having taken the lead in confidence-building with government bodies, independently of the KAM. Its output level depends on local supplies of accessories which, in turn, are import-intensive. Hence the overall availability of foreign exchange is a 'double-edged Damocles sword'. As vehicles are not price-controlled, rises in input prices have been passed on.

Bb was in a serious financial predicament, with losses building up in 1989. The firm had been designed for the regional market and was over-capitalised in present circumstances. The management had had no involvement in the evolution of adjustment, had obviously misinterpreted the government's exchange-rate policy and considered adjustment not to have been clearly enunciated at its inception, nor transparent thereafter. Neither did it have appropriate ways of interacting with government decision-makers. Liberalisation to date had had no positive impact to offset the negative consequences of adjustment via depreciation, which had raised the local cost of its foreign debt service considerably.

The early years of adjustment were very difficult for firm Bc and losses were again on the rise in 1989, even with a much greater cash-flow. There had been no dialogue on adjustment before the publication of the 1986 Sessional Paper, which outlined policy 'clearly and unambiguously'. Buoyant domestic demand and improved foreign-exchange allocations and licensing were acknowledged as positive adjustment outcomes. The Kshilling depreciation had helped the firm increase exports, but 'sticky' price control on one of its two products - for which 20% of inputs were imported and becoming progressively dearer - squeezed its profit margin [17]. Production costs had been rising, including utility rates and overdraft charges. These were readily passed on in the case of the non-controlled

product, to which the firm was switching.

Workshop Bd had enjoyed multiple (if not absolute) protection - from being the only manufacturer of a bulky and relatively low-priced product (LPG cylinders), and from the system of 'No Objection Certificates'.[18] The stiffer competition heralded by adjustment was an 'understandable but hardly transparent' policy on which reactions were inevitably a posteriori and on which KAM's intervention was of little avail. The steady increase in demand for the firm's products was ascribable less to the effects of adjustment per se than to a decrease in the use of charcoal for cooking/heating resulting from afforestation campaigns.

Workshop Be's owner/manager reported the firm to be 'still struggling' and seeing no improvement in 1989 because, though more orders had been received, longer settlement periods (3 months) had to be extended in the face of the adjustment-generated credit squeeze. Import authorisations had become more available but were not automatic and 'required having a friend in the right place'. Earlier, the firm was unsuccessful in obtaining import licences for necessary intermediate products and was obliged to procure them from an importer whose margins added 200% to the cif price. No official explanation for licence refusals was given. Little credence was placed by the manager on adjustment policy pronouncements, but a more sympathetic attitude to manufacturing was acknowledged. Competition from legal imports had become stiffer and costs of production were on the rise (reflecting the Kshilling depreciation and higher interest rates) but were being passed on.

The receivership manager of the bankrupt firm traced its problems to its origins based on the use of locally developed kenaf blended with local sisal. However, kenaf production never took off and the firm sank under the joint pressure of price ceilings on its finished products (gunny bags) which came nowhere near the price of imported jute[19] and external competition verging on dumping. Although efficiency had been low from the start, the firm's machinery was more modern than that of its competitors in Bangladesh whose production and exports benefitted from government subsidies and for which second-quality jute yarn was used, while only costlier first-class yarn was exported to African spinners. Throughout

the 1980s dialogue with government circles 'had been difficult and little sympathy was shown because of vested interests linked to importers' cf. Coughlin and Ikiara, 1988, p.281. Adjustment was seen as 'too piecemeal' and as failing to attack industry's root problems. With a normal workforce of 4,300 - each with 5 dependants on average - the plant's closure constituted a social calamity.

As regards the firms' appreciation of the business environment. Ba's management was encountering more 'understanding' on the part of government. It also felt that dealers' profitability must have suffered from adjustment measures, with increasing competition among the already too numerous makes of commercial vehicles - a fact already widely noted (viz. ibid.). Export sales (10-15%) had not expanded beyond East Africa where the firm had a proximity advantage and had 'Africanised' its vehicles, inter alia by installing heavier springs and by offering 15% discounts for payment in Kshillings. An interesting aspect of Ba's defensive strategy was its venture into counter-trade and triangular dealings through a commercial subsidiary. It had access to its parent-TNC's market information and had not changed its traditional way of distributing its products through independent dealers. Its current 2-year labour union contract had been 'broadly indexed' to domestic inflation.

Firm Bb also found government 'more helpful in recent months'. Although prices paid to farmers had been rising, demand for the firm's agricultural implements had not followed suit, while traders' margins had tended to increase. Periodic interruptions had been occurring in the supply of local steel and other domestic inputs, traceable by management to adjustment. Along with tight bank credit, all this gave rise to a 'difficult environment' and prompted the firm to postpone settling its own bills, to the detriment of its credit standing. Its costs of production had risen by about 30% over the last 4 years[20] and it had recently lost the sales tax rebate privilege on inputs for its agricultural equipment. Exports had dropped to zero by 1989. In respect of its defensive reaction to adjustment difficulties, it planned to develop a new export-oriented product with the help of foreign (Asian) credit, based on a feasibility study by the Commonwealth Industrial Development Unit. The manager claimed that the quality of his products was among the best and ex-factory prices

were already 'at rock bottom'. The firm introduced 'in-house' quality control and its own norms 'were superior to international ones' because they had to withstand rougher handling than was usual in other parts of the world.[21] It would not compromise on quality to beat the competition but had increased its discounts for cash settlement. For its part, it had to offer up to 3 months grace on large volume sales. It intended to start importing its steel once its credit rating became firm. Further savings could not be made in inventory management, stocks already being down to 1 week of normal requirements.

