

A Study for

Analysis the State of Kenya's Foreign Reserves and the Impact of the $$760 Million Loan (From the IMF) to Kenya's Development

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Analysis the State of Kenya's Foreign Reserves and the Impact of the $$760 Million Loan (From the IMF) to Kenya's Development

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List of Acronyms

AAI	ActionAid International
AAIK	ActionAid Kenya
AIA	Appropriation in Aid
BOP	Balance of Payment
CBK	Central Bank of Kenya
CSO	Civil Society Organisation
EAC	East African Commission
ECF	Extended Credit Facility
ESF	Exogenous Shock Facility
ICC	International Criminal Court
FDI	Foreign Direct Investment
GoK	Government of Kenya
IFI	International Financial Institutions
IMF	International Monetary Fund
GDP	Gross Domestic Product
MDGs	Millennium Development Goals
MTP	Medium Term Plan
MW	Megawatts
PFM	Public Finance Management
PRSP	Poverty Reduction Strategy Paper
SDR	Special Drawing Rights
SSA	Sub Saharan Africa
ToT	Terms of Trade
VAT	Value Added Tax

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Executive Summary

The Government of Kenya and the international Monetary Fund (IMF) signed a loan of $$508.7 million in January 2011. The funds are expected to be released in three different tranches spread out till 2013. According to Treasury, between $$100 and $200 million of this loan will be used to develop the energy and infrastructure sectors, while the rest will be used to shore up hard currency reserves, aimed at ìbuilding Kenyaís import cover positionî which, according to the CBK, have been stuck for months at 3.5 months of import cover, below the statutory requirements of 4 months. Latest CBK data showed that on December 4th 2011, usable official foreign exchange reserves stood at $$4.142 billion equivalent to 3.72 months of import cover.

ActionAid International (AAI) has consistently challenged the policy conditionalities propagated by the International Financial Institutions (IFIs), particularly the IMF, to the recipient countries of their loan programmes.

Following the signing of the above mentioned loan programme, AAIK sought to analyze the level of Kenyaís foreign exchange reserves, against the background of the loan agreement, while at the same time, establishing the policy conditionalities surrounding the new loan agreement, and the resultant impact of the same to Kenyaís development agenda. Here we present the summary of the research findings.

The support has not pushed the country's foreign reserve to the country's constitutional threshold of an amount sufficient to cover four months of imports. Despite Fund support under the Exogenous Shock Facility (ESF) and the 2009 Special Drawing Rights (SDR) allocation, international reserves remained below target at 3.4 months as capital inflows remained subdued relative to other developing economies. Even though the country has experienced increased tea exports, tourism receipts, and remittances that have contributed to improved external current account, adverse exogenous shocks -- high energy prices and drought -- have curtailed the growth in the foreign reserve to the levels below threshold.

The program has no direct infrastructural investment component. While both government and the IMF officials cited investment in infrastructure, especially for energy generation, as one of the key sectors that would be supported by the IMF program , the study observes that the ECF program has not set any targets for its realisation both as a structural benchmark thus making us conclude that the funding is not connected to infrastructure financing but is rather a buffer for fiscal adjustment to meet the cost for investment in the infrastructure.

The direct linkage of infrastructural development to IMF financing is generally misleading to the general public as this aspect of financing is not within the fundís mandate.

The program also has no direct connection to poverty reduction-related expenditures. Even though the program mentions poverty reduction as one of the performance criteria, there are no direct programs, targets or outcomes that have been embedded on the program design. Furthermore the program aims to maintain a policy of rationalizing recurrent expenditure, including restraining growth in wage payments to free resources towards development expenditure. It seeks to protect pro-poor wage expenditure in health and education sectors while limiting new recruitment in the public service. This in our view does not reflect the ever expanding social expenditure currently underway by the government through food subsidies, the expanding delivery safety nets and basic social services and the implementation of the new constitution.

The IMF appears to have failed to consult broader stakeholders in the design of its program. CSOs are completely sidelined while the members of parliament are merely debriefed. This has not only limited the broader ownership of the fund's program but also missed inputs in setting the appropriate projections and targets for the government. This can largely be seen in the context of emerging challenges both from the fiscal and the monetary side of the program targets and expected outcome. The rising inflation, the weakening external position of the government due to deteriorating terms of trade, emergency importation of food grains, and dwindling direct foreign investment due to political uncertainty leave the program objectives very vulnerable and perhaps even untenable. The loan has the potential of becoming an odious debt, adding additional debt burden to the country without commensurate benefits even as Kenya has already passed the debt threshold of 45% as set in the medium term debt sustainability management.

Background

The global financial crisis affected the level of reserves in many developing countries. It put some downward pressure on reserves in recent years. Most countries were been hit by lower external demand for their exports of goods and services and a decline in capital flows. Some also experienced deteriorating terms of trade. Lower external demand and financing have forced economies to adjust. As a result, a reduction in domestic absorption and growth is at play, and most countries in the have suffered currency depreciation.

The crisis has also caused a surge in risk aversion, a decline in capital and trade flows, and a deterioration in international commodity prices. Faced with these external shocks and lower growth prospects, countries have implemented policies that have often led to a decline in international reserves. When possible, they have increased foreign borrowing. However, where the room for accessing external finance and using reserves is limited, countries have had to adjust their policy stances and/or let their exchange rates depreciate.

In response to the crisis, multilaterals, and the IMF in particular, have stepped up their support. A number of multilateral creditors have increased their commitments or have front-loaded disbursements under existing loan agreements. The IMF has strengthened its support in different ways.

First, it has responded quickly to its membersí requestsóthe commitments for use of IMF resources have jumped to about US$150 billion and the number of financial arrangements on concessional terms increased substantially. Second, a major overhaul of the IMFís lending toolkit allowed a doubling of access limits for all types of arrangements, a modernization of lending instruments, and a streamlining of conditionality. In addition, an allocation of SDRs equivalent to about US$280 billion was agreed upon by the IMF shareholders and became effective in September 2009.

Reserves in Perspective

Foreign reserves play an important role in insuring developing countries against exogenous shocks and reducing the probability of panic driven crisis. This is particularly true for developing countries that are often faced with large external shocks and have limited or no access to international capital markets. Reserves act as an important means of self insurance in these countries in the face of external shocks.

For many countries foreign reserves are held for financing foreign exchange operations of the public and the private sector especially in countries with substantial exchange controls and a large proportion of foreign exchange transactions channelled through the central bank, help avoid potentially disruptive adjustments in the exchange rate or domestic consumption and investment, *help foster confidence in the government policy framework and its capacity to meet external obligations*, and as a by-product of this export promotion policy

Countries in sub-Saharan Africa (SSA) are routinely faced with different shocks including extreme weather, abrupt exogenous movements in the prices of key exports/imports and a change in the net aid flows, which can contribute to higher volatility in aggregate output and, in extreme cases, to economic crisis.

An IMF study of 2008 on reserves adequacy in SSA showed that actual response of output and consumption to a shock varies significantly with the level of reserve holdings of a country. Countries with a high level of reserves to GDP ratio show very little effect of a terms of trade or aid shock on their output and consumption. (Drummond and Dhasmana ; 2008). This is largely because the higher the level of reserves the easier it is for the countries to adjust to shocks and cushion output and consumption from disruption. Countries with reserves above the critical threshold are also able to smooth the impact of price shocks on domestic absorption through counter-cyclical fiscal policies.

