

UNIVERSITY OF NAIROBI

INSTITUTE OF DIPLOMACY AND INTERNATIONAL STUDIES

**EFFECTS OF THE INTERNATIONAL MONETARY FUND (IMF) ON KENYA'S
ECONOMY (2000-2013)**

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**A Research Project Submitted in Partial Fulfillment of the Requirements of the Degree of
Masters of Arts in International Studies of the University of Nairobi**

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DECLARATION

This thesis proposal is my original work and has not been submitted for a degree to any other University.

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DEDICATION

This thesis is dedicated to someone who inspired me to go back to school. Bishop Jefferson Nyatuka , I honor you sir for your encouragement and uplifting messages “CAP DIEM”. You are an inspiration to me and this generation. I would also like to dedicate this thesis to my dear wife Betty for putting up with my late night studies and tireless encouragement have helped me come this far.

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ABSTRACT

The effectiveness of monetary policy on economic growth in Kenya. The International Monetary Fund (IMF or the Fund) is an organization of 188 countries, working to nurture global monetary cooperation, protect financial stability, expedite international trade, stimulate high employment and viable economic growth, and moderate poverty around the world. The data collection tools for the secondary data that was cast-off were information collecting, and document investigation. This technique largely involved literature research. Data collected in this procedure comprised of; opinions, quotations and precise knowledge and background information concerning to the IMF on Kenyan economy. The study finds that economic development does not respond to fiscal policy shocks indicating that there are other factors that influence the economic growth in Kenya. The study also finds the interest rate channel followed by the credit channel to be the most operational channels in influencing economic growth.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The International Monetary Fund (IMF) or the Fund is an organization of 188 countries, working to nurture global monetary cooperation, protect financial stability, expedite international trade, stimulate high employment and viable economic growth, and moderate poverty around the world.¹ The IMF was established in New Hampshire, USA in 1944 after the Second World War at the Bretton Woods Conference, where the initiators established on a framework for international economic cooperation. In the reverberation of the Great Depression of the 1930s, countries had been trying to raise blockades for foreign trade in order to shore up their financial prudence.² This led the originators of IMF to form an international monetary system in effort to ensure exchange rate solidity and encourage its member countries to continue their trade without exchange rate constraints. The IMF closely censored all currencies of its members, and lent to countries if their value of currency fell in order help shore up their economies. Also depreciation of currencies had to be approved by the Fund. This intensive monitoring of exchange rates, principally between the industrialized countries of Western Europe and the US, has little to do with the Fund's fiscal programs as they have been during the recent years, where the emphasis area have mainly been the developing world.³

IMF as an establishment that provides emergency credits to countries that have found themselves in difficult situation , either as a result of poor pecuniary policies or through circumstances beyond their control, such as a drop in commodity prices, or an economic crisis in

¹ PC (2012) *Report of the Special Group on Targeting Ten Million Employment Opportunities per Year*, New Delhi, Planning Commission

² Maturu, B.O., K Kethi and I. Maana, (2010) "A New Keynesian Phillips Curve for Kenya", Central Bank of Kenya Working Paper Series, Working Paper

³ IMF (2005), *World Economic Outlook*, Washington D.C., International Monetary Fund.

a neighboring country. In return the country is obligated to enforce some austerity measures, usually geared towards reduction in budget deficits, through expenditure cuts or greater than before revenue (taxation), an increase in interest rates to reduce inflation, and an alteration of the exchange rate usually referred to as (devaluation).

IMF programs are much more mutual than people might think, and participation rates are gradually increasing. Based on statistics up until the year 2000, Vreeland states in his reserve that "during any given year, about one quarter of the world was under an IMF platform at some point". IMF's engagements are intended to address some precise and multiple goals. To equitably evaluate the Fund's effect in the world economy and results of their work thereof, it is important to first address the objectives of IMF, and then later look at how their work has affected the countries under the IMF programs. Various studies done by Rodrik, & Subramaniam⁴, and Mishra, Mody, and Murshid⁵, have shown different effects on how IMF engagements affect different pointers that stability of payments, inflation, poverty, income dissemination, the environment, foreign direct investments (FDI) fiscal growth and social expenditure. Some have focused their research on only one of the mentioned indicators, other have protracted their studies into macroeconomic analysis.⁶

The IMF loan services since 1977 have been expansively used by Third World and Post-Communist Countries.⁷ IMF lends to countries with a history of payments problems. This financial support is intended to help countries refurbish macroeconomic steadiness by rebuilding their international investments, steadying their currencies and reimbursing for imports and all

⁴ Rodrik, D. & Subramaniam, A., 2008, 'Why Did Financial Liberalization Disappoint?', IMF Staff Papers, International Monetary Fund, Washington, DC.

⁵ Mishra, D., Mody, A. and Murshid, A.P., 2001, 'Private Capital Flows and Growth', *Finance & Development*, International Monetary Fund, Washington, DC. Vol. 38, 2

⁶ Regional Markets." *Journal of Money, Credit, and Banking* 35 (4), 557-589.

⁷ Maturu, B.O., K Kethi and I. Maana, (2010) "A New Keynesian Phillips Curve for Kenya", Central Bank of Kenya Working Paper Series, Working Paper

indispensable conditions for growth⁸. Further, it offers concessional loans to increase income countries to help them progress their economies and decrease poverty. This are in form of emergencies, protracted arrangements, structural adjustment services and higher structural adjustment facilities, recently rechristened (Poverty Reduction and Growth Facilities)⁹.

A challenging task is to pinpoint what outcomes are due to the circumstances of the beneficiary countries (country-specific aspects such as; economic dynamics, nature of government, political enthusiasm etc., and overall world economic situations such as; level of international trade, international credit rates etc.), and what results are due to the IMF's contribution¹⁰. The Fund has been under a lot censure and has received a lot of stick from various quarters. This condemnation increased in the second half of the 1990s after numerous crisis affected different parts of the world. It is primarily the conditions the IMF attaches to its loans that led to most of the criticism. Moral vulnerability has also been a term extensively deliberated by critics, where "moral hazard is a forward-looking conception: where moral exposure exists in financial marketplaces, borrowers and lenders take hazards based on the support they expect receiving in the impending certain undesirable events occur".

1.2 Statement of the Research Problem

Institutions that govern Globalization such as the International Monetary Fund (IMF), the World Bank and the World Trade Organization (WTO) are main actors in the International Political Economy and more so Globalization. The IMF was created after World War II to assist in the reconstruction of Europe and provide mechanisms for international cooperation in managing the

⁸ Maturu, B.O., K Kethi and I. Maana, (2010) "A New Keynesian Phillips Curve for Kenya", Central Bank of Kenya Working Paper Series, Working Paper

⁹ Joicey, N. and Pickford, S. "The International Monetary Fund and Global Economic Cooperation" in Nicholas Bayne and Stephen Woolcock, *The New Economic Diplomacy: Decision-Making and Negotiation in International Relations*, (Ashgate Publishing, 2011).

¹⁰ Mishra, D., Mody, A. and Murshid, A.P., 2001, 'Private Capital Flows and Growth', *Finance & Development*, International Monetary Fund, Washington, DC. Vol. 38, 2

global financial system. However, their functions have been critiqued as some have argued that they act to advance the interests of developed countries. After all, nation states hardly act out of love but in pursuit of self-interests. Developed countries like Kenya have advanced their national interests at the expense of developing countries in Africa and specifically those in East Africa, thus making them poorer than they had been by imposing conditions before these developing countries can even benefit from the financial loans given by these global financial institutions.¹¹

State-owned resources are to be sold whether they generate a fiscal profit or not. IMF conditionalities generally require countries to devalue their currencies against the dollar, lift import and export restrictions; balance their budgets and not overspend; and remove price controls and state subsidies¹². Devaluation makes their goods cheaper for foreigners to buy and theoretically makes foreign inputs more expensive¹³. In principle it should make the country wary of buying expensive foreign equipment. In practice, however, the IMF actually disrupts this by rewarding the country with large foreign currency loan that encourages it to purchase imports. By devaluing the currency and simultaneously removing price controls, the immediate effect is generally to hike prices up three or four times, increasing poverty.