Plant Bc pinned all its hopes on its non-price-controlled roofing material for which local and regional demand was 'promisingly strong', justifying investment in promotional activity and capacity extension. The firm had so far managed to get cash payment for its up-market products. It did not intend switching its input sources, nor compressing its work-force. Training abroad was already available from the suppliers of its equipment. The plant extension was to be financed by increasing share capital, together with whatever local bank loans could be raised and, possibly, some CDC funds.

Bd's manager considered that tariff 'rationalisation' still left too high a protective duty (25% ad val.) on its main input (steel sheets). The firm had experienced difficulty in getting its product accepted by the local transnational oil subsidiaries. It was now investing in a new production facility with foreign markets in view,[22] having managed to raise a foreign-denominated loan from the Kenyan Industrial Development Bank and enlarged its share capital. It expected to achieve economies through higher labour productivity in the new plant and by recycling scrap metal. There was no problem in coping with new technology. It had incorporated quality control but needed to provide additional training for workers in the new plant. As it would be directly importing several new inputs, it required information on foreign sources of supply and also on potential foreign markets. In Kenya its products were not distributed by any structured network.

The Be workshop's manager thought that the public administration had become 'more attentive' of late. Neither the firm's middlemen (traders')

stance nor its margins had changed as a result of the sharper competitive climate. With personal assets as collateral, the owners had been able to extend their overdraft credit, but at a higher rate of interest. With costs of production rising steadily, no cheaper input sources in view, and irreducible wage outlays, their business environment was termed 'unstable'. However the firm was purchasing its premises and equipment from the KIE, and pinned its hopes on expanding its export sales.[21]

The bankrupt firm's turnover during the recent period of adjustment had dropped precipitously from Ksh 21 to 6 million. During the early years of adjustment the servicing of foreign loans for new plant became progressively burdensome and foreclosed regular provision for replacements. The major lesson learned by management was that 'a firm must have adequate working capital to be able to adapt to changes in the economic environment'. The firm was caught in a vicious circle of growing indebtedness and loss of market share. Yet local demand was buoyant for several of its products (those based on sisal and polypropylene, rather than on jute) and some export of these was possible. Converting the plant to their sole production entailed a massive injection of funds, plus advance assurance of protection (i.e. subsidy), the abandonment of price ceilings on products, and the free purchase of domestic sisal at Kshilling rates set by the domestic market.

As to the results of other firms' adjustment efforts on the performance of the 6 firms studied, firm Ba's profitability had improved steadily but it still had 'a long way to go' in helping its domestic suppliers of accessories to organise their production more efficiently, to install specialised machinery, and to exercise tight quality control. Ba was constantly modernising its production processes, using foreign supplier credit for this purpose, but it was also having to shoulder costly forward cover (4% per month premium for a Yen/Kshilling option).

Labour productivity in firm Bb should triple with the planned rationalisation of capacity use - which was very low (25%) in mid-1989. The introduction of new lines was expected to double the volume of output (at a 70% rate of capacity utilisation) 30% of which could be exported. Profitability remained dependent on the stability of the Kenyan shilling.

Firm Bc's output had been increasing in physical terms at an average 15% per annum in 1985-9 as capacity expanded. Domestic sales were currently absorbing 80% of output, but with profitability being squeezed, the firm would have to continue 'surviving on exports'.

Workshop Bd was also export-oriented and was prospecting for foreign partners to develop its new products. Its new capacity was expected to operate at 70% even in its first year. The profitability margin was very slender, as the difference between ex-factory price and duty-paid import price averaged only 10%. Workshop Be showed less positive results of coping with adjustment measures: sales volume was poor and pre-tax profitability came to a mere 30% of turnover.

D. Adjustment Stance of Financial Intermediaries

The cardinal importance of credit availability and its cost for firms' ability to live with adjustment measures makes the stance of the main purveyors of credit of particular interest. Unfortunately, time limitations in the field allowed only interviewing the manager of the Kenya Commercial Bank Ltd.[24] His views are supplemented by information drawn from secondary sources on three DFIs in which government is the majority shareholder - the above-mentioned ICDC, the Industrial Development Bank (IDB) and the Development Finance Company of Kenya (DFCK).

The structures of the DFIs' investments were similar in several respects and frequently overlapped. They followed no clearly observable priorities so that large investments were made in sub-sectors and enterprises with a low developmental impact and suffering excess capacity; some industrial sectors (e.g. textiles) and firms appeared to be favoured; and there was no apparent effort to promote export-oriented activities, with the bulk of finance going to import-substituting enterprises.[25] The three DFIs had historically been incapable of investing all the funds available to them, much of which were tied foreign loans.

Kshilling devaluations in the course of adjustment diminished the number of objectively viable projects. Nor were many local enterprises keen to borrow foreign currency in view of the expectation of further devaluations. At

the same time the supply of domestic currency for investment diminished as monetary policy became tighter. Thus in 1982-3 all three DFIs received less in annual allocations from the Treasury than previously. Nor was government ready to guarantee or insure loans for want of enabling legislation. The shortage of funds to cover the local component of aid credits, in turn, made drawing them down more problematic. Tied foreign credits involving obligatory sourcing of equipment etc., were particularly unpopular and little used, causing the DFIs to incur considerable costs in commitment fees and charges on unutilised balances. The broad lesson drawn from the Kenyan adjustment experience was that 'unless developing countries can raise investment capital locally, devaluation is likely to slow industrialisation since it raises the cost of borrowing foreign development finance' (Coughlin and Ikiara, 1988, p.230). In succeeding years the DFIs alleviated the local currency shortage by raising more share capital and increasing internal surpluses, in line with the provisions of the 1985 Banking (amendment) Act, now consolidated in the 1989 Banking Act.