Dhasmana (2008) observesthat there are significant threshold effects in the relationship between foreign reserve holdings and the impact of exogenous shocks on growth, investment consumption. Countries with reserves to GDP ratio below four percent face a greater decline in growth, investment and consumption due to exogenous price shocks and reduced per capita income compared to the countries with reserve above 4 percent of GDP. In fact countries with reserve to GDP ratio above four percent do not face any significant impact on growth, investment and consumption due to price shocks.

On the other hand, countries with low reserves to GDP ratio show a significant decline in their output growth and an even more dramatic decline in their per capita consumption as their options are fairly limited . This has important implications for the welfare of the developing countries that do not carry sufficient reserves.

Many countries in Africa mainly focus on the self-insurance motive of keeping higher reserve levels, with reserve adequacy standards having changed with the nature of BoP disruptions. They use the Bretton Woods system to determine the appropriate levels for reserves where the Reserve adequacy is primarily assessed on the basis of capital mobility, with a key benchmark being a reserve coverage ratio of three months of imports of goods and services. However as capital flows grew and countries become susceptible to sudden stops in the flows, the focus changed to capital account-based measures of reserve adequacy. These two elements now intertwine to provide analytical framework for adequacy in reserve levels. Most African countries appear to have adopted the Bretton wood system.

The debate on the appropriate levels of reserve still remains unresolved thus making the standard advice to maintain reserves sufficient to cover 3 – 4 months of imports having been advised by the bretton wood institutions. Other optimal reserve models generally focus on the opportunity cost, which depends on alternative uses of foreign exchange reserves for example choosing between prepaying external debt and undertaking public investment projects

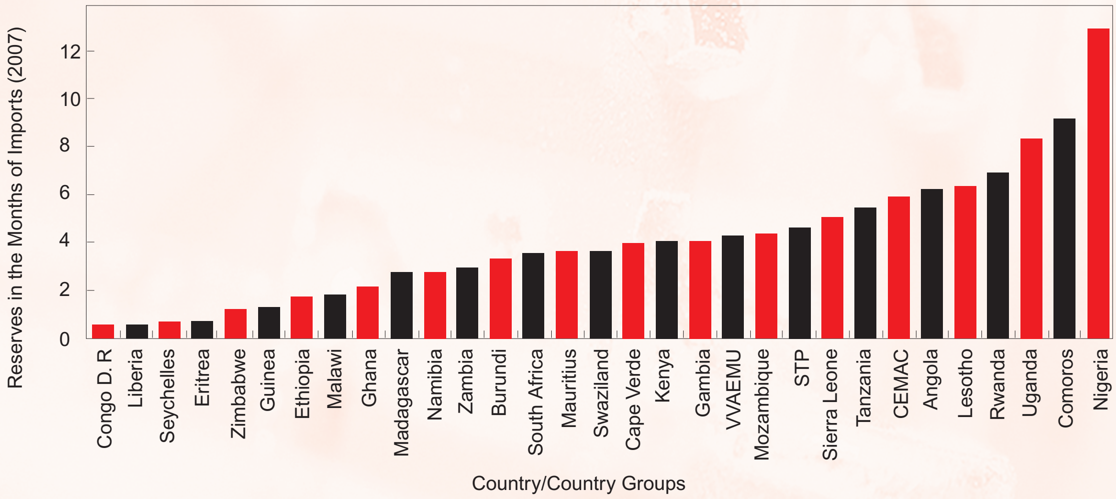
Key conditions for a country to have a flexible reserve level should hinge on its ability to easily secure adequate and sustainable alternative sources of financing over and above current account and capital account instruments.

Trends of Reserve Holdings in Africa

African countries higher accumulated international reserves until 2008 before the financial crisis. This was supported by generally favourable international environment and prudent macroeconomic policies that these countries pursued.

However, relative measures of international reserves provide a more contrasted picture of this reserve accumulation. While the absolute levels of official international reserves increased, the other traditional metrics used to assess reserve adequacy showed a stable or declining trend. For example while the reserves remained relatively high in east African countries, the import coverage ratio remained only right around the traditional target of three months of imports, and thus, below the EAC objective of an import coverage ratio of four. While it has increased to above six months of imports in Rwanda, Tanzania, and Uganda

Chart 1 Reserves in Sub-Saharan African Countries, 2008 Reserves in Months of Imports



Source: World Economic Outlook 2007

Kenya in Perspective

Kenya has not been immune to the financial crisis that faced the world. It has been hit by lower external demand for its goods and services, deteriorating terms of trade, and a decline in capital flows. The official foreign exchange reserves have started to decline. Kenya benefited from substantial IMF financial support to help cushion the impact of the global financial crisis on its economy. The IMF approved in May 2009 a disbursement of SDR 135 million (or about US$200 million) for Kenya, under the rapid access component of the ESF, SDR 325 million (or about US$508.7 million) was approved in January 2011 for a three year ECF and a top up of US$ 241.3 million in December 2011.

Economic performance

Kenyaís aggregate fiscal performance has remained subdued since the beginning of 2011. Inflation has increased from 3 percent to 12 percent by june, the shilling has lost ground against major global currencies, and the stock market has declined by 10 percent (Treasury 2011). Global shocks, especially the rapid rise in food and fuel prices, have added to Kenyaís economic challenges. The poor rainfall during the traditional long rains of March-May 2011 has put further stress on food prices. Political uncertainty, linked to the International Criminal Courtís (ICC) investigations into prominent public figures and the upcoming 2012 elections, has also added to the current economic volatility, as investors and international partners remain more cautious due to perceived high political and economic risk.

Addressing inflation

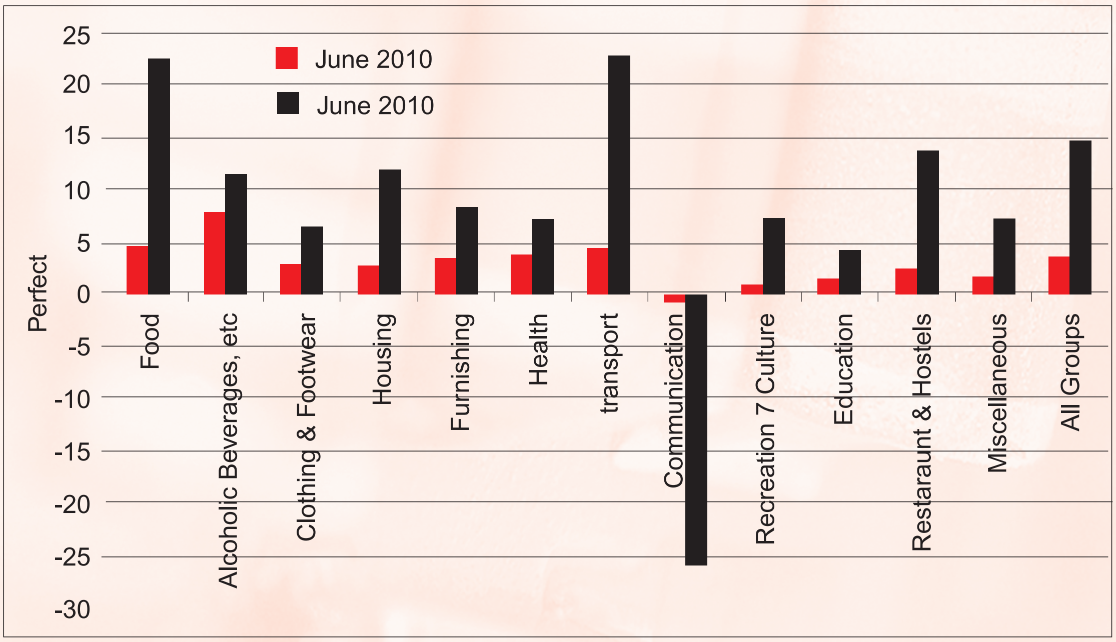
Inflationary pressure in Kenya continues to have a negative impact on the livelihood of ordinary Kenyans. The experience with inflation has largely been reflected in an increase in prices of food and fuel. The increase in food prices rose by 22.5 percent from 107.8 in June 2010 to 132.1 in June 2011. The average retail price of dry maize more than doubled from Ksh 19.4 per kilogram in June 2010 to Ksh 41.6 per kilogram in May 2011. This increase was reflected in overall food inflation as the price of the staple food accounted for 8.4 percent of the ëFood and Non-Alcoholic Beveragesí index. The general increase in food prices reflected constrained food production in the year to June 2011 owing to drought and unfavourable distribution of rainfall.