Further, balancing national budgets can be done by raising taxes, which IMF frowns upon, or by cutting Government spending, which it recommends. Conditionality had undermined democracy by making elected governments accountable to Washington based institutions instead of their own people.” The potential for unaccountability and corruption therefore increases as well.¹⁴As a result, IMF programmes resulted in deep cuts in programs like education, health and

¹¹Said Adejumobi, *Globalization and Africa’s Development Agenda: From WTO to NEPAD*, Occasional Paper, No. 12 (Addis Ababa; Development Policy Management Forum-DPMF,2003)p.2

¹² Cardoso and Helwege, *Latin America’s economy*(Cambridge, MA:MIT Press, 1992)

¹³ Shapcott R, International Ethics, in Baylis J,et al, *The Globalization of World Politics: An introduction to International Relations*,5th ed(Oxford:OUP, 2011) p.207

¹⁴ Smith A., *Wealth of Nations*, Books IV; Chapter VIII,(Everyman’s Library, Sixth Printing,1991)p.577

social care, and the removal of subsidies designed to control the prices of basics such as food and milk. So IMF programmes hurt the poor most, because they depend heavily on these services and subsidies. This threatened and continues to threaten state sovereignty, autonomy and nationhood when these international organizations impose authority over states. By encouraging foreign investments countries have benefit by finding new markets for their exports. However, for millions of people especially, those in East Africa, believe that globalization has not worked.¹⁵ It is hurting the same people it was meant to help. Many have seen their jobs destroyed and have become insecure. Democracies have been undermined and cultures eroded. Those who have been left out of this global village have continued to be a threat to state security as they have felt powerless against forces above them.

This study identifies and examines the role played by IMF Programmes in socio-economic development.¹⁶ These harsh economic measures have deepened poverty, undermined food security and self-reliance and lead to unsustainable resource exploitation, environmental destruction, and population dislocation and displacement. These according to Mwangi¹⁷ are non-military security threats to human security. These factors point out that societies in all conflict phases are fragile and in danger of igniting, sustaining or regressing to open armed conflict.¹⁸It can be inferred that it is no wonder that Africa including the Horn of Africa experience many conflicts from around the same time these IMF programmes were introduced. Peace and Security are necessary for sustainable social-economic growth and development which the IMF wanted developing Countries to achieve.

¹⁵ Stiglitz J., *Globalization and its Discontents*, op. cit p. 2

¹⁶ Ross P. Buckley, *the Rich Borrow and the Poor Repay*; The Fatal Flow in in International Finance World Policy Journal, Volume XIX, No. 4 Winter 2002/03

¹⁷ Mwangi M., *Human Security Setting the Agenda for the Horn of Africa*, (Nairobi: Africa Peace Forum,2008)p.18

¹⁸ Ibid

Following this indication it appears that the role of financial policy in influencing fiscal growth in Kenya is not clear. A few studies have been done on Kenya to investigate the efficacy of financial policy on economic growth.¹⁹ However, all these studies used quarterly data and also used data on inflation which was figured using the old methodology of arithmetic approach. In view of these shortcomings this study intends to contribute to the debate on the effect of international monetary fund on Kenya economy.

1.3 Objectives of the Study

The general objective of this study is to investigate on the effects of the international monetary fund (IMF) on Kenya's economy (2000-2013)

1.3.1 Specific Objectives

1. To examine the contribution of International Monetary Fund towards the improvement of education, agriculture, infrastructure and health sectors
2. To establish the effect of International Monetary Fund on the growth of Kenya's economy
3. To establish time taken for the full effect of International Monetary Fund's monetary policy actions on Kenya's economy.

1.4 Literature Review

1.4.2 The International Monetary Fund

The IMF was to be a supra-National body fundamentally with dual functions. It was to standardize the rates at which currencies were exchanged among affiliate countries; it would also help safeguard international firmness by making loans at times of emergencies in member

¹⁹ Regional Markets." *Journal of Money, Credit, and Banking* 35 (4), 557-589.

countries' stability of payments.²⁰ Peet has argued that though its mission statement has remains essentially the same, the IMF has experienced changes that have brought about in an overall accumulation of power and stimulus. Today the IMF is undoubtedly the single most powerful non-state establishment in the world whose policies affect the financial prudence of 184 countries.²¹ These policies sometimes often unsuccessfully affect the lives of most of the world's society.

Shah argues that liability is an effectual tool. It certifies access to other peoples 'raw materials and infrastructure on the cheapest plausible term. Many developing nations are in debt and poverty partly due to the rules of IMF and the World Bank²². Their programs have been profoundly censured for many years for resulting in abject poverty. This has led to an increase in developing countries' dependency on the richer nations. This is notwithstanding these two institutions proclaim that they will contain poverty.²³ Structural adjustment of a state by eliminating "superfluous" government controls and endorsing market competition as part of the neo-liberal programme of Globalization monitored by the Bank.²⁴ They were established in the early 1980s as a way of gaining stronger stimulus over the frugalities of debt impoverished governments. Macro-economic crunches spread across Africa and Latin America during that period, the IMF got involved in low-income countries.²⁵ To ensure constant flow of funds, East African Countries already overwhelmed by debt responsibilities particularly as a direct

²⁰ Peet R. *Unholy Trinity*, the IMF, World Bank and WTO. (Wits University Press, Zed Books 2003) p.56

²¹ *Ibid*

²² Shah A. 'Structural Adjustment-a major cause of poverty; Global Issues <http://www.globalissues.org>. Accessed on 13/07/2013.

²³ Maturu, B.O., K Kethi and I. Maana, (2010) "A New Keynesian Phillips Curve for Kenya", Central Bank of Kenya Working Paper Series, Working Paper

²⁴ Collier P. et al, 'The IMF's role in Structural Adjustment', *The Economic Journal* Vol.109 No.459 (November, 1999) pp. F634-F651:p F634

²⁵ *Ibid*

consequence of colonization had little choice but to follow to the conditions required by the IMF and World Bank.²⁶

The Enriched Structural Adjustment Facility is an IMF mechanism to support of macro-economic programmes and SAPs in low-income nations through low interest grants.²⁷ SAPs policies replicate the neo-liberal ideology that pushes globalization. They intend to achieve enduring and fast-tracked economic growth in poorer countries by streamlining the economy and decreasing government interference. SAPs policies comprises of currency deflation, accomplished steadiness of payments, reduction of government facilities through public expenditure cuts/budget deficit cuts, reducing inflation, privatization, reducing tax on high earners, lower tariffs on imports and tighter monetary policy, cuts in social spending, increased free trade, wage suppression, and business deregulation.²⁸

Governments are also reinvigorated to decrease their role in the economy by privatizing state-owned businesses and opening up their frugalities to foreign competition.²⁹ According to Hanhel, some of the structural adjustment programs include fiscal austerity measures, financial austerity, fiscal liberalization and privatization.³⁰ The IMF its own economic principles on nations that may wish to grow .IMF loans then become a point of departure at which social scuffles within a society articulate with strains between the people and the global system, with two foremost institutes-the State and the IMF at the center of argument. The IMF then draws conditions that favor reimbursement at the costs of poor and employed people.³¹ By joining the

²⁶ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

²⁷ Collier P. et al, 'The IMF's role in Structural Adjustment', *The Economic Journal* Vol.109 No.459 (November, 1999) pp. F634-F651:p F634