The KCB, for instance, used 75% of its 1985/6 profits to strengthen the group's capital base. In the opinion of the group manager interviewed, adjustment policy really began to bite in 1987 with the enforcement of IMF guidelines on credit creation. Banks were obliged to limit monthly loan expansion to 0.8% (10% p.a. growth). This ceiling took no account of undrawn funds in the pipeline and the high rate of credit under-utilisation.[76] Permitted credit growth from this narrow base left a large share of loan requests unsatisfied and the KCB made strong representations to have the ceiling raised. At the beginning of 1989 (a 15% annual credit expansion was allowed) after the improvement in foreign-exchange availability. But even with this enlargement, the KCB's advances fall far short of meeting its clients' demand for both short- and medium-term credit. An auction has been introduced for Treasury bills and bonds and a refinance facility set up in the Central Bank in an effort to open up financial markets. Since the loan operations of non-bank financial institutions are not subjected to the credit restriction, borrowers are diverted to them in large numbers but have to shoulder higher interest rates in consequence. On the whole, credit ceilings have throttled new investment and industrial activity - foreclosing much-needed employment opportunities - in the course of the adjustment process. For this reason

the KCB, with other banks, has argued for their removal, leaving inflationary pressures to be contained by the existing bank liquidity and deposit ratios, which they deem sufficient. Thus the KCB considers itself to be the major transmission belt for entrepreneurial views on money and credit to the authorities concerned." Parastatal credit needs are also serviced by the KCB and subject to a special ceiling under the IMF Guidelines which has also been very restrictive. The loans and advances by the KCB to priority sectors during the period 1985-8 are shown in Table 7. An important government agency for financing small manufacturing enterprises, the Kenya Industrial Estates (KIE), has also seen its activities curtailed by the adjustment-inspired credit squeeze, particularly since 1986 as shown in Table 8.

Government has begun to rationalise the interest-rate structure by raising the maximum rate for long-term commercial bank lending and has strengthened the banking supervision capabilities of the Central Bank. From June 1989 parastatals are to be charged market rates on local currency loans, thus ensuring the further transparency of their subsidies.

As set out in its Policy Framework Paper for 1988-90, the government intends to strengthen the country's money and capital markets to provide more flexibility in financial sector policies, to allow increased market determination of interest rates and to support the divestiture of industrial parastatals. It currently has a financial sector adjustment loan agreement with the World Bank for this purpose. As a first step it announced the appointment of a Capital Markets Development Authority in June 1989, thereby reducing the constraints on the capital market imposed by the Capital Issues Committee which have proved a major deterrent to firms tapping the equity market.

The 1989/90 budget announced a policy of radical tax reform, broadening the tax base and increasing the elasticity of the tax system. Sales tax is also to be replaced by a Value Added Tax. Institutional capacity for these reforms is to be strengthened.

IV. THE RECORD OF INDUSTRIAL ADJUSTMENT

The average annual growth rate of value added in constant (1982) prices in the manufacturing sector for the 1984-8 period came to 5.5% with relatively little year-to-year variation. During the preceding four years real VA growth had not only been lower (averaging 3.9% p.a.) but also subject to violent annual variations. These early years of adjustment witnessed rapid increases in output by the miscellaneous manufactures sub-sector, printing and publishing, petroleum and rubber products. Subsequently the flow of real investment into manufacturing accelerated, and the 5 leading sub-sectors by 1988 (in quantum terms, 1976 = 100) were in order: transport equipment, miscellaneous manufactures, printing and publishing, clothing; petroleum and other chemicals.

The 6 most laggard sub-sectors, again as indicated by the quantum index, were in order: wood and cork products, furniture and fixtures, leather and footwear, meat and dairy products, metal products, and non-metallic mineral products. It is arguable that these sub-sectors fared worst in the face, first, of recession and, next, of improvement in the overall economic performance of the country during the second half of the adjustment period.

As regards employment in the manufacturing sector, the number of formally employed workers increased from 146,300 in 1981 to 158,700 in 1985 - at a growth rate of a mere 2.2% p.a. During the following four years, the employment level crept up even more slowly (at 1.7% p.a.) to reach 170,300, 22% of whom were employed by manufacturing parastatals.

There are no published data in Kenya on the sectoral distribution of imports, nor did the author have access to input-output tables from which to estimate the share of imports in the manufacturing sector's intermediate consumption. However, the World Bank's 1986 survey of firms did allow extrapolations of the import content of 9 manufacturing sub-sectors output for the year 1985. These are reproduced in Table 9. From information obtained on the nature of subsequent manufacturing investment, these values could not have changed significantly by 1989 under the impact of adjustment.

The World Bank's survey allowed calculation of the sampled firms' comparative efficiency in the use of domestic resources (direct resource

cost) and the degree of subsidy received by their value added from protection (effective rate of protection). The average (short-run) DRC for the sample of 46 manufacturing firms came to 0.55 and their ERP to 89% - both indices suggesting relatively good efficiency for a medium-income developing country. Their average financial rate of profit (non-wage value added/fixed capital) for the year 1985 was 25%.

Changes in the pattern of Kenyan manufactured exports during the 1982-8 period, when adjustment measures were building up in effectiveness, can be deduced from Tables 3.1 - 3.3, which show the relative export shares of consumer durables, non-food industrial supplies, transport equipment and machinery gaining some ground at the expense of refined petroleum products (based on imported crude). Confirmation of this trend is provided by a recent study of the sources of growth of Kenya's manufacturing sector. (Sharpley and Lewis, 1988) which shows exports contributing a mere 2% to the total expansion of manufacturing output between 1980 and 1984, with the largest contributing sub-sectors being consumer products, food, beverages and tobacco, and industrial intermediates.