Domestic fuel prices rose in tandem with the increase in world oil prices. The import price of crude oil rose from US dollars 74.8 per barrel in June 2010 to US dollars 120.7 per barrel in April 2011 before declining to US dollars 112.2 per barrel in June 2011. The rise in oil import price during the period under review was directly reflected in the average retail prices of petrol and diesel (Chart). The rise in fuel prices was also reflected in the upward adjustment in fees charged on public transport services and electricity.

In the monetary area, to ease the liquidity situation, the CBK cut its policy rateó the Central Bank Rate (CBR)óby a total of 75 percentage point and lowered banksí reserve requirement ratio from 6 percent to 5 percent without weighing on how this was to support economic activity In the country. This created a room for speculation in the market thereby contributing to the to high inflationary rate.

The foregoing factors have not only contributed to increase in inflationary rate but also exerted pressure on the Kenya Shilling. In order for the government to increase the importation of maize to address the food insecurity and to sustain the economic demand for fuel energy, the use national reserves increased and this had a negative impact on the exchange rate as well.

Chart 2 Inflation rates for goods and services



Source CBK 2011

Inflation affected the poor more than any other households as reflected in table 1. It is therefore imperative that efforts over the use of the countryís reserve is not only used to spur economic activities across the sectors, but also provide safety nets through subsidies on basic consumables such as food, electricity, gas and fuel.

Table 1 Inflation impact by Income Group

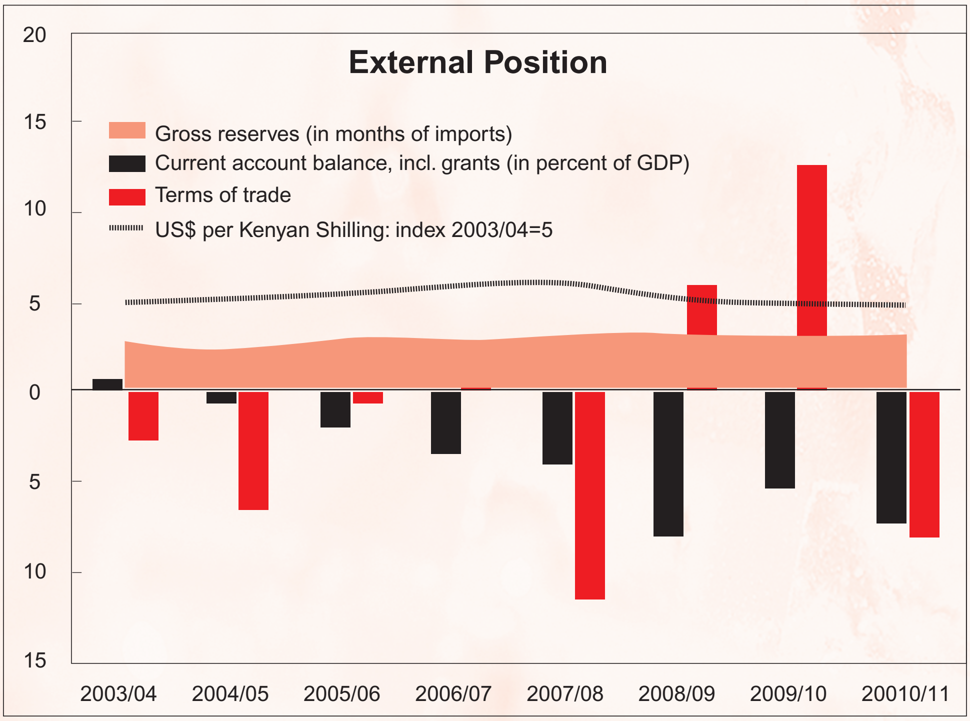
	Nairobi			Total Nairobi	Rest of Kenya
	lower income	middle income	upper income		
Food & Non-Alchoholic Beverages	25.28	13.75	10.06	21.98	22.89
Alchoholic Bevrages, tobacco & narcotics	9.83	11.19	2.61	9.89	12.58
Clothing & footwear	4.47	6.95	7.71	5.18	7.47
Housing, Water, Electricity, Gas & other Fuels	10.81	6.76	4.43	9.63	13.57
Furnishings, Household Equipment & Routine Household Maintenance	7.68	8.46	3.37	7.70	8.60
Health	5.04	1.66	0.89	4.08	9.52
Transport	24.60	22.94	24.87	24.22	21.60
Communication	-33.33	-9.21	-15.81	-26.89	-25.38
Recreation & Culture	6.74	7.86	7.04	7.02	7.33
Education	5.04	10.71	4.42	6.42	2.75
Restaurant & Hotels	17.69	5.51	3.80	14..26	13.31
Miscellaneous Goods & Services	5.17	5.46	2.88	5.15	8.68
All Groups	**15.96**	**9.57**	**10.14**	**14.24**	**14.66**

Source CBK 2011

Kenyaís counter-cyclical fiscal stance in the last two years succeeded in cushioning the economy from adverse shocks but resulted in a higher fiscal deficit of 6 percent of GDP and minimum impact on the inflation. The countryís public debt level remained above the medium term debt management strategy target of debt-to-GDP ratio of 45 per cent. The This risks plunging the country to unsustainable debt levels if not adequately addressed. (Treasury 2011)

Kenyaís current account position worsened as the deficit widened by 75.7 percent to US$ 3.3 billion in 2011 from US$ 1.9 billion in 2010. This was due to US$ 2.3 billion increase in imports compared with US$ 609 million increase in exports. (CBK 2011)

Figure 1 External position



Source Treasury 2011

The import bills on basic commodities (fuel, clinker and maize) to support its domestic economy, increased rapidly. Merchandise imports increased by 17.4 percent, exceeding total export growth which was 14.4 percent in 2010. Trade in services was robust, increasing by 9.8 percent in 2010. But while the share of merchandise exports in GDP increased from 15.3 to 17.3 percent in 2010, the share of imports also increased significantly from 35 to 40.6 percent in 2010.

The value of goods exported increased by 12.3 percent from US$ 4,9 billion in 2010 to US$ 5.5 billion during the fiscal year 2011. The improvement in export performance came mainly from exports of manufactures, chemicals and raw materials. At the same time the value of Kenyaís commodity imports rose to US$ 13.6 billion in 2011 from US$ 11.2 billion in 2010. The above coupled with the strengthening of the US dollar against the Euro in the international market contributed to the weakening of the shilling against the US dollar.

The current account deficit was financed by large inflows in the capital and financial account with the main sources coming from the official flows, FDI, and short term flows which improved by $1.1billion. The surplus on the capital and financial account improved from US$ 2.5 billion in 2010 to US$ 3.6 billion in 2011.