²⁸ Collier P. et al, 'The IMF's role in Structural Adjustment', *The Economic Journal* Vol.109 No.459 (November, 1999) pp. F634-F651:p F634

²⁹ <http://www.who.int/trade/glossary/story084/en/> accessed on 22/06/2013

³⁰ Hanhel R., *Panic Rules!*(Sound End Press, 1999)p.52

³¹ Collier P. et al, 'The IMF's role in Structural Adjustment', *The Economic Journal* Vol.109 No.459 (November, 1999) pp. F634-F651:p F634

IMF, some less industrialized countries capitulated. Some of their sovereign fiscal privileges particularly over how to fix their exchange rates, in return for cooperative conditions of exchange solidity, orderly exchange measures, the circumvention of competitive exchange devaluation, and a liberal administration of international disbursements were radically changed.³² According to Payer undeveloped Countries joined the IMF in the 1960s. In the late 1960s and 1970s, the IMF asserted in the implementation of ‘equilibrium programs’ as a requisite for emergency and other financial arrangements. These comprised of programs like elimination or liberalization of foreign exchange and import controls, exchange rates depreciation and superior hospitality for foreign private investments.³³

Under the pretext of alleviating the balance of payments condition in a country, the IMF engaged in the ‘fiscal programming’ of an applicant nation’s fiscal and other monetary policies under the universal term ‘conditionality’ and retaining its powers of Article IV surveillance. In return to exhausting the IMF’s general capitals and emergency arrangements, members were invited to implement corrective measures in accord with funds Policies. The IMF then presented adjustment programs with members, including remedial measures that would permit the fund to support a standby agreement. According to Peet, in the late 1970s, the IMF presumed greater powers of mechanism over longer term fiscal policies through structural adjustment programs.³⁴

1.5 Theoretical Framework

The world has seen a remarkable increase in the global connections and foreign trade in contemporary years. The reason for this is that more nations are getting involved in exchange

³² De Vries, M.F., *The IMF in a Changing World 1945-85*. (Washington: DC IMF, 1986) p.15

³³ Payer C. *The Debt Trap: The International Monetary Fund and the World Bank*, (New York: Monthly Review Press, 1974) p.33

³⁴ Collier P. et al, ‘The IMF’s role in Structural Adjustment’, *The Economic Journal* Vol.109 No.459 (November, 1999) pp. F634-F651; p F634

with each other in order to increase their profit or transactions or shielding them from being worn by competition³⁵. Structural Adjustment Programs stereotypically include a lot of unrelated doctrines which interrelate with each other. It is most likely that the countries in which SAPs are executed diverge in terms of their frugalities and pre-program circumstances from non-program states but also from each other. Therefore, it is not easy to separate the influences of SAPs on insufficiency, which are universally complex and not clear-cut.³⁶

Guidelines which might impact poverty and income dissemination include currency devaluing, decreases in the budget shortfall and variations in growth rates, deflation rates and interest rates. Some contend that fiscal growth of a country has an uninterrupted influence on deficiency as gains attained via growth would filter down and profit the poor leading to a decrease in poverty. However most agree that neither macroeconomic steadiness nor economic development is enough for lessening poverty³⁷. Although sophisticated growth rates are on average conveyed by greater progress in poverty mitigation - as certain monetary means are required to battle poverty which can only be achieved via development - this does not show that trickle down policies are the best approaches to combat poverty. It is vital to take distributional effects into interpretation as well. Therefore, the upright politico-economic plans are needed³⁸. The following segment should give a common overview of speculative expectations of these restructurings on poverty.

A main objective of Structural Adjustment Programs is a reduction of inflation. It is generally agreed that extraordinary levels of inflation have negative effects on development and

³⁵ George, Ritzer.2007. *The Blackwell Encyclopedia of sociology*. Volume II C. Blackwell Publishing Ltd.

³⁶ Maturu, B.O., K Kethi and I. Maana, (2010) "A New Keynesian Phillips Curve for Kenya", Central Bank of Kenya Working Paper Series, Working Paper

³⁷ Gunter, B. G., Cohen, M. J., and Lofgren, H. (2005): Analyzing Macro- Poverty Linkages: An Overview. *Development Policy Review*, pp. 243-265.

³⁸ Stiglitz, J. (2002): *Globalization and Its Discontents*. New York: W.W.Norton & Company.

poverty. Some studies though find that countries which attain and uphold macroeconomic steadiness might not essentially gain significant pay-offs in growth and poverty reduction³⁹. Lower inflation is likely to improve the real incomes of the poor if the adjustment of incomes to a rise in disbursements due to inflation is slow.⁴⁰ The effect of lower inflation rates on income circulation depends on the rigidities of revenue to prices of each assemblage of individuals. That means that if subordinate entities face elongated adjustment lags than wealthier people, lesser inflation will reduce disparity in income circulation. Easterly and Fisher report that inflation escalates poverty as the more wealthy have a better access to inflation-protected assets or other financial instruments that hedge in some way against inflation⁴¹.

In theory though, the consequence of currency devaluation is a reduction in the value ratio of non-tradable to tradable goods⁴². This might be good for lessening poverty and progress income distribution within a state if the deprived are rural farmers producing goods for export as their proceeds are increased but it might deteriorate income circulation if the poor are urban consumers who are fronting higher food prices or rural farmers producing for domestic feeding. Reduction may deteriorate income dissemination as well if elite groups engross in investment flight prior to the devaluation⁴³.

Fiscal Policy is a vital component of IMF programs, which aim to reduce the budget discrepancy. This can be realized through greater levels of taxation and/or diminutions of public expenditure. Of course the re-distributional effects of such a programme depend on the

³⁹ Gunter, B. G., Cohen, M. J., and Lofgren, H. (2005): Analyzing Macro- Poverty Linkages: An Overview. *Development Policy Review*, pp. 243-265.

⁴⁰ Maturu, B.O., K Kethi and I. Maana, (2010) "A New Keynesian Phillips Curve for Kenya", Central Bank of Kenya Working Paper Series, Working Paper

⁴¹ Easterly, W. (1999): The Effect of International Monetary Fund and World Bank Programs on Poverty. *World Bank Policy Research Working Paper No. 2517*.

⁴² Gunter, B. G., Cohen, M. J., and Lofgren, H. (2005): Analyzing Macro- Poverty Linkages: An Overview. *Development Policy Review*, pp. 243-265.

⁴³ Pastor, M. (1987): The International Monetary Fund and Latin America: Economic stabilization and Class Conflict. *London: Boulder: Westview Press*.

arrangement of the budget cuts of the administration, but are also prejudiced by producer flexibility and the malleability of consumer configurations. Real expenditure reduction is normally achieved through reduction in social disbursement, public sector retrenchment and privatization⁴⁴. A study conducted by Johnson and Salop states that a descending adjustment of government expenditure to GDP is very possible to be borne out by public sector personnel betrothed in capital-intensive projects which come to be deferred⁴⁵. Disbursement cuts in public sector employment which lead to an at least provisional increase in redundancy and lower wages and salaries of people employed in the public sector, will tend to intensify poverty and worsen income distribution, particularly when those declines hit low-level government employees.⁴⁶ How these dogmas affect prices of consumption goods is vague⁴⁷. Changes in values might affect real incomes of the poor in either way, independent of their minimal incomes and therefore increase in poverty. Access to domestic credit affects deficiency and income dissemination as well. Bigger interest rates or bank reserve necessities as well as obligatory credit ceilings will reduce admission to domestic acknowledgement and will make it easier for large companies to get recognitions in contrast to small and medium-sized firms⁴⁸. Generally the urban sector is preferred over the rural sector. Fiscal cuts or higher levels of tax policy, as well as decreases in real wages and credit limitations, are very likely to lessen domestic demand. This leads to a decrease of general spending. Heller states that such a reduction of spending is almost certain to lessen the well-being of both labor and the lowliest members of an economy. If demand curb in

⁴⁴ Gunter, B. G., Cohen, M. J., Lofgren, H. Analyzing Macro- Poverty Linkages: An Overview. *Development Policy Review*, pp. 243-265. (2005):

⁴⁵ Johnson, O., & Salop, J. (1980): Distributional aspects of stabilization programs in developing countries. *IMF Staff Papers*, 27.