Two more indices are of considerable interest: the extent to which investment was attracted by the manufacturing sector, and the relative share of labour in manufacturing output and value added, (see Tables 10 and 11). In the second half of the adjustment programme, after 1984, investment in manufacturing increased at a high rate. Labour productivity also improved, but without wage earners benefitting fully therefrom - since the share of wages in gross output and MVA slumped considerably.

V. CONCLUSIONS AND MAIN FINDINGS

Readers of this report will have remarked that all respondents found the cutting edge of adjustment to be the credit squeeze and the lower purchasing power of the Kshilling in terms of foreign currencies. The Kenyan authorities - throughout the decade of adjustment - have stayed true to their reputation for caution and pragmatism in 'managing capitalism' in a delicate balance of political (and tribal) interests. Up to the late 1970s, large-scale deficits were rare phenomena, the official exchange rate remained more or less in line with the (notional) equilibrium market rate,

relations with the Fund and the World Bank were not seriously perturbed (as in so many other African countries), and the adjustment option was accepted by the media.[18]

It is therefore useful, in evaluating the effects of the adjustment measures on industry, to emphasise the aspect of continuity in the government's choice of policy instruments and its reliance thereon. Looking back briefly, one finds the first post-Independence decade free of significant external and internal disequilibria, with the economy expanding impressively at around 7% p.a. on average, in real terms. Inflation was well-nigh non-existent, foreign-exchange reserves were large, and capital inflow rising. But even in those heady days the share of exports in GDP was beginning to slide and there was little noticeable diversification in manufacturing and exports.

Already by 1981, under the effects of the second oil shock and of the general economic downturn, the economy was facing a crisis. The foreign debt had risen to around Ksh 1.7 billion and the debt-service ratio to over 18% of foreign exchange earnings; inflation nudged 15% p.a. and imports were burdened by a food deficit. The considerable deterioration in the terms of trade brought the current account into heavy deficit and the internal imbalance became aggravated by heavy government borrowing against a backdrop of falling agricultural output (due to bad weather). Under close IMF supervision devaluations reduced by 24% the SDR value of the Kshilling. Other adjustment measures were put in train, including that of gradually eliminating import quotas.[19] Total domestic credit expansion and government borrowing were assigned target ceilings. Also of relevance is the fact that, during this period, import-substituting industries were growing more import-dependent (Ikiara, 1981). Thus, early in the adjustment period the authorities' monetarist approach was tightening the credit constraint on industry, obliging it to seek loans from non-bank sources at higher cost, while overall foreign-exchange shortages provided a continuing motive for import licence stringency and for delaying the replacement of quantitative restrictions by tariffs.

Returning to our all-too-narrow sample of manufacturing enterprises and their reaction to adjustment, it is gratifying to note that, big or small

and whatever the product mix, all going concerns pinned their hopes on adding new lines and were confident about being able to export on present trends. Also, the majority were mobilising funds for expanding capacity while keeping their workforce stable. There is every likelihood that the past trend of rising labour intensity of manufacturing output will be prolonged. Other common features include a start in the diversification of export outlets and import sources.

Firms have still fully to digest and adjust to the new Restrictive Trade Practices and Price Control Act (1988) which aims at reducing the concentration of market power in a few hands.[*] They hope that the resulting increase in investigative controls on the part of the administration will not add to firms' burdens in 'paper chasing', and that fixed profit margins on designated goods and services will not be biased in favour of competing imports - as has been the frequent occurrence in French-speaking African countries.

On the whole, judging by published data and interview information, Kenyan manufacturing has a long way to go in raising average capacity utilisation, integrating production processes, improving profitability, and lowering the indebtedness of enterprises to less critical levels. Success along this difficult path requires several conditions to be met, including:

i. higher rates of investment in manufacturing with more participation by foreign risk capital, following the review of the Foreign Investment Protection Act;

ii. export incentives and export diversification to counter the increasingly inward-looking trend, The search for new markets and for deeper penetration of the PTA is of prime importance, plus faster progress with the setting up of EPZs. An important factor in this is the establishment of a realistic exchange rate;

iii. continuining official balance-of-payment support until the trade gap narrows;

iv. speeding up of domestic reforms aimed at greater transparency, with

the dissemination of reliable and up-to-date information among the business community; also greater encouragement to small-scale enterprises for employment generation;

v. multinational support for the various PTA initiatives, including those specifically targeted on establishing industrial complementarity and product differentiation;

vi. external technical assistance to improve input procurement, export market penetration and use of distributive channels abroad, as well as to enhance the managerial and technical competence of manufacturing personnel.

Table 1. Kenya: Economic Indicators 1984-8

Indicator	1984	1985	1986	1987	1988
GDP factor cost Ksh bn	3.80	4.37	5.08	5.65	6.55
Real GDP growth (%p.a)	0.9	4.8	6.3	4.8	5.2
Consumer price inflation	9.1	10.7	5.7	7.1	10.7
Population (mn)	19.5	20.2	21.2	21.8	22.3
Exports (US$mn)	1,078	977	949	748	785
Imports (cif) US$mn	1,522	1,462	1,337	1,431	1,495
Current Acct Bal US$mn	-126	-98	-102	-496	-550
Reserves (ex gold) US$bn	390	391	413	256	280
Publ. Ext. Debt US$bn	2.62	2.88	3.44	3.80	-
Debt-Service Ratio (%)	13.9	19.3	23.2	34.7	33.3
Exch. rate Ksh:US$ av.	14.4	16.4	16.2	16.5	18.3