Capital flows to the Government comprising project grants increased from US$ 180 million to US$ 229 million in 2011. However, medium and long-term flows to Government declined from US$ 531 million in 2010 to US$ 335 million in 2011. The high position in 2010 reflected additional allocation of Special Drawing Rights from the IMF in August 2009 to mitigate adverse impacts of the global recession. (CBK 2011)

Foreign Reserves In Kenya

Over the last 7 years, fast reserve accumulation has been notable. Foreign reserves for Kenya increased by an all time high of $3.3 billion in 2008 from US$ 2.7 Billion. This is due to largely low initial reserve holdings, the increasing openness of the Kenyan economy, and a policy choice to build precautionary levels to insure against balance of payment risks by the Central Bank of Kenya. Following the IMF's intervention through the **Exogenous Shocks Facility 2009, the country's reserve level shot up from USD 2.8 bn in 2009 to USD 3.8 bn, marking a 33.7% from the previous year.** (see Table 2).

Table 2 Reserves of foreign exchange and gold: $4.585 billion (31 December 2010 est.)

Year	Reserves of foreign exchange and gold	Percent Change	Date of Information
2004	$1,455,000,000		2003
2005	$1,500,000,000	3.09 %	2004 est.
2006	$1,799,000,000	19.93 %	2005 est.
2007	$2,350,000,000	30.63 %	2006 est.
2008	$3,355,000,000	42.77 %	31 December 2007 est.
2009	$2,879,000,000	-14.19 %	31 December 2008 est.
2010	$3,850,000,000	33.73 %	31 December 2009 est.
2011	$4,142,000,000	19.09 %	31 December 2010 est.

Source, Treasury and CBK 2011

The official foreign exchange reserves held by the Central Bank of Kenya increased from US$ 3,799 million (3.9 months of import cover) to US$ 4,142 million (3.9 months of import cover) See table 2. The improvement in gross official foreign exchange reserves reflected domestic inter bank purchases by the Central Bank to enhance import cover, and program disbursement under the IMFís Three - Year Extended Credit Facility.

Legal Framework for Reserves in Kenya

The management of the national reserves is vested with the Central Bank of Kenya. This is enshrined under the old constitution in CAP 491. The Act among other things defines reserve amount the country should hold at any particular time.

Section 26 of Central Bank of Kenya Act states that *"The Bank shall at all times use its best endeavours to maintain a reserve of external assets at an aggregate amount of 4 months imports recorded and averaged for the last preceding three years[1]"*.

Despite the existence of this law **Kenya's reserves remain relatively low despite the authorities' reserves build up efforts (see figure 3).** At the same time the EAC has set a target for it member countries of 6 months of imports for the convergence criteria for the establishment of a monetary union. Kenya is yet to meet this target while the rest of East African states are close to the target.

EAC Macroeconomic Convergence Criteria

Since May 2007, the Governors of EAC Partner States adopted a new set of convergence criteria. The criteria were classified into primary criteria and secondary criteria. The primary criteria sets the preconditions for convergence, which must be met. The primary criteria include benchmarks on fiscal deficits, inflation and external reserves. The secondary criteria include areas of policy and real convergence.

The primary criteria are:

(a) Overall budget deficit/GDP ratio (excluding grants); of not more than 3 percent;
(b) Annual average inflation rate not exceeding 5 percent;
(c) Minimization of central bank financing to 0 percent target; and
(d) Foreign exchange reserves equivalent to six months of imports of goods and non-factor services.The EAC target has been set higher due to the following

1. As the EAC countries continue to implement reforms aimed at reaping the benefits of more integration into the world economy, either through enhanced trade or by liberalizing capital account transactions the economy is also likely to become more susceptible to the global economic environment. Higher reserve levels may then be useful to guard against more pronounced external shocks.
2. The adoption of a common currency, to influence the policy framework, for exchange rate regime and manage the susceptibility of the monetary zone to shocks—degree of openness to world trade and capital flows

It is important to note that the proposed public finance management bill under the current constitution does not apply to the CBK as current bill only address roles and responsibilities of the treasury and recognises the central bank as its banker. It however does not confer any authority to the Secretary of treasury to exercise its powers over the institution. The government is yet to come up with a new bill to streamiline the operations of CBK to fit within the current constitution.

1 The constitutionally acceptable reserve levels are yet to be reviewed under the current constitution.

IMF Funding Program in Kenya

Rapid Access Component of the Exogenous Shocks Facility (RAC-ESF) 2009

The difficulties in maintaining the macroeconomic stability as agreed with the Fund forced Kenya to seek the support of the International Monetary Fund to address both the financial crises as well as shore up its national reserve to a comfortable level.

In May 2009, the Executive Board approved the disbursement of SDR135.7 under the Rapid Access Component of the Exogenous Shocks Facility (RAC-ESF) to address the impact of exogenous shocks and the balance of payments gap. The disbursement of was meant to close the estimated cumulative financing gap for 2009 and 2010, while enabling the country to rebuild foreign reserves. In the aftermath of the disbursement, foreign reserves reached almost 3.7 months of imports at end-September.

Even though the Fund's 2009 Exogenous Shocks Facility (ESF) disbursement and SDR allocations helped boost reserves to 3½ months of imports by end-2009, the impact on the national reserve level was short lived, implying that just additional borrowing to shore up the reserves was not sufficient to address the perennial shortfall in reserves.

Overall and food inflation declined briefly while aided by the large imports of maize, which filled the gap in domestic supply. However the prices of the maize commodity as price distortion remained due to corruption and government subsidies to its entities. As a result well connected people exploited the loop hole and subdued the price stabilisation. The government were however able increased expenditures on infrastructure and pro - poor programs through food subsidies.

On Fiscal side the support failed to generate the intended stimulus of 2.1 percent of GDP (cyclically adjusted) in 2009. Both nominal revenue and expenditure were below the budgeted level, reflecting a slowing economy and low implementation rates for foreign-funded projects, respectively. This coupled by prolonged drought wiped out the gains made as higher levels of imports of maize and higher fuel prices than envisaged at the time of the RAC-ESF took effect.

The Extended Credit Facility 2011 - 2014

The Extended Credit Facility covering the period January 2011– January 2014 and seeks to provide the Kenyan authorities enough fiscal space to implement key structural reforms to strengthen the external and the fiscal position of the country as well as establishing the country's credibility with international markets. The program aims at addressing Balance-of-Payments (BoP) financing needs arising from the impact on domestic demand of the government's investment plan, especially into geothermal energy; providing a reserve cushion to help address adverse external shocks; and maintaining macroeconomic stability in the implementation of the decentralization process envisaged in the new constitution. (GoK 2010)

The Fund facility is envisioned to **boost international reserves, while allowing the needed fiscal adjustment to take place in a gradual manner over a three-year horizon.** The international reserve buffer is projected to increase well above 4 months of prospective imports of goods and services. The supporting policies are aimed at preserving stability, and creating the conditions for sustainable growth. The program is broadly envisaged to:

- Protect the external position in the face of higher domestic demand and an expected terms-of-trade shock;
- Implement a gradual fiscal adjustment that protects priority spending;
- Maintain fiscal discipline in the implementation of the decentralization process envisaged in the constitution; and
- Target low inflation and maintain the floating exchange rate regime.