⁴⁶ PC (2012) *Report of the Special Group on Targeting Ten Million Employment Opportunities per Year*, New Delhi, Planning Commission

⁴⁷ Gunter, B. G., Cohen, M. J., and Lofgren, H. (2005): Analyzing Macro-Poverty Linkages: An Overview. *Development Policy Review*, pp. 243-265.

⁴⁸ Garuda, G. (2000): The Distributional Effects of IMF Programs: A Cross-Country Analysis. *World Development* Vol. 28, No 6, pp. 1021-1051.

countries which contribute in Fund programs is greater than it would have been otherwise, it is most likely for poverty levels to increase. If the contribution in IMF programs were to have a positive effect on the overall growth, poverty proportions would get lower due to job formation. To assess the effects of job growth, it is essential to know the configuration of growth and the segments of the economy in which poverty is critical. Therefore, agricultural development may lead to decreases in poverty if rural poverty is extensive⁴⁹. Gunter, Cohen and Lofgren state that in overall poor people suffer more from policy vicissitudes and shockwaves than the rich and therefore need to be safeguarded from the effects of contractionary economic policies.

IMF programs advocate trade liberalization most of the times. Trade liberalization is likely to have two conflicting effects on poverty. First, sectors which were safeguarded before the liberalization will reduce and lead to lower earnings in these areas. Apart from that nevertheless, trade liberalization might detriment labor-intensive zones and finally result in higher earnings or lesser unemployment⁵⁰. Gunter, Cohen and Lofgren survey the recent empirical literature about the effects of trade liberalization on insufficiency and poverty⁵¹. According to them, most of the studies demonstrate that trade liberalization has had - or could have had - a positive influence on poverty decrease but led to a greater inequality. They also mention that, dependent on production, trade and consumption dynamics, some deprived people are positively and some negatively affected by trade liberalization. It depends on the type of arrangement if trade liberalization aids developing countries or not.

The effects of labor market reform are equivocal as well. Constraints tend to improve the

⁴⁹ Garuda, G. (2000): The Distributional Effects of IMF Programs: A Cross-Country Analysis. *World Development* Vol. 28, No 6, pp. 1021-1051.

⁵⁰ Handa, S., King, D. (1997): Structural adjustment policies, income distribution and poverty: A review of the Jamaican experience. *World Development* Volume 25, pp. 915-930.

⁵¹ Garuda, G. (2000): The Distributional Effects of IMF Programs: A Cross-Country Analysis. *World Development* Vol. 28, No 6, pp. 1021-1051.

condition of the employed to the disadvantage of the unemployed⁵². Fiscal liberalization is a collective tool used by the IMF to strengthen changes in the national capital markets of third world countries. It can be shown that there is a strong connection between monetary liberalization, faintness in the national banking sector and money crisis⁵³. It is generally agreed that monetary liberalization needs to be escorted by sound fiscal policies and legal and regulatory foundations to progress economic enactment, since they would have strongly undesirable effects on some deprived groups otherwise⁵⁴.

Structural Adjustment Programs can be accomplished successfully in many different ways which suggest different significances on poverty and income delivery. Political influence plays an important part in determining the way of attaining a program. Consequently, it is most probable that IMF programs are applied in such a way that damages politically powerful groups least, habitually at the expense of the poor⁵⁵.

1.5.1 Modernization theory

Modernization theory recognizes the conditions that have specified rise to development in the first world, and stipulate where and why these were wanting in the third world⁵⁶. Kenwood and Lougheed defined modernization as "a process those revivals the economic and political competences of a society: it upsurges economic capabilities through industrial development, and administrative capabilities through bureaucratization"

⁵² Handa, S., King, D. (1997): Structural adjustment policies, income distribution and poverty: A review of the Jamaican experience. *World Development* Volume 25, pp. 915-930.

⁵³ Bird, G., Rajan, R. S.: Banks, Financial Liberalization and Financial Crises in Emerging Markets *The World Economy*, pp. 889-910 (2001)

⁵⁴ Kenwood, A. G & Lougheed, A.L., *The growth of the international economy 1820-2000* (London: Routledge, 1996)

⁵⁵ Vreeland, J. R. The Effect of IMF Programs on Labor. *World Development* Vol. 30, pp. 121-139. (2002):

⁵⁶ Kenwood, A. G & Lougheed, A.L., *The growth of the international economy 1820-2000* (London: Routledge, 1996)

Modernization theorists contended that changes must take place in poor nations in order to breakdown the vicious cycle of poverty and low production⁵⁷. Clearly, modernization theorists thought that development prerequisites Westernizing elites, or some kind of tutelage in capitalist standards. Hence, lithe West could help catalyse up the process of growth in the third world, for instance by distribution its capital and know-how, to bring these nations into the modern age of capitalism and liberal democracy". From this standpoint, poor African countries could only hook up with the developed countries by participating into the global capitalist system⁵⁸.

Nevertheless, modernization theory presumes that development is a universal process, which will allow the same results of affluence across all states and societies. Such norms are highly Eurocentric as the aim of the theory is to mimic the development in Europe and North America, labelling them as models for success. Upon these disapprovals, world-systems theory was recommended by Immanuel Wallerstein as an alternate explanation to modernization theory⁵⁹. In his own words, Wallerstein stated that he intended at achieving "a clear conceptual interruption with theories of modernization and thus provide a new theoretical pattern to guide our investigations of the advent and development of industrialism, capitalism and national states⁶⁰. Wallerstein maintains that the growth of capitalism in the world have been reconstructed under neoliberalism which still reproduce under new circumstances, and in new forms, the new disparities built in its structuring of the world.

⁵⁷ Wallerstein, Immanuel. *The Essential Wallerstein*. New York: The New York Press. (2000).

⁵⁸ Watlerstein, Immanuel. (1974). *The Modem Working-System: Capitalist Agriculture and the Origins of the European World-Economy in the sixteenth Century*. New York: Academic Press.

⁵⁹ Wallerstein, Immanuel. (2000). *The Essential Wallerstein*. New York: The New York Press.

⁶⁰ Wallerstein, Immanuel. (2000). *The Essential Wallerstein*. New York: The New York Press.

1.5.2 Dependency theory

A second viewpoint proceeding debt and growth centers on world organizations is dependency theory. According to this scheme, poverty can't be fully unstated without taking into account the connections between dominant "essential" or "epicenter" developed countries and the subordinate "marginal" developing countries. The term 'dependence' denotes to one economy being profound and subject to the guidelines of another. For example, in an article titled "The Structure of Dependence," Theotonio Dos Santos inscribes: "we can comprehend what is happening in the less developed countries only when we see that they progress within the framework of a process of dependent production⁶¹." People who approach modification in this angle would see a need for altering the relations between countries, rather than concentrating on adjusting the economic guidelines within a debtor country.

Condemnations of the IMF SAPs are based in a diversity of conceptual approaches, stretching from world systems and growth theory to political ecosystem and social equity. The World Bank's assertions of the achievements of adjustment have been endangered to fierce scrutiny by the United Nations Children's Fund (UNICEF) and the United Nations Economic Commission for Africa (ECA) among others⁶². In particular, ECA's evaluation of SAPs "cast doubt on the perception of several of the major SAP policy mechanisms". The ECA claims that the "discrimination and contradiction" of World Bank studies lead to distorted conclusions⁶³.