Source: EIU 1989 and RoK, Economic Survey, 1989

Table 2. GDP Structure 1984, 1986, 1988

Origin of GDP (% of total)	1984	1986	1988
Agric, Forestry, Fishing	31.7	31.1	30.7
Manufacturing	12.9	12.9	13.1
Bldg & Construction	5.1	4.9	4.9
Electricity & Water	1.4	1.4	1.5
Trade, Restaurants, Hotels	10.6	11.2	11.4
Transport, Stor. Communic.	6.4	6.2	6.1
Government Services	15.0	15.2	15.3
All other activities	16.9	17.1	17.0
GDP at factor cost	100.0	100.0	100.0
Expenditure of GDP (% of cost)	**1980**	**1986**	**1988**
Private Consumption	61.0	61.0	60.6
Government Consumption	20.2	18.5	19.0
Gross Fixed Capital Form.	30.0	19.6	19.5
Change in Stocks	-	5.0	6.0
Exports of Goods & Servic	29.0	21.3	21.8
Imports of Goods & Servic	-40.0	-26.4	-26.9
GDP at market prices	100.0	100.0	100.0

Source: UNCTAD, 1987, Supplement and RoK: Economic Survey 1989

Table 3.1. Direction of Trade 1987, 1988

Main Destination of Exports (as % of total)	1987	1988
United Kingdom	16.8	19.6
Fed. Rep. Germany	9.6	12.0
Uganda	8.8	8.8
Netherlands	7.2	5.1
USA	5.4	4.9
(Total EC)	(42.3)	(47.6)
Main Origin of Imports (as % of total)		
United Kingdom	17.0	18.9
Japan	10.9	12.3
Fed. Rep. Germany	8.2	9.5
USA	7.0	5.0
Middle East (total)	19.5	14.3
(Total EC)	(43.4)	(47.7)

Source: as for Table 1

Table 3.2. Trade Quantum Changes 1984, 1986, 1988

Quantum Indices 1982 = 100	1984	1986	1988
Exports			
Food & Live Animals	102	126	120
Beverages & Tobacco	105	340	180
Crude materials, inedible	110	119	153
Mineral fuels	84	89	96
Oils and fats, edible	460	82	150
Chemicals	94	95	88
Manufactured goods	78	99	88
Machinery/Transport equip	38	38	53
Misc manufactures	82	144	122
All Exports	95	114	116
Imports			
All imports of which:	93	101	119
Crude materials, inedible	134	129	178
Oils and fats, edible	63	112	165
Chemicals	87	100	126
Manufactured goods	91	97	125
Machinery/Transport equip	84	104	134
Misc. manufactures	103	105	107

Source: RoK ECONOMIC SURVEY, 1989

Table 3.3. Trade Structure 1984. 1986. 1988 (%)

Broad Econ. Category Exports	1984	1986	1988
Food & Beverages	61.9	67.5	59.5
Ind. Supplies (non-Food)	15.0	15.3	21.2
Fuel & Lubricants	18.8	11.2	12.9
Machinery & capital equip.	0.3	0.5	0.6
Transport equipment	0.1	0.3	0.6
Consumer goods n.e.s.	3.8	5.2	5.2
Other products n.e.s.	0.1	-	-
TOTAL	100	100	100
Imports	%	%	%
Food & Beverages	11.6	8.7	5.7
Ind. Supplies (non-food)	26.4	30.5	36.4
Fuel & Lubricants	30.3	17.8	13.9
Machinery & capital equip.	16.9	19.0	23.5
Transport equipment	10.3	19.4	15.1
Consumer goods n.e.s.	4.3	4.5	5.3
Other products n.e.s.	0.2	0.1	0.1
TOTAL	100	100	100

Source: Ibid

Table 4. Main Foreign-Exchange Rates 1984. 1986, 1988

Main Foreign Exchange Rates (end of year)	1984	1986	1988
Kenya shillings per unit			
US Dollar	15.8	16.0	18.6
Pound Sterling	18.4	23.6	33.3
Deutsche mark	5.0	8.2	10.4
French franc	1.0	2.5	3.1
Swiss franc	6.1	9.9	12.3
100 Japan yen	6.3	10.0	14.8
Indian rupee	1.3	1.2	1.2
Overall trade-weighted index 1982 = 100)	97.2	125.8	161.7

Source: Ibid

Table 5. Nominal Tariffs 1978, 1984 (% ad valorem)

Average Unweighted Tariffs	1978	1984
Major Sectors		
Agriculture	11.4	16.9
Food	25.4	39.0
Beverages & Tobacco	90.1	111.8
Textile & Clothing	56.7	64.9
Leather & Footwear	30.7	39.6
Wood, Cork, Furniture	28.2	44.7
Paper, Printing, Publish	24.1	38.1
Bldg Material, Clays, Glass	23.5	38.0
Petroleum	15.7	18.0
Chemicals & Rubber	21.2	34.8
Metal Prod. incl Base Metals	19.5	34.8
Machinery, Transport Equipment	20.9	34.9
Misc. Manufactures	25.1	35.0
ALL SECTOR AVERAGE	29.5	41.0

Source: Sharpley and Lewis, 1988, Table 9.

Table 6. Balance-of-Payments Changes 1986-8

Annual variations in Ksh	1986	1987	1988
Exports (fob)	+174.5	-201.9	+155.3
Imports (fob)	-134.5	-154.9	-264.3
Services (net)	-2.1	-30.4	-15.1
Transfers (net)	+10.5	+8.7	130.5
Current Account change	+48.4	-378.4	+6.5
Private long-term capital (net)	+21.5	-15.2	-27.3
Short-term capital, EOE	-8.6	+52.5	-14.5
Net Monetary Movement	+167.3	-177.4	+36.7

Table 7. Loans by KCB 1985-8 to Priority Sectors

KENYA COMMERCIAL BANK LTD Kshm (approx).