The program estimates total external financing needs of the country to be $1.4 billion over 2011–13 in order to facilitate foreign exchange reserves build up while preventing an abrupt adjustment in domestic demand. The IMF agreed to provide $ 508.7 million (IMF 2011)

The access is split over three years: $122.1 million was made available upon approval. Two additional disbursements of $ 81.42 million each, would be made during the year, following successful completion of the March 2011 and the June 2011 reviews.

The envisioned main risks to the program are:

- ❑ A deterioration of the political outlook in the run up to elections in 2012 and during the implementation of fiscal decentralization, which could weaken political support for the program;
- ❑ A sharper-than-anticipated deterioration of the terms of trade and further weakening of the global economy, affecting the demand for non traditional exports;
- ❑ A sudden reversal of the benign weather conditions in 2010, leading to stronger pressures on the external position; and
- ❑ Limited scope to relax fiscal policy in the event of adverse shocks given the high fiscal deficit and the gradual pace of its reduction in the baseline scenario.

Policy Objectives of the Program

A closer examination of the program reveals the following program objectives

Fiscal Policy

Policy objective: *The program is based on gradual fiscal consolidation.* The program targets a reduction in the central government primary deficit to 1.2 percent of GDP in 2013/14 (3.8 percent in 2010/11) through tax reform and strict control of current spending, aiming at lowering the debt burden to 45 percent of GDP in net terms by the end of the program period. The program's initial focus is on the central government but is envisioned to expand to encompass the general government before fiscal decentralization takes place.

The need for the to meet this policy objective has a clear implication on how it will address the current industrial strikes by the public work force as the program does not allow for real wage increase for public servants and does not envision hiring of additional workforce . The program also limits that ability of the government to be flexible in its use the primary defict to finance economic activities..

Expenditure measures and control

The program allows for the allocation of sufficient resources to implement the new constitution and has allowed the government to set aside an equivalent to 0.5 percent of GDP over the next two fiscal years for that purpose. It also provides for the government to present a final estimate after it creates the legislative commissions in charge of organizing the transition to new constitutional arrangements become fully operational.

Under the program the government should reprioritise the development expenditure including pursuing the poverty reduction objectives and millennium development goals (MDGs), in line with the Poverty Reduction Strategy Paper (PRSP). The government should protect priority social expenditure to ensure progress in achieving social objectives as elaborated in the social pillar of the Vision 2030 and Medium Term Plan. Key priorities include the consolidation of gains in school attendance, vaccination rates, and access to improved water sources. Other measures include steps to mitigate the poverty impact of food insecurity on the vulnerable, cash transfers to the vulnerable population, antiretroviral treatment expenditures, and free primary and secondary education. The program however does not address the infrastructural elements as well human resource components of the poverty reduction related expenditures. Consolidating access and the quality of these public goods and services in themselves are not sufficient to guarantee increased access and quality should human capital and their welfare not addressed.

It must be noted that while the sections of the programs have developed key performance criteria and structural benchmarks to be achieved in the structural reforms, and macroeconomic framework reforms, it is very vague and ambiguous on poverty reduction and development related targets and benchmark expenditure. It has failed to set targets and indicators for the social sector performance. It heavily relies on government policy statement which in itself lacks details on targets, and expected outcome in the document. At the same time human rights approach to development and creating enabling environment for democratic ownership of development programs seem not to the focus of the program for poverty reduction. Citizens in the program are seen to be mere recipients of short term outputs rather than as participants in consolidating long term gains arising from such expenditures. Furthermore the expenditure plans under the program stipulate the need for consolidation of gains, mitigations, and protection of expenditures around safety nets. It does not cover the need for scaling up access and improvement of quality of services.

The program targets a gradual strengthening of the international reserves buffer. The monetary program envisions an increase in the reserve coverage to over 4 month of prospective imports of goods and services by the end of the program period. The Central Bank of Kenya (CBK) is to maintain a prudent policy stance, focusing on its medium term inflation target of 5 percent and refrain from financing the government beyond short-term use of its statutory overdraft facility. This partly explains why the central bank has been reluctant to intervene as the Kenya Shilling's value falls rapidly against the major currencies as well as failing to raise the interest rates.

It is importart to note as indicated in the other section of the paper that, lower interest rates coupled with lowering of banks reserve requirement have greatly contributed to greater liquidity in the market which has had a role in increasing the inflationary pressure currently being felt by Kenyans.

Program Policy Conditionalities

The arrangement includes performance criteria and structural benchmarks in the fiscal, monetary and financial policy areas, with emphasis on public finance management reform. It contains the following conditionalities:

Fiscal measures to reduce the primary budget deficit to about 2 percent of GDP in 2012/13 *(performance criterion)* from 3.8 percent projected for 2010/11 (see table 2) – Remains a major challenge given the fiscal requirement for the implementation of the new constitution and the widening current account

Modernize VAT legislation to help improve administration and compliance *(structural benchmark) (see table 3) – On going*

Implementation of a new public finance management (PFM) legislation. In line with constitutional implementation process, a draft PFM Bill will be submitted to the Commission for the Implementation of the Constitution by December 2011 *(structural benchmark)* for consideration and submission to parliament – this has been done and currently the commission is seeking input from various stakeholders. However its contents seem to be geared towards strengthening the central government's efforts of public finance with limited cognisance of the counties.

Accelerate reforms in public financial management under a coordinated strategy to revitalize Public Finance Management Reforms, as well as facilitate adoption of a Single Treasury Account by June 2012 to strengthen cash management system and improve resource management *(structural benchmark)* – on going. However the implementation of a single treasury account is likely to negate the aspect of devolution as envisioned in the county government under the current constitution where it is envisioned that the counties will have certain elements of autonomy with regards to the county finance management including having their own accounts. The public finance management reform program will have to be aligned to the new constitutional requirement if it is remain relevant and diffuse the tension currently arising from its implementation.

Likely impact of IMF conditions and policies on provisions for decentralized public spending under the new constitution (PFM bill, the fiscal relations bill and the integrated financial management bill released by the CIC.

The constitution creates a shared governance model of government and states that national and county government are both distinct and interdependent and shall operate on the basis of cooperation and consultation.[3] This in essence denotes the autonomy of both governments and neither level is subordinate to the other, both being distinct in their constitutional functions including resource allocation and management as well as institutional arrangements.

The International Monetary Fund (IMF) in its advice to the Ministry of Finance proposed for the creation of an integrated Public Finance Management Bill and the creation of a Single Treasury Account. Both these positions found their way into the IMF Loan Agreement with the Government

1 Article 4(2) of the 2010 Constitution

of Kenya[4] as conditionalities which attract penalties if violated without a formal waiver from the IMF Board.

The IMFís perceived political interference on the implementation of the Constitution is severely detrimental to the devolution process. The Ministry of Finance and the Ministry of Local Government have differed sharply on how to regulate the management of public resources in the new dispensation. On one hand the Ministry of Finance in accordance with the IMF deal has fronted an Integrated Public Financial Management Bill, 2011 covering the two levels of government - the National and the County.

While on the other hand, the Ministry of Local Government working through the Task Force on Devolved Government has put forward two related Bills, one specific to the financial management of the county government and the other an Intergovernmental Fiscal Relations Bill whose aim is to create mechanisms for ensuring coherence between the two levels of government in relation to the management of public finance.

The Issues

a) The single Integrated Public Finance Management Bill approach seeks to weaken the devolution process and in a silent way of re-centralising and controlling economic power by the central government. This negates the principles of the Constitution[5] that creates two levels of government which are independent of each other and shall conduct their affairs in a mutual relation on the basis of consultation and co-operation for the public good and not one level dominating the other.