Another critique originates from a study probing the outcomes of ESAF programs in sub-Saharan Africa. The authors found that emerging economies participating in ESAF not only experienced lower fiscal growth than those not participating, but that neither IMF-

⁶¹ Dos Santos, Theotonio. 1970. "The Structure of Dependence." *American Economic Review* 60(231).

⁶² David Brown (eds.). 1998. *The Struggle for Accountability: The World Bank, NGOs, and Grassroots Movements*. Cambridge, Massachusetts: MIT Press.

⁶³ Reed, David (ed). 1996. *Structural Adjustment, the Environment, and Sustainable Development*. London: Earthscan Publications.

obligated macroeconomic policies nor the Highly Indebted Poor Countries (HIPC) Inventiveness have “adequately reduced these nations’ debt burdens”⁶⁴. Dependency theory is the theory that will be used throughout this research to explain effect of IMF on Kenya economy.

1.6 Justification of the Study

This study will help in providing literature in theory and practice on the context of effects of the international monetary fund (IMF) on Kenya’s economy. The study pursues to put into perspective the role of monetary policy on fiscal growth in Kenya bearing in mind the measures for and against it while trying to clearly outline its main objective.

This study therefore will be important in highlighting the phenomena and add more knowledge useful to policy makers which will assist them in dealing with effects of the international monetary fund (IMF) on Kenya’s economy to make informed policy decision. This study will also assist policy makers to know the implications of general policy which are not country specific and therefore be able to modify imported policies to suit their country.

1.7 Study Hypotheses

1. International Monetary Fund influences the development of education, agriculture, infrastructure and health in Kenya
2. International Monetary Fund in form of grants and loans has contributed to the growth of Kenya’s economy
3. International Monetary Fund influences growth and development in African countries

⁶⁴ Naiman, Robert and Neil Watkins. April 1999. *A Survey of the Impacts of IMF Structural Adjustment in Africa: Growth, Social Spending, and Debt Relief*. Center for Economic and Policy Research.

1.8 Research Methodology

The research design that was used for this study was the explanatory design. This involved description of effects and foundations of the independent and dependent variables related with the problem. The study depends on secondary from data books, journals and academic papers.

The data collection tools for the secondary data that was cast-off were information collecting, and document investigation. This technique largely involved literature research. Data collected in this procedure comprised of; opinions, quotations and precise knowledge and background information concerning to the IMF on Kenyan economy.⁶⁵ This method is ideal because it allows for prudent contrast of the research findings.⁶⁶ The qualitative design chosen for this research is natural autopsy. Research clarifies and arises empirically from the data and is more receptive to circumstantial values rather than researcher values⁶⁷.

Data collected was both qualitative and quantitative.⁶⁸ content and descriptive methods were chosen because the data collected therefore require analytical indulgent. When human coders are used in content analysis, reliability explains to the amount of correspondence or arrangement among two or more coders.⁶⁹ Reliability in content analysis was guaranteed by analyzing the amount of correspondence or agreement among the key informants. The secondary data were collected from electronic periodicals, book, articles and periodic reviews.

The statistics was scrutinized by making connections to the prevailing, and integrating it with significant concepts and theoretical framework. Data was organized categorized and analyzed into patterns that produce the explanation of the phenomena or a description of the

⁶⁵ Jorgenson, Dale and Khuong Vu (2013) "Information Technology and the World Economy," *Scandinavian Journal of Economics* 107 (4), forthcoming.

⁶⁶ D. R. Cooper and P. S. Schindler, *Research Methods* (7th ed. New York: Irwin/McGraw-Hill, 2000) p 112

⁶⁷ Jankowicz A. D., *Research Projects* (6th ed. London: Thomson Learning, 2002) p 87

⁶⁸ Holsti, O.R., "*Content Analysis for the Social Sciences and Humanities*", (MA: Addison-Wesley 1980) pp, 7

⁶⁹ Neuendorf, K. A., "*The Content Analysis Guidebook Thousand Oaks*", (CA: Sage Publications, 2002) pp. 56

synthesis.⁷⁰ As a result, there could be dissimilar meanings to the same phenomena because the denotation will depend on the context. Since it is a qualitative investigation the hypothesis was produced after the data is collected. This involved analyzing and evaluating the data to define the adequacy of its information and its usefulness, credibility, validation and consistency of the hypothesis. This was the final step that involved giving a vivid descriptive justification of the situation under study. It will give a systematic view citing the implication and suggestions of the findings.⁷¹

1.9 Chapters Summary

The study comprises of five chapters. It begins with the introduction to the study. The introduction is generally on the background of IMF policies and its effect in East Africa, with special attention on Kenya. The statement of the research problem, objectives of the study, literature review, the hypotheses to be tested, the theoretical framework and the methodology to be applied and the chapter outline of the study.

Chapter two provides a discussion of the issues presented in chapter one. It critically deliberates issues of Globalization and the impact of IMF and World Bank Structural Adjustment Policies generally and the debates surrounding the developed and developing countries.

Chapters three discusses impact of international monetary fund and the World Bank organizational adjustment programs in developing countries. . The chapter looks at the impact of IMF/World Bank Structural Adjustment Policies in developing countries. Of interest to look at will be the education, health and agricultural sectors.

⁷⁰ GoK, 2005, *Draft National Policy on Peace Building and Conflict Management*, National Steering Committee (NSC), Nairobi.

⁷¹ Burrow, E. Gichohi H & M. Infield, 2001, *Rhetoric or Reality; a review of Community Conservation Policy and Practice in East Africa*, Nairobi.

Chapter four is a critical analysis of the emerging issues on international monetary fund (IMF) and the World Bank structural adjustment programmes in Kenya

Chapter five is the conclusion that summarizes the study, the findings, recommendations and suggested direction for further research.

CHAPTER TWO

ROLE OF INTERNATIONAL MONETARY FUND ON DEVELOPED ECONOMIES

2.1 Introduction

Most developing countries are so dependent on aid that without it almost half of their yearly budgetary commitments cannot be satisfied. Under the age-old saying that “you cannot bite the fingers that feed you,” these countries leaders are incapable to speak out when fake and unwanted goods flood their markets. To a large extent, development in Africa is dependent on “African political reformer, African private sector entrepreneurs, African civic activists and not on what bureaucratic, ineffective, unaccountable and poorly informed and aggravated outsiders do”⁷². moreover, there is steady debt servicing where recipients regularly report to donors and try to keep things “normal”⁷³, thus neglecting domestic issues and development.

2.2 Globalization of IMF and World Bank Structural Adjustment Policies in Theory

Globalization refers to global alliance and reliance in the matters of trade, culture and economy. It heavily banks upon worldwide expansion and integration. In most basic terms, the globalization of the world economy is the integration of economies throughout the world through trade, financial flows, the exchange of technology and information, and the movement of people⁷⁴. The extent of the trend toward integration is clearly reflected in the rising importance of world trade and capital flows in the world economy. An increasingly large share of world GDP is generated in activities linked directly or indirectly to international trade. And there has been a phenomenal growth in cross-border financial flows, particularly in the form of private equity and portfolio investment, compared with the past. In addition, the revolution in communication and transportation technology and the much improved availability of information

⁷²Easterly (2005)

⁷³Kanbur (2000) there is constant debt servicing where recipients routinely report to donors, service donor consultants and try to keep things “normal

⁷⁴ Rifkin, Jeremy. *The End of Work: the decline of the global labor force and the dawn of the post-market era*. New York : G. P. Putnam's Sons, 1994

have allowed individuals and firms to base their economic choices more on the quality of the economic environment in different countries. As a result, economic success in today's world is less a question of relative resource endowments or geographical location than it used to be in the past. Now, it is more a question of the market perception of the orientation and predictability of economic policy⁷⁵.