Sectoral Loans and Advances	1985	1986	1987	1988
Agric, Fishing, Forestry	775	555	480	575
Industry	700	765	1,075	1,085
Domestic & Foreign Trade	655	840	830	930

Estimated from charts in KCB's ANNUAL REPORTS.

Table 8. Approved Industrial Investment (1986-8) by Government-owned Financial Agencies

	Number of Projects			Expenditure (Ksh mn)		
	1986	1987	1988	1986	1987	1988
I D B	10	18	15	5.65	11.30	6.52
D F C K	10	12	4	4.23	6.12	0.69
I C D C	12	15	14	6.06	7.63	3.06
K I E	411	164	205	4.33	2.44	3.31
All Four	443	209	238	20.27	27.49	13.58

Source: RoK, Economic Survey 1989, Table 11.6

Table 9. Manufacturing Sub-sectors' Import Content of Output

Sub-sector:	1985 (%)
Food Processing	36
Beverages & Tobacco	33
Textiles & Clothing	62
Leather & Footwear	44
Paper & Wood Products	11
Plastics & Pharmaceuticals	93
Basic & Other Chemicals	81
Cement & Glass	59
Iron & Steel Products	62
Electrical & Transport Equip.	83
SUB-SECTOR AVERAGE	52

Source: World Bank Report 6711-KE June 13, 1987

Table 10. Gross Fixed Investment in Manufacturing, 1985-8

	1985	1986	1987	1988
Value of GFC in manufacturing (current Ksh m)	65.2	88.9	89.6	112.5
Sector share of total GFCF (%)	10.9	12.6	12.7	14.6

Source: RoK, Economic Survey 1989

Table 11. Labour Cost and Productivity in Manufacturing
1980-1988 (% Annual Change)

	1980	1984	1986	1987	1988
Change in labour produc'ty in manufacturing	-	-	+2.1	+3.4	+5.7
Labour cost in manufacturing					
- as % of gross output	9.3	6.9	4.8	4.6	4.1
- as % of value added	-	-	33.8	32.8	30.7

Source: Ibid.

Table 12. Average Capacity Utilisation

Average Capacity Utilisation (by sub-sector)	Year	% Rate
Cold-rolled Steel	1985	21
Cutlery	1985	16*
Electrical Cables	1985	59*
Foundries	1983	23*
Glass Bottles	1985	48
Handtools	1985	24*
Hot-rolled Steel	1985	22
Metal Engineering	1983	34*
Paper	1987	91
Pharmaceuticals	1985	21*
Plastic Processing	1983	53*
Refractory Bricks	1985	42*
Steel Billets	1985	48
Steel Pipes	1985	13
Steel Sheet Galvanising	1985	62
Sugar	1985	67
Textiles	1986	82
Transport Vehicles	1985	23*

Note: * = 120 hours/week
Other rates at 168 hours/week

Source: Coughlin and Ikiara (1988), p.278

CHART 1

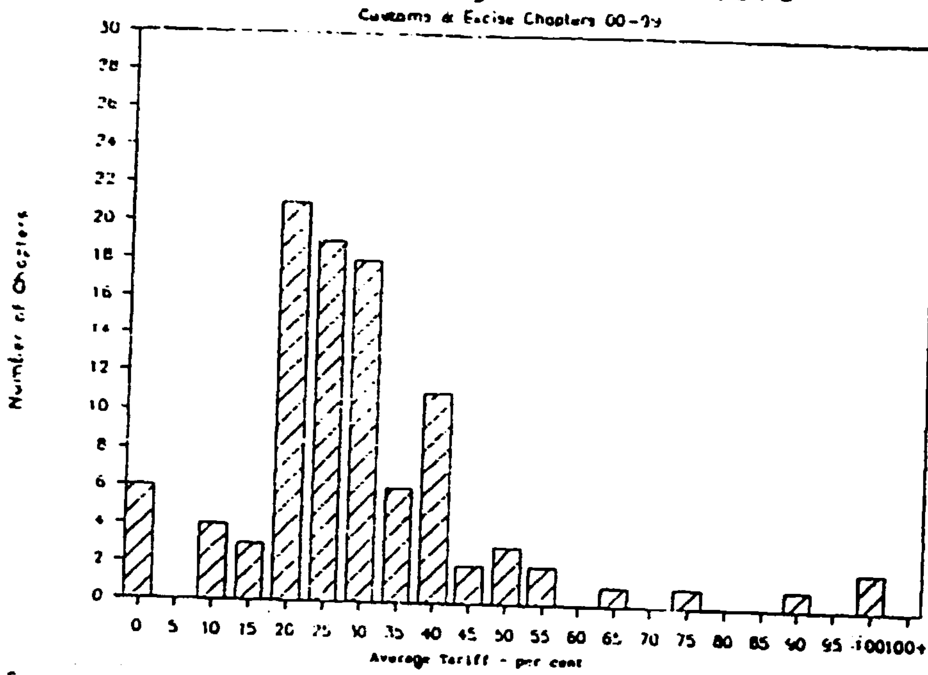
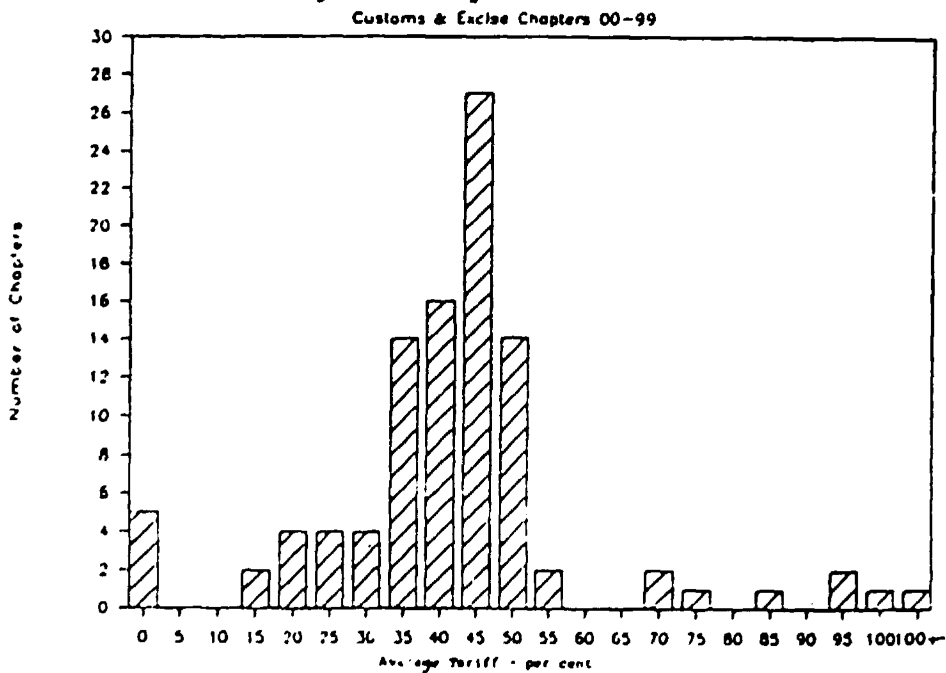