   This has raised contention and concern among key policy players that the said ëharmonizedí Public Finance Management law fundamentally deviates from constitutional principles and provisions, and in particular, those anchoring a devolved system of governance and transforming the tradition of public finance management to assure equity and genuine citizensí participation. It is apparent that the core recommendations made by the Task Force on Devolution have been deliberately excluded and watered down, effectively retaining centralization and excessive control by the national Treasury.

b) The creation of a single Treasury account for both national and county governments hence failing to delegate financial management powers beyond County Government will serve to recentralise power at the county level and this will deny counties their rightful share of national revenue and stifle development at the grassroots thus weakening the aims and objects of devolution as set out in the constitution.[6]

Maintain non-concessional financing including guarantees at below $700 million in the remainder of fiscal year 2010/11 and $700 million in the year 2011/12 *(performance criterion) – Remains a challenge, with the public debt stock currently above the Medium term debt sustainability strategy target.*

Protect priority social expenditures to ensure progress in achieving social objectives as elaborated in the social pillar of the Vision 2030 MTP *(indicative target). While this is a key component for ordinary Kenyans, there lacks clear targets from the Fund to measure the efficacy of its support in this sector. The protection of such expenditures is key in a country such as Kenya, being a developing country, Kenya needs to focus on how to not only deepen public expenditure in these*

4 http://www.imf.org/external/np/loi/2011/ken/011711.pdf
5 Articles 1(4) & 6(2) of the 2010 Constitution
6 Article 74 of the Constitution

sectors but also progressively expand access, and improve the quality of the outcome for such expenditures. In this regard, particularly in the short term protection of social expenditure must go hand in hand with additional resources to these sectors and also address the human capacity in this regard. For example the teacher – pupil ratio will need to be reduced as well as doctor – patient ratio if the education and health sector[7] are to register an improved outcome in terms of human development index.

Policy of not incurring external arrears *(performance criterion)* – A challenge. Court cases on "Anglo-Leasing-like contracts," allegedly corrupt and fictitious arrangements with shady foreign firms, are yet to be concluded thus are not being serviced. The government has been forced to run into arrears in terms of servicing the debt as well as the interest. At the same time the government debt sustainability levels have been surpassed given its increased activities in the domestic market to finance its budget deficit. This has the potential of greatly impacting its ability to service the debts[8].

Keep the 5 percent inflation target and maintain a floating exchange rate regime, pursue a prudent money supply growth and embark on a gradual accumulation of international reserves that will lift the import coverage to over four months of following year's imports of goods and services by the end of the program period *(performance criterion)*, consistent with the CBK statutory obligation.

This remains serious challenge with the inflation currently above 5 per cent caused by food and monetary inflation. Low interest rates coupled by reduced reserve requirement of the banks by central bank have contributed to the weakening Kenya shilling against major currencies as well as and the high prices on basic comodities.. The government has revised the monetary policy to a higher interest rate.

Table 2 Kenya: Proposed Performance Criteria
(In billions of Kenyan shillings; unless otherwise indicated)

		2011		
	2010 Projection End-Dec.	Perfor-mance Criteria End-March	Perfor-mance Criteria End-June	Perfor-mance Criteria End-Dec.
Quantitative performance criteria				
Fiscal targets				
Primary budget balance of the central government (=deficit, floor) 1/2/3/	-20.7	-55.0	-25.0	-50.0

7 The ratio of teacher to pupil in primary school stands at 1:46 while doctor to patient ratio stands at 0.14:1000. These are way below the globally set standards by UNESCO and WHO (1:600) respectively

8 The debt sustainability level in the medium term has been set at 45 per cent debt to GDP ratio

9

1/ The primary budget balance of the central government is defined as overall balance including grants, minus concessional project loans, plus interest payments

2/ For 2010, end-March 2011, and end-June 2011: cumulative flow, from October 1, 2010 (beginning of the second quarter of the 2010/2011 fiscal year).

3/ For end-December 2011: cumulative flow, from July 1, 2011 (beginning of the 2011/2012 fiscal year).

	2010 Projection End-Dec.	2011 Performance Criteria End-March	Performance Criteria End-June	Performance Criteria End-Dec.
Monetary targets 4/5/				
Stock of central bank net international reserves (floor, in millions of us$) 6/	3,505	3,450	3,480	3,695
Stock of net domestic assets of the central bank (ceiling)	-45.0	-40.0	-40.0	-25.0
Public debt targets				
Contracting or guaranteeing of medium and long-term non-concessional external debt by the central government (ceiling; millions of us$) 7/8/	450	700	700	
New central government and central government guaranteed external payment arrears (ceiling, millions of us$) 9/	0	0	0	0
Indicative targets				
Priority Social Expenditures of the Central government (floor) 10/3/	5.9	17.6	24.8	7.0

Source IMF 2010[9]

4/ For program monitoring, the daily average for the month when testing dates are due.

5/ The NIR floor will be adjusted upward (downward) by the excess (shortfall) of external budgetary support (grants and loans) and external commercial debt relative

to the programmed amounts. The NDA ceiling will be adjusted downward (upward) by the excess (shortfall) of external budgetary support (grants and loans) and external

commercial debt relative to the programmed amounts.

6/ Excludes encumbered reserves.

7/ Cumulative flow of contracted debt, from January 1, 2011.

8/ For 2011, the targets do not include the planned issue of sovereign bond that is now scheduled for 2012/13 fiscal year.

9 Continuous

10/ For 2010, end March 2011, and end-June 2011: the target is cumulative from July 1, 2010.

Table 3 Structural Benchmarks under the Extended Credit Facility Arrangement

Measure	Proposed Time Frame
Tax measures Submit VAT legislation to help improve administration and compliance. ***Macro criticality:*** *The VAT reform will allow for higher mobilization of revenue that will reduce the fiscal imbalance.*	Second Review
Expenditure control Submit PFM legislation to the Commission for the Implementation of the Constitution, to help accelerate reforms in public financial management. ***Macro criticality:*** *PFM management legislation is crucial for increasing both spending efficiency and improving fiscal management.*	Third Review
Adopt a Single Treasury Account adoption will improve both liquidity management and expenditure control. ***Macro criticality:*** *Single Treasury Account adoption will improve both liquidity management and expenditure control.*	Fourth Review
Banking supervision Amend the Banking Act to reinforce prompt corrective action by the banking supervision authority. ***Macro criticality:*** *Reinforcing the banking supervision authority is crucial to reducing the risk of macroeconomic instability.*	First Review
Capital markets Introduce legislation to allow the demutualization of the Nairobi Stock Exchange, to remove the conflict of interest from the governing body of the exchange and to strengthen capital markets. ***Macro criticality:*** *Demutualization of the Nairobi Stock Exchange is essential for the development of deeper financial markets that will enhance financial stability.*	First Review

Source IMF 2010

Key Observations from the Impact of Conditioalities

From the foregoing structural benchmark and performance criteria, it is clear that the program seeks to keep fiscal adjustment program conservative thereby limiting the expansionary expenditure envisioned in Kenya's social, economic and political reforms. The efforts to implement Vision 2030, implement the new constitution especially in the establishment of counties and the fiscal policies that will accompany them could be at risk if the IMF restrictions are adopted.

Further, the running of the counties will require additional personnel thereby having the potential of increasing the public wage bill. This will directly conflict with the requirement of the condition in the facility that calls for the freezing of hiring in the public sector. The treasury will have to move carefully in seeking to balance deficit reduction with the implementation of the decentralisation program as envisioned in the constitution in the short term.