Lester Brown author of the periodical could food shortages bring down civilization, writes, "Water shortages, soil losses and rising temperatures from global warming are placing severe limits on food production"⁷⁶. A lack of food causes secondary issues, especially in high poverty areas⁷⁷. These issues include a rise in terrorism, the sale and consumption of illegal drugs, and weapons, which are all detrimental to national and international security. People were also forced to migrate under harsh and unsanitary conditions, and they inadvertently spread disease in other nations. At times citizens in LDCs have had to take matters into their own hands in order to survive the detestation caused by policies implemented by the IMF and the World Bank⁷⁸.

Due to amazing innovation and rapid advancement in the field of information technology, the world has literally shrunk into a village today. Globalization has virtually swept away the political boundaries. The IMF's quota system was created to raise funds for loans. Each IMF member country is assigned a quota, or contribution, that reflects the country's relative size in the global economy. Each member's quota also determines its relative voting power. Thus, financial contributions from member governments are linked to voting power in the organization.

⁷⁵ Bordo, M. D. "The Bretton Woods International Monetary System: A Historical Overview", in *A Retrospective on the Bretton Woods System*, edited by M. D. Bordo and B. Eichengreen. London:1993;

⁷⁶ Brown, L. R. Could Food Shortages Bring Down Civilization? *Scientific American*, 300(5), 50-57 2009).. Retrieved from EBSCOhost.

⁷⁷ Colgan, A.L, *Hazardous to Health*, The World Bank and IMF in Africa, (Africa Action, April 18, 2002)

⁷⁸ Mohan, Giles et al.. *Structural Adjustment Theory, Practice and Impacts*. New York, NewYork: Routledge. 2000

This system follows the logic of a shareholder-controlled organization: wealthy countries have more say in the making and revision of rules. Since decision making at the IMF reflects each member's relative economic position in the world, wealthier countries that provide more money to the fund have more influence in the IMF than poorer members that contribute less; nonetheless, the IMF focuses on redistribution⁷⁹.

The IMF's membership is divided along income lines: certain countries provide the financial resources while others use these resources. Both developed country "creditors" and developing country "borrowers" are members of the IMF. The developed countries provide the financial resources but rarely enter into IMF loan agreements; they are the creditors. Conversely, the developing countries use the lending services but contribute little to the pool of money available to lend because their quotas are smaller; they are the borrowers⁸⁰. Thus, tension is created around governance issues because these two groups, creditors and borrowers, have fundamentally different interests in terms of the conditions of these loans.

The criticism is that the system of voting power distribution through a quota system institutionalizes borrower subordination and creditor dominance. The resulting division of the Fund's membership into borrowers and non-borrowers has increased the controversy around conditionality because the borrowing members are interested in making loan access easier while the creditor members want to maintain reassurance that the loans will be repaid⁸¹.

Globalization encompasses three institutions: global financial markets and transnational companies, national governments linked to each other in economic and military alliances led by

⁷⁹ Diamond, Jared. *Third Chimpanzee: the evolution and future of the human animal*. New York: HarperCollins, 1992. Human evolution, social evolution, Man in nature.

⁸⁰ Mukherjee, Bumba (2008). "International Economic Organizations and Economic Development". *SAIS Review of International Affairs* **28** (2): 123–137.

⁸¹ Burrows, William E., and Windram, Robert. *Critical Mass: The Dangerous Race for Superweapons in a Fragmenting World*. New York: Simon&Schuster, 1994.

the US, and rising “global governments” such as World Trade Organization (WTO), IMF, and World Bank⁸². Charles Derber argues in his book *People before Profit*, "These interacting institutions create a new global power system where sovereignty is globalized, taking power and constitutional authority away from nations and giving it to global markets and international bodies." ⁸³Titus Alexander argues that this system institutionalizes global inequality between western countries and the Majority World in a form of global apartheid, in which the IMF is a key pillar.

The establishment of globalized economic institutions has been both a symptom of and a stimulus for globalization. The development of the World Bank, the IMF regional development banks such as the European Bank for Reconstruction and Development (EBRD), and, more recently, multilateral trade institutions such as the WTO indicates the trend away from the dominance of the state as the exclusive unit of analysis in international affairs. Globalization has thus been transformative in terms of a conceptualizing of state sovereignty

Globalization has become a major topic of discussion and concern in economic circles since the mid-1990s. It is clear that the trend toward more integrated world markets has opened a wide potential for greater growth, and presents an unparalleled opportunity for developing countries to raise their living standards. At the same time, however, the Mexican crisis has focussed attention on the downside risks of this trend, and concerns have arisen about the risks of marginalization of countries. All of this has given rise to a sense of misgiving, particularly among developing countries⁸⁴.

⁸² Mukherjee, Bumba (2008). "International Economic Organizations and Economic Development". *SAIS Review of International Affairs* **28** (2): 123–137.

⁸³ Derber, Charles (2002). *People Before Profit*. New York: Picador.

⁸⁴ Mukherjee, Bumba (2008). "International Economic Organizations and Economic Development". *SAIS Review of International Affairs* **28** (2): 123–137.

Globalization is first and foremost a result of the expansion, diversification and deepening of trade and financial links between countries, especially over the last ten years. This reflects above all the success of multilateral tariff reduction and trade liberalization efforts⁸⁵. The Fund has played a key role in encouraging current account convertibility as a basis for the expansion of world trade, and more than two-thirds of the Fund's member countries have committed themselves to this principle by accepting the obligations⁸⁶. Also, economic thought itself has evolved over time, toward the general acceptance of the fact that outward-oriented and open economies are more successful than closed, inward-looking ones. Consequently, more than at any time previously, individual countries in all parts of the world are liberalizing their exchange and trade regimes in the conviction that this is indeed the best approach for growth and development⁸⁷. Moreover, there is a deeper commitment of national authorities throughout the world to sound macroeconomic policies, and to creating a more stable environment for investment and the expansion of economic activity. Finally, with the increasing liberalization of financial markets, and their growing sophistication, capital markets have become integrated, and capital flows are now largely driven primarily by considerations of risk and return⁸⁸.

The benefits of these developments are easily recognizable--increasing trade has given consumers and producers a wider choice of low-cost goods, often incorporating more advanced technologies, and facilitated a more efficient use of global resources. Greater access to world markets has allowed countries to exploit their comparative advantages more intensively, while opening their economies to the benefits of increased international competition. The rapid

⁸⁵ Alexander, Titus (1996). *Unravelling Global Apartheid: an overview of world politics*. Polity press. pp. 127–133.

⁸⁶ Burrows, William E., and Windram, Robert. *Critical Mass: The Dangerous Race for Superweapons in a Fragmenting World*. New York: Simon&Schuster, 1994.

⁸⁷ Held, David, McGrew, Anthony, Goldblatt, David, and Perraton, Jonathan, 1999, *Global Transformations: Politics, Economics and Culture*, Stanford: Stanford University Press.

⁸⁸ Kymlicka, Will, 1999, "Citizenship in an Era of Globalization: A Response to Held," in Ian Shapiro and Casiano Hacker-Cordon (eds.), *Democracy's Edges*, Cambridge: Cambridge University Press.

increase in capital and private investment flows has raised the resources available to countries able to attract them, and accelerated the pace of their development beyond what they could otherwise have achieved⁸⁹.

Moreover, greater openness and participation in competitive international trade have increased employment, primarily of skilled labour, in tradable goods sectors. With the expansion of these sectors, unskilled labour has found increased employment opportunities in the non-tradable sectors, such as construction and transportation. The expansion of merchandise trade may also have reduced by pressures occasioned by migration of population.⁹⁰ On the other hand, the movement of labour across national boundaries has in many cases lessened production bottlenecks, raising the supply response of recipient economies, and increasing income in the supplying countries through worker remittances. Openness to foreign expertise and management techniques has also greatly improved production efficiency in many developing countries.