CHART 2



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Field work for this case study spanned 12 week days following the entation of the 1989/90 budget on 15 June 1989. Government and statal officials, bankers and representatives of other institutions generous in providing information. The reaction of private sector gers/owners to the enquiry was guarded at best and, in several cases, tive. Little quantitative information at the firm level was hsafed. The reluctance on the part of managerial personnel to discuss r firm's financial situation, diversification plans and market ntial was based on the fear that such information might reach etitors. A case was cited of consultants of a bilateral aid agency who ised such data in a subsequent feasibility study for another client. hermore, in view of the government's caution and pragmatism in ralising the economy, the managers refrained from 'rocking the boat' by losing the tactics used in overcoming bureaucratic hurdles and diting procedures. Since access to the firms' accounts was out of the tion, the economic hardships encountered by firms were probably gerated as part of a rearguard action to defer all further reductions rotection and other entitlements.

uent reference is therefore made to secondary source material - such as 1987 World Bank study of Kenya's industrial sector and the papers ared by a team of lecturers in Nairobi University for the 1986 erence on industrialisation in Kenya. This was the first time that the emic community, industrialists, local and multinational entrepreneurs parastatal managers had taken a critical look at industrialisation in a.

The Economist Intelligence Unit's Country Report on Kenya (1989) es that at the last Paris meeting of the Consultative Group donors essed satisfaction with Kenya's restructuring efforts. Aid to the tune S$ 1.1 bn was promised for 1989 to help maintain a GDP growth of around .a., while keeping foreign-exchange reserves and imports at required .s. One-third of this aid came from Kenya's largest donor - Japan. in officials stressed their concern about the social costs of stment and its impingement on the vulnerable groups. There has been page' in conforming with donor conditionality, based on self-idence regarding the country's standing with donors.

The Sessional Paper of 1980 reads, in part: 'The economic problems onting Kenya are inter-related. The balance of payments constraint is ely linked to the budgetary constraint; and both constraints operate to overall growth of the economy as well as the availability of irces required to support various social welfare and public investment ammes. ... What is required is a comprehensive set of mutually rtive policies ...'

The second set of structural adjustments aimed at co-ordinating ms relating to industry with those in agriculture, trade and ation policies. For more details see Hecox, 1988.

Ibid, pp. 213-15

6. For metal products, in 1984, the protective tariff on final products averaged 43% ad val. while that on the relevant intermediate inputs came to 27%. With the ratio of value added:gross output of only 12.2 at that time, the implied effective rate of protection was 160% (Sharpley and Lewis, 1988, p.64).

7. The then Minister of Finance said, inter alia, 'we have for too long tried to avoid changes in our industrial structure and that is now beginning to hurt us'.

8. The Central Bank could doubtless pursue an allocation policy that would positively discriminate in favour of industrial sub-sectors deemed to be strategic, or deny allocations for the importation of competing products. This, however, does not appear to have been the common practice. Enquiries carried out recently by researchers from the University of Nairobi divulged frequent allegations of corruption among those responsible for allocating both import licences and the corresponding foreign exchange (see Coughlin and Ikiara, 1988, p.244).

9. The University of Nairobi's investigations revealed that 'the majority of people in charge of industrial policy in the country have little first-hand information even about the large industries ...' ibid.

10. Among the measures taken to restrain credit creation by commercial banks, the 1986 cash ratio obliged them to maintain with the Central Bank, at all times, a cash;deposit ratio of 6% of their total deposit liabilities. Towards the end of 1987 they were ordered to reduce the rate of their lending to private borrowers to 10% per annum. In January 1988, maximum commercial bank rates were raised to 15% and savings deposit rate reduced to 10% p.a. The issue of Ksh 3 bn of high-premium Treasury Bonds in 1988 also pre-empted the flow of savings to commercial banks for on-lending to industry. In sum, the growth in money supply in the year to June 1988 was a mere 4.3% compared to the 23% increase in the preceding year. However, this had no effect on 'importe ' inflation resulting from the continued depreciation of the currency nor on reducing the budget deficit. In the light of such developments and faced with business discontent, the Central Bank raised the ceiling on commercial bank credit expansion, at the beginning of 1989, from 10 to 13% per annum.