It is also important to note that although the program recognises the need for social protection; it does not set forth the structural benchmark or performance criteria in this regard or how its measures are aligned to the vision 2030 social and economic pillar. This makes it difficult for assessment of the performance of the program in this sector. Social sector development remain an important factor in the achievement of the vision 2030, therefore protecting and expanding expenditure is not only important in translating the benefit of economic development to ordinary Kenyans but in ensuring that citizens directly and indirectly enjoy the benefits of loans contracted on their behalf. The macroeconomic framework set out in the current facility does not appear to support the goal of achieving the objectives of the social pillar. We attribute this due to the restrictiveness of the program to allow for expansionary monetary policy.

The Kenyan government is in a position to reject the advice of the fund on expenditure controls as it can support both its recurrent and development expenditure with limited support from donors. This however implies exercising discipline in public expenditure under the MTEF, sealing of leakages in public finance, increasing absorption capacity in the public sector and increasing the mobilisation domestic revenue (see tables 3 and 4 below).

Table 3 Projected Recurrent Expenditure in Ksh Millions

	2012	2013	2014
Government	416,951	443,077	476,628
AIA	75,963	79,617	84,945

Source: Treasury

Table 4 Projected Development Expenditure in Ksh Millions

	2012	2013	2014
Government	170,014	171,235	322,298
AIA	132,434	127,047	126,672

Source: Treasury

While the program is meant to shore up the national reserve, it is highly doubtful that the support given to the government is sufficient to create the required buffer for the treasury to make the fiscal adjustment and finance the physical infrastructure especially in the energy sector. We make this argument due to the following facts

- Political uncertainty continues to keep capital inflows through direct foreign investment into the country subdued. At the same time remittances are yet to reach the pre – financial crisis level. Foreign reserves coverage has remained flat despite Fund support under the ESF and the 2009 Special Drawing Rights (SDR) allocation,

- The reserve levels have been below the constitutionally acceptable level….averaging three and half level worth of imports, when the constitution requires 4 months worth of imports and the EAC customs required 6 months worth of import by 2010.

- The country has been facing negative terms of tradeToT since the signing of the credit facility. Energy prices have been rising at a much higher rate than Kenyan exports. This followed by the food insecurity prompting grain importation, the falling Kenyan shilling and the rising cost of living, which put the program into serious jeopardy.

We are therefore of the opinion that the program is likely to fail in its first quarter of implementation due to the above factors and create additional debt burden to the country without Kenyans realising its benefits through sustainable employment, and cheaper energy prices.

The box below illustrates the dilemma the country finds itself in.

Box 1. CBK Kills Cabinet Plan to Use Forex Reserves

The Central Bank of Kenya has rejected a decision by the Cabinet to use the country's foreign exchange reserves to fund five large privately owned power projects that were supposed to add 600 MW of power to the national grid by 2013. The proposal to fund the projects from the national reserves account was based on a Cabinet paper signed by Finance Minister and his Energy counterpart, dated July 5 2010.

Under the arrangement, the Central Bank of Kenya was to release $209 million to an escrow account from which funds were to be drawn by the Kenya Power and Lighting Company to issue letters of credit to the five independent power producers to serve as guarantees for future electricity payments to the IPPs by KPLC. After the Cabinet passed the paper, the Head of Public Service fired off a memo to the Ministries of Finance and Energy and the Central Bank to officially communicate the decision by the supreme policy-making body, directing that it be implemented forthwith.

But in an unprecedented display of independence, the Central Bank effectively countermanded what has been agreed by the Cabinet, reportedly informing the government that releasing $209 million from the country's reserves would put adverse pressure on the exchange rate and have grave macroeconomic consequences. The Central Bank also maintained that it had an obligation to keep national foreign reserves at a level equivalent to four months' cover, arguing that releasing the $209 million would cause reserves to fall below that threshold.

The projects whose implementation will now be delayed are Lake Turkana Wind Power (300MW), Kinangop Wind Power (100Mw) and three diesel plants, namely the Athi River-based Gulf Power (84MW), the Thika-based Menelec Power (252MW), Triumph Power (84MW) and the geothermal plant Ol Karia Power4 (54MW).

Turkana Wind was supposed to get state guarantees worth $52 million for six months' worth of electricity it would supply in advance. Kinangop Wind was to get the equivalent of three months of electricity supplies or $18 million. Ol Karia Power 4 was to get $14 million, equivalent to four months' supplies and the three diesel plants were to get six months guaranteed capacity charge and the state would buy the diesel they would burn, all for $18 million.

These are projects that were chosen on the grounds that they had short implementation lead times. They were supposed to help the country end the power rationing that has become common every year. The Treasury and the Ministry of Energy have been playing a ping-pong game on how to structure the guarantees for the IPPs for a long time.

Meanwhile, Kenya must brace for a season of electricity supply interruptions as the acute electricity supply deficits in the national grid continue to worsen. The latest signs of stress in the system were a series of loadshedding incidents in the month of October blamed by the Ministry of Energy on withdrawal of generation capacity for maintenance.

With KPLC connecting new customers at the rate of 200,000 per month, the gap between supply and demand has been expanding rapidly, with the consequence that any minor problem in the system results in loadshedding and rationing.

Source: AllAfrica.com - originally EastAFrican, no? Possible to have a date on this?

From box 1, there are indications that due to the demand on the CBK to implement the conditionalities set by the IMFís on monetary policy side of the program, policy directive including that from the cabinet seem not to influence the policy changes at the central bank. The Central Bank indeed took it upon itself to defend the policy conditionalities from the Fund. This shows to some extent the capture of the Central Bank by the IMF to the extent that the bank has failed to contextualise its policies within the current and immediate development needs of the country.

Augumentation Fund

Following from the second review of Kenyaís economic performance and high inflation challenges currently facing the country, the government of Kenya sought the Funds support to augument funds to the current exsisting credit facility with the fund. The government sought for ad got approved an augmentation of access equal to 60 percent of quota, which would lead to a total access of 180 percent of quota, an amount equivalent to SDR 488.52 million (about US$760.63 million), under the ECF arrangement.

This enabled the country to immediately receive disbursement of an amount equivalent to SDR 92.276 million (about US$143.67 million), bringing total disbursements under the ECF arrangement to an amount equivalent to SDR 200.836 million (about US$312.7 million).

The fund also approved a modification of three performance criteria for end-December 2011 and end-June 2012 related to the net international reserves, the net domestic assets of the central bank, and the primary budget balance of the central government. More specifically:

- Monetary policy will be tightened to bring down the rate of expansion of credit to the private sector to levels that can be sustained and to reduce the demand for foreign exchange.
- The floating exchange rate regime has helped the country cope with adverse shocks and will be maintained. Once the shilling stabilizes, the CBK will resume the gradual accumulation

of international reserves to reach the medium term objective of reserve coverage of four months of prospective imports.

- Fiscal policy in 2011 and 2012 will be geared towards rationalizing non - priority expenditure and reducing the demand for imports, while expanding targeted policies to shield the poor from the impact of higher prices. This will help contain the primary fiscal deficit and reduce the public debt-to-GDP ratio to below 45 percent by end 2012/13.
- Preparations for fiscal decentralization will focus on strengthening transparency and expenditure control at both central and county government levels through the adoption and implementation of new public financial management legislation.
- Financial sector reforms will aim at strengthening cross border supervision and enhancing risk management through stress testing, while deepening the sector to transform it into a regional hub for financial services.