But there are also risks to globalization. The ability of investment capital to seek out the most efficient markets, and for producers and consumers to access the most competitive source, exposes and intensifies existing structural weaknesses in individual economies. Also, with the speedy flow of information, the margin of maneuver for domestic policy is much reduced, and policy mistakes are quickly punished⁹¹. Indeed, increased capital mobility carries the risk of destabilizing flows and heightened exchange rate volatility, in cases where domestic

⁸⁹ Scholte, Jan Aart, 1996, "Beyond the Buzzword: Towards a Critical Theory of Globalization," in Eleonore Kofman and Gillians Young (eds.), *Globalization: Theory and Practice*, London: Pinter.

⁹⁰ Pogge, Thomas, 2002, *World Poverty and Human Rights: Cosmopolitan Responsibilities and Reforms*, Cambridge: Polity Press.

⁹¹ Held, David, McGrew, Anthony, Goldblatt, David, and Perraton, Jonathan, 1999, *Global Transformations: Politics, Economics and Culture*, Stanford: Stanford University Press.

macroeconomic policies are inappropriate. And finally, it is clear that countries that fail to participate in this trend toward integration run the risk of being left behind⁹².

Success in open markets, and in attracting new investment and advanced technology, also means that the structure of economies is changing more rapidly than ever before. As with any structural change, there will be some segments of society that are at a disadvantage in the short term, even while other segments, and the economy as a whole, are benefiting. This does not mean, however, that countries should seek to isolate themselves from globalization. Rather, governments must fully embrace globalization in awareness of its potential risks, and seek to provide adequate protection for the vulnerable segments of society during the process of change. While globalization raises the rewards of good policy, it also accentuates the costs of poor policy. Credibility of economic policy, once lost, has become more difficult to regain. What is now critical is the perception of markets that economic policy formulation and implementation is consistent and predictable⁹³. This underscores the importance of flexible and well-informed policy-making, of solid, well-governed institutions, and of transparency in governance. Countries with a poor or inconsistent policy record will inevitably find themselves passed by, both from expanding trade and from private capital flows for development. These are the countries that run the risk of marginalization.

2.2.1 Challenges of Globalization

Globalization will continue to reinforce the interdependencies between different countries and regions. It can also deepen the partnership between the advanced countries and the rest of the world. And to support this partnership in a mutually beneficial way, the advanced countries could help to further open their markets to the products and services in which the developing

⁹² Pogge, Thomas, 2002, *World Poverty and Human Rights: Cosmopolitan Responsibilities and Reforms*, Cambridge: Polity Press.

⁹³ Zolo, Danilo, 1997, *Cosmopolis: Prospects for World Government*, Cambridge: Polity Press.

world has a comparative advantage. In addition, the reform efforts of the African countries will need to continue to be supported by adequate financing on concessional terms⁹⁴.

The challenge facing the developing world, and African countries in particular, is to design public policies so as to maximize the potential benefits from globalization, and to minimize the downside risks of destabilization and/or marginalization. None of these policies is new, and most African countries have been implementing them for some time⁹⁵. In particular, sub-Saharan Africa has made substantial progress toward macroeconomic stability:

There has been continued improvement in overall growth performance. Average real growth has increased from less than 1 percent in 1992 to over 5 1/2 percent in 1996, and this positive trend is expected to continue; There has been some success in bringing down inflation-- many countries have already achieved single digit inflation rates, and for the region as a whole, average inflation is expected to fall from the peak of 60 percent in 1994 to 17 percent in 1997; Countries have also reduced their internal and external imbalances. The external current account deficit has fallen from an average of 15 1/2 percent of GDP in 1992 to about 9 percent projected for this year, while the overall fiscal deficit has been cut from almost 12 percent of GDP to 6 percent over the same period.

African governments have also made considerable strides in opening their economies to world trade. A good indicator of this is the fact that 31 Sub-Saharan African countries have accepted the obligations of Article VIII of the Fund's Articles of Agreement, almost all of them since 1993. Most countries have moved ahead with trade and exchange liberalization, eliminating multiple exchange rates and nontariff barriers, and also lowering the degree of tariff protection. A recent qualitative study by the African Department of the Fund indicates that the

⁹⁴ Moschella, M. *Governing Risk: The IMF and Global Financial Crises* (Palgrave Macmillan; 2010).

⁹⁵ Held, David, McGrew, Anthony, Goldblatt, David, and Perraton, Jonathan, 1999, *Global Transformations: Politics, Economics and Culture*, Stanford: Stanford University Press.

number of countries in Sub-Saharan Africa with a "restrictive" exchange regime declined from 26 in 1990 to only 2 in 1995, while the number of countries with a "substantially liberal" trade regime rose from 26 to 38 over the same period⁹⁶.

Finally, the restructuring of many African economies is gaining momentum. Throughout the continent, government intervention in economic activity is on the wane. Administrative price controls are being reduced and agricultural marketing has been widely liberalized⁹⁷. The process of restructuring and privatizing state enterprises has been underway for some time in most countries, though with varying speed and degrees of success. And finally, fiscal reform is gaining ground African countries are taking firm steps to rationalize their tax systems, to reduce exemptions, and to enhance administrative efficiency⁹⁸. At the same time, they are also reorienting expenditures away from wasteful outlays towards improved public investment and spending on key social services, particularly health and basic education⁹⁹.

2.2.2 Globalization and Regional Integration

Closer economic integration, each country has an interest in ensuring that appropriate policies are followed in its partner countries. This could be achieved by coordination the relevant national policies within a regional context. Throughout the continent, African governments are coming together to coordinate components of their policies, and virtually all countries are now members of regional organizations. Efficient regional cooperation allows the economies of Africa to overcome the disadvantages of their relatively small size and, by opening access to larger markets, to realize economies of scale. The obligations of membership in some of these

⁹⁶ Colgan, A.L, *Hazardous to Health*, The World Bank and IMF in Africa,(Africa Action, April 18, 2002)

⁹⁷ Fieldhouse, D.K. *The multinational, a critique or a concept* in Alice Teichova et Al (eds.) *Multinational Enterprise in historical perspective*, (Cambridge: Cambridge University Press, 1986)

⁹⁸ Fieldhouse, D.K. *The multinational, a critique or a concept* in Alice Teichova et Al (eds.) *Multinational Enterprise in historical perspective*, (Cambridge: Cambridge University Press, 1986)

⁹⁹ Held, David, McGrew, Anthony, Goldblatt, David, and Perraton, Jonathan, 1999, *Global Transformations: Politics, Economics and Culture*, Stanford: Stanford University Press.

organizations also make it easier for each individual country to achieve further progress in regulatory and judicial reform (as is the case in the CFA franc zone); to rationalize payments facilities and to relax restrictions on capital transactions and investment flows (as in the Cross-Border Initiative); and to develop the mutual economic infrastructure (as in the SADC). Enhancing the trade links among themselves naturally also strengthens their ability to participate in trade on a global scale, and could lead toward further progress in the direction of non-discriminatory multilateral trade liberalization¹⁰⁰.

The challenge for the future will be to ensure that these regional organizations are perceived as effective vehicles for the integration of African countries into the world economy, providing mutual support to their members in their reform efforts. They should not be considered as defensive mechanisms, intended to ward off the "negative" aspects of globalization. Common regional objectives should be set in terms of international best practices. And the regional organizations should seek to push through reforms in the areas of the legal and regulatory frameworks, financial sector restructuring, labour and investment code reform, and exchange and trade liberalization that seek to reach international standards as quickly as possible. The pace of progress should be what is feasible, not what is comfortable for the slowest member.