11. Several instances are recorded when projects were turned down for technical reasons by the Committee only to be reinstated under pressure of local interests. (Swainson, 1980, quoted in Coughlin and Ikiara, 1988, p.245).

12. See UN ECA, African Alternative Framework to Structural Adjustment Programmes for Socio-Economic Recovery and Transformation. Addis Ababa, July 1989.

13. By June 1989 only 12 products remained under price control: charcoal, salt, maize and maize meal, milk, fats and edible oils, bread and flour, tea, rice, sugar, and stout beer.

14. However, an argument against undifferentiated export subsidies lies in the fact that several large multinationals in Kenya (e.g. producers of canned pineapples and cement) have been exporting 95% of their output for many years at a profit.

15. There are 5 textile mills in the public sector, employing some 5,000 persons. They have not been integrated within a mutually supporting framework. Many require rehabilitating and managerial improvements, of which the holding company (ICDC) is well aware but which have so far not received the requisite political go-ahead to carry out a (costly) restructuring, even with the (tacit) blessing of the World Bank. (See the annex section on textiles in World Bank, 1987). The local spinning mills will have to produce finer quality yarns before Kenyan finished textiles can become competitive.

16. Spare parts for the original 1965 vintage Japanese equipment in the textile mill were no longer in stock and had to be manufactured to order. To become competitive, modern high pressure dyeing would have to be installed. Although the firm believed it could amortise this investment in 2 years, its patron bank considered its financial state 'too shaky' to warrant the required credit. In the manager's view partial or total privatisation was still too distant an option as government policy had not yet drawn up specific ground rules.

17. The cif price of one of the principal imported inputs (zinc) rose in Kshilling terms from 34 per kg. in 1988 to 65 by mid-1989. The Office of Price Control took up to 6 months to process a request for price adjustment. The other inputs were price-controlled steel sheets, produced by an affiliated rolling mill.

18. However, there were cases of import licences having been issued even when the firm had the capacity to satisfy demand.

19. In the years 1985-7 the cif unit price of imported jute bags was Ksh 26 but the controlled price allowed the firm was only Ksh 15.5/bag, giving rise to a Ksh 46 million loss. It took 13 months for the firm to get the controlled price raised to Ksh 20.9/bag, by which time the world jute price had fallen by 60%, bringing down to Ksh 11 the duty-paid price of an imported bag. With the firm's working capital depleted, it was unable to compete with legal imports which benefitted from the support of powerful vested interests.

20. Whereas prices were previously quoted to hold for 3 months, they were currently held for only 2 weeks, the Kshilling cost of locally purchased inputs (in principally steel sheets) had doubled since the start of the 1980s.

21. Thus, wheelbarrows in Europe and Asia are normally built to carry 50 kg loads, whereas as much as 200kg are hauled in African conditions and are often 'throw-loaded'.

22. Gas cylinders have (finally) been included in the PTA'S list of preferentially reduced tariffs, thanks to the firm's lobbying.

23. The firm manufactures bio-gas lamps designed under the aegis of West German technical aid in East Africa. These lamps are sold to FRG-aided projects in Tanzania and Burundi, but could spread to other PTA countries with some promotion.

24. The Kenya Commercial Bank is affiliated with Kenya Commercial Finance and Kenya Savings and Loans. KCB is the market leader with an extensive branch network and an office in London. By the beginning of 1989 the KCB group controlled 30% of all savings account deposits in the country. KCB became a public company with its shares listed on the Nairobi Stock Exchange in 1988. It acts as the intermediary for administering donor agency credit lines (IFC, OPEC, USAID). African Business Review, July 1989.

25. At the end of 1982, out of 100 DFCK projects, only 9 were foreign-exchange earning exporters. (Coughlin and Ikiara, 1988, P.228).

26. The under-utilisation of pipeline credit was due principally to difficulties in meeting the exacting conditions on which external loans had been extended, on the one hand, and inadequate project preparation by Kenyan borrowers, on the other.

27. The KCB has been attempting, without success up to the time of writing, to get the aid funds in its control excluded from the ceiling restriction and from the purview of the IMF Guidelines.

28. For a detailed study of Kenya's relations with the Fund and the World Bank see Killick, 1984, vol 2., chapter 5 and Hecox, 1988.

29. For the first time the Fund included import policy among the performance criteria of the renewed 1981 Stand-by agreement, thereby reinforcing the World Bank's SAL conditionality agreed in 1980. The Fund's official historian has stated: 'Ceilings on domestic credit expansion were emphasised because performance criteria in Stand-by arrangements were based on the view ... that changes in the supply of money and credit in an economy had a strong impact on aggregate domestic demand and a related effect on the balance of payments', de Vries, 1976.

30. The new Act restricts, inter alia, the formation of trade cartels or associations for the purpose of controlling/fixing prices or production quotas. It aims at disintegrating (in terms of shareholding or market share) production, distribution and retailing activities. The Ministry of Finance is to keep track of production, distribution and retailing patterns of goods and services to that end. It can also set maximum profit margins for particular goods and services. The Act forbids discrimatory trade arrangements and collusive tendering and bidding, as well as resale price maintenance. The executive Commissioner's staff is authorised to search premises and peruse business records without notice in order to investigate alleged restrictive practices. (Kencom Digest, Nairobi, April 1989).