(IMF 2011)

Other program objectives and conditionalities remain as originally signed

IMF Consultation with the local stakeholders

Consultation of key stakeholders in Kenya remains paramount, especially now with the current constitution. Consultation is not only necessary to bring about consensus on key development issues affecting the country, but also in guaranteeing democratic ownership of the plans, programs and the outcomes that arises thereof.

While the IMF claims that it consults CSOs on a weekly or monthly basis through the resident representative; and each time a mission from the Washington-based country team visits Nairobi on economic developments, macroeconomic policies, growth prospects, public financial management, and role of the IMF in Kenya, our findings show that there is no consultation with CSOs with regard to macroeconomic framework. The current credit facility and the previous one (the ESF) is not an exception.

The fund however does hold periodic briefings with the Public finance committee of the Kenyan Parliament. However the meetings with the members of parliament appear subdued and heavily dependent upon the willingness of the executive and more specifically the treasury to facilitate the meeting. Their meeting with the Fund therefore is not mandatory and not clearly defined in the constitution. This in essence limits the level of preparedness by the committee to engage with the fund on various critical issues of the macroeconomic framework.

A closer examination of the nature of the meetings reveals that the consultation or subject of discussion between the IMF Mission and the Committee depends mainly on the purpose of the Mission visit and is pre - determined by the Fund.

The Mission Team was in the country from 11th to 24th May, 2011 and a meeting between the Committee and the Mission Team took place on 18th May, 2011.

The purpose of the visit was to conduct the first review under the Extended Credit Facility arrangement whose successful completion would enable the government to draw the second disbursement under the arrangement. We however note that the reviews are in themselves stand-alone initiatives with no connection to program design, policy dialogues and oversight role of the parliament.

The IMFís effort in getting the views of other national stakeholders in designing the program for supporting the country remains weak. Key players such as the civil society organisations and parliament appear to have been eclipsed from the institutionís engagement with the government. From our analysis it is evident that a country office led process of consultation is missing with emphasis being put on the country mission reports and the governmentís letter of intent.

Recommendations

The Fund remains a crucial institution to the government of Kenya under the current program especially in assisting the country to;

- Build up a cushion of foreign exchange reserves at the level of the CBK at the constitutionally acceptable level,

- Provision of adequate allocations in the 2011/12 Budget for the implementation of the new Constitution and
- Technical assistance for the drafting of the new public financial management law that will take into account the provisions of the new Constitution.

Key areas still need attention if the program is to realise elements of development. Specifically the program should address the following;

Align the Support to long term poverty reduction efforts: While areas of of the program covering the macroeconomic and structural reforms are clear in targets, outputs and expected action from the government, the program remains weak with regard to defining the key expected interventions and expected results from such intervention within the framework of vision 2030. This will call on the program to move beyond referencing to the vision 2030 and the medium term plan (MTP) and move to specific measurable outcomes within its program. The program must move beyond securing and rationalising social expenditures to supporting additional expenditures on the social sectors especially in health and education. More attention should be given to human resource and infrastructural development as well as meeting the welfare needs and improved working conditions of the care givers. In this regard, programs that promote deeper and broader access to social services, and those that guarantee sustainable employment to Kenyan citizens ought to be key features of the program.

IMF must design measurable indicators for poverty reduction efforts of its program. This must go beyond just mentioning the MTP to structural benchmarks as well as the performance criteria. Consulting other stakeholders in assisting the fund identifies the right indicators and targeting the right sectors would be key in this regard.

Readjust the expected outcomes targets for the program; While key policy outcomes are expected from the current credit facility, all indicators show that, the program will not achieve its objectives. This is because of the subdued returns on Kenyan exports and the high energy prices contributing to the widening current account. Furthermore the importation of grains to address the emergency food insecurity, the run away inflation, the implementation of the new constitution compound the problem even further.

The program further seems to be out of touch with the current reform programs of the government under the new constitution. While the efforts of the government are towards decentralisation of PFM systems to the county level, the program is heavily loaded with centralised framework of PFM. Both the government and the fund must therefore meet to harmonise these systems with the fund aligning its support to the governmentís decentralisation efforts to the county level. The proposal towards the creation of a singular legislation to regulate public finance management at both the national and county levels of government should be supported.

At the same time fear by IMF and Treasury that county governments will lack the capacity to manage funds can be overcome if the government can offer technical assistance and other necessary support to county governments.

Explore other avenues for shoring up foreign reserves: With the current debt level having surpassed the medium term debt sustainability threshold, the government must limit additional debt burden especially from the Fund given its program conditionality levels. Government must explore other non-debt-creating avenues to boost its current and capital account. Environmentally sound foreign direct investments and Diaspora investments are among the many options the government should explore.

IMF and government should create structures and structured frameworks to engage Parliament, other organs created by the Constitution and non-state actors including CSOs: CSOs in the country seem to lack the framework and the structure for engaging the Fund and the government on important macro economic as well as social issues with regard to IMF support and policy focus. This is clearly evident in the lack of CSO involvement in program design.. CSOs need to approach the fund and the government for a direct dialogue on program design, implementation and execution. This will call for moving beyond just sending and receiving information about the Fundís program to carrying out deliberate research and advocacy on the fund and the government on macro economic issues.

Parliamentís role to be strengthened; Parliament should play a crucial role in the design and approval of the overall fiscal framework for the country. This is because of their important role in approving the annual budget. The framework used in designing the credit facility totally eclipsed them from the process thereby exposing the country to programs that lack broader national ownership. The current constitution provides for a deeper and meaningful engagement of the parliament that moves beyond debriefing. Parliament must therefore take on the new impetus from the constitution and play its rightful role. This should include but not be limited to creating enabling legal framework for their engagement as well as requirements for IMF and government to meaningfully and structurally engage with the relevant parliamentary committees on key program support before the signing of agreements. In playing this role, the Parliamentary Budget Office will have to be strengthened to build the capacity of the Senate and Members of Parliament.

Furthermore the parliament must protect the policy and fiscal space of the government. This is particularly important with regard to limiting and eventually eliminating program conditionalities that come with IMF conditionalities.

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Annex

Scope and focus of the research

The research was organized around the following key processes:

1. Gathering of primary data and information through consultation and interviews with relevant stakeholders.
2. Literature review of relevant country medium term plan, IMFís ESF program, LoI and MOU between the fund and the Kenya, and aid related reports as well as other related relevant reports on reserves.
3. Analysis and interpretation of the gathered data and information together with identification of key policy and practice gaps on the use of the countryís reserve
4. Preparation of a draft research report, key findings and recommendations at a debriefing session.
5. Final submission of a final report.

4. Methodology and Process of the Research

The methods used in the research are explained below:

4.1 Literature review

Desktop Analysis covered the key documents relevant to the research area. In addition, the research reviewed some specific sector plans, strategies and reports as was illustrate the extent of the use of stimulus package in as fas as they showed direct connection with the fundís support. The period of review will cover largely the past 3 years.

4.2 Key interviews and consultations.

Key people from across the various sectors (civil society, government, and IMF) were interviewed to provide relevant. These included:

Ministries of Finance

Department of External Resource

External Debt Department

Central Bank of Kenya.

Civil Society Representatives

Institute of Economic Affaris

Institute of Policy Analysis and Research

Fida

Parliament

Finance Committee

Parliamentary Office

A Study for

Analysis the State of Kenya's Foreign Reserves and the Impact of the $$760 Million Loan (From the IMF) to Kenya's Development