2.2.3 International Financial Institutions

The World Bank and the International Monetary Fund (IMF) are two international financial institutions that provide funds to countries globally. The World Bank was initially created after World War II as an international institution that would help countries finance rebuilding

¹⁰⁰ Fieldhouse, D.K. *The multinational, a critique or a concept* in Alice Teichova et Al (eds.) *Multinational Enterprise in historical perspective*, (Cambridge: Cambridge University Press, 1986)

projects¹⁰¹. However, as their focus moved beyond western, industrialized nations, the World Bank quickly recognized that developing countries did not have the infrastructure in place to rebuild like most western countries and began focusing on education policy to develop the human capital of developing countries. Now the World Bank continues to work on reconstruction projects but has also taken on the responsibilities of poverty reduction and sustainable growth in the poorest regions of the world¹⁰².

The IMF, founded in 1945, was initially an institution that was responsible for helping maintain the stability of the fixed exchange rate system. According to the Articles of Agreement, under which the IMF was created, the Fund serves six purposes: "to promote international monetary cooperation," to facilitate the expansion and balanced growth of international trade," "to promote exchange stability," to assist in the establishment of multilateral system of payments," to give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards," and to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members". The purposes, as described above, have remained the same over time but the way to achieve these purposes changed when the fixed exchange rate system collapsed in 1971.

Both the World Bank and IMF began operating in more extensive ways than originally intended only a few decades after their creation. Once the concept of infrastructure changed for the World Bank the focus of the Bank's efforts turned to promoting education with the development of an education department¹⁰³. The goal of the assistance from the education department was to help increase the analytical aspects of curriculum. The IMF was not as

¹⁰¹ Zolo, Danilo, 1997, *Cosmopolis: Prospects for World Government*, Cambridge: Polity Press.

¹⁰² Fieldhouse, D.K. *The multinational, a critique or a concept* in Alice Teichova et Al (eds.) *Multinational Enterprise in historical perspective*, (Cambridge: Cambridge University Press, 1986)

¹⁰³ Scheurman, William E., 2010, "The (classical) Realist Vision of Global Reform," *International Theory*, 2 (2): 246–82.

directly involved in determining the policies of specific social services but it did negotiate reforms for developing countries that were struggling to repay their debt as conditions of restructuring their loan to be affordable¹⁰⁴. As the IMF and World Bank ventured into the world of policy-making the countries that relied on receiving monetary assistance at low interest rates were forced to accept the conditions and reforms that the institutions had attached to the loans.

2.2.4 IMF and World Bank

The International Monetary Fund (IMF) and the World Bank were founded in 1944 just after the Second World War during the United Nations Monetary and Financial Conference held in Bretton Woods, the area in Washington that gave rise to the name “the Bretton Woods Institutions”. These institutions were created as a response to the economic instability following the Second World War, and their first focus was to facilitate the reconstruction of Europe. Since the 1970s the focus has been on the developing world as the debt-crises and other economic events have forced these nations to request aid with their situation¹⁰⁵.

The stated purpose of the IMF and World Bank, as of recent decades, is to achieve poverty alleviation and to stabilize the economic situation of countries in the developing world. This should be achieved by arranging for capital inflows into labor-intensive market, and thereby spur growth with the help of open-market reforms¹⁰⁶.

The role of the IMF, an organization with 186 member countries, is to foster global monetary cooperation, facilitate international trade, promote high employment and sustainable

¹⁰⁴ Cardoso and Helwege, *Latin America's economy* (Cambridge, MA:MIT Press, 1992)

¹⁰⁵ Pogge, Thomas, 2002, *World Poverty and Human Rights: Cosmopolitan Responsibilities and Reforms*, Cambridge: Polity Press.

¹⁰⁶ Kymlicka, Will, 1999, “Citizenship in an Era of Globalization: A Response to Held,” in Ian Shapiro and Casiano Hacker-Cordon (eds.), *Democracy's Edges*, Cambridge: Cambridge University Press.

economic growth and reduce poverty. The IMF is financed through the quotas paid by their member nations, which also determines their voting weight when taking decisions and appointing senior officials. The most important decisions require a supermajority of 85% of votes, which has led the US to always be the only country with veto right.

The World Bank has undertaken the task of achieving the “Millennium Development Goals” stated by the UN concerning poverty and the living conditions in the developing world. They work by providing loans, mostly to middle-income countries at beneficial interest rates and by promoting an environment for investment, jobs and sustainable growth. Traditionally, the Bank President has always been a US citizen nominated by the United States, the largest shareholder in the bank. The nominee is subject to confirmation by the Board of Governors, to serve for a five-year, renewable term.

2.3 Role of IMF in India

Amongst countries with at least 10 million people in 2003, India has been growing very speedily since 1980.¹⁰⁷ The IMF reports that while India’s grew at 5.7%. Of the five countries that grew faster than India during this decade, none did so successively during 1990-2003. In 2003-04, India’s GDP growth rate shot to 8.5%, powered by recovery from a severe drought in the previous year. The projected growth rate for 2004-05 is 7.5% and the estimated rate for 2005-06 is 8.1%.

In terms of absolute level of Gross National Income (GNI) at Purchasing Power Parity (PPP) exchange rates in 2003, India with \$3 trillion in GNI was fourth after the U.S., China and Japan (3.6 trillion). It is possible that in 2005, India substituted Japan as the country with the third largest GNI. IMF approximates India’s share in global output at PPP exchange rates to

¹⁰⁷ MGI (2011) *India: The Growth Imperative*, Mumbai, McKinsey Global Institute.

have increased from 4.3% in 1990 to 5.8% in 2004, and India's development during 2003 and 2004 to have accounted for one-fifth of Asian growth and one-tenth of World development, as compared to China's input respectively of 53% and 28%. It should cause no surprise then that the speedy growth of India has had substantial impact on the World economy, though, not predictably, to the same extent.¹⁰⁸

Indian government has been instructed to endure liberalization. *The McKinsey Quarterly* states that eliminating core obstacles "would open India's economy to grow as fast as China's, at 10% a year".¹⁰⁹ There has been extensive debate, conversely, around liberalization as a comprehensive economic growth policy. Since 1992, income disparity has deepened in India with consumption among the humblest staying steady while the wealthiest produce consumption growth. As India's gross domestic product (GDP) growth rate developed to be lowest in 2012-13 over a decade, growing only at 5%, more condemnation of India's economic reforms reappeared, as it deceptively failed to address employment growth,¹¹⁰ nutritional values in relation to food intake in calories, and also exports growth and thus led to a deteriorating level of current account deficit compared to the prior to the restructuring period.¹¹¹

2.3.1 Indicators of the Extent of Integration in World Markets for Goods and Services

An inclusive indicator of integration in the degree of international trade in the domestic economy as dignified by the share of exports and imports in GDP¹¹² and in the global economy as

¹⁰⁸ Huang, Yasheng and Tarun Khanna (2003) "Can India Overtake China?," Foreign Policy, July-August.

¹⁰⁹ *The McKinsey Quarterly*. 2013. Removing main obstacles "would free India's economy to grow as fast as China's, at 10% a year".

¹¹⁰ PC (2012) *Report of the Special Group on Targeting Ten Million Employment Opportunities per Year*, New Delhi, Planning Commission

¹¹¹ Huang, Yasheng and Tarun Khanna (2003) "Can India Overtake China?," Foreign Policy, July-August.

¹¹² MGI (2011) *India: The Growth Imperative*, Mumbai, McKinsey Global Institute.

measured by the stake of a country's exports and imports in global exports and imports. The pertinent data are in Table 3 below.¹¹³

Table 2.1: Measures of Integration with the World Economy

Measures of Integration with the World Economy				
		<u>Percent of Total</u>		
		<u>1983</u>	<u>1994</u>	<u>2004</u>
Share in GDP of Exports of Goods and Services	India	n.a.	7 ¹	14 ²
Share in GDP of Imports of Goods and Services	India	n.a.	9 ¹	16 ²
Country Share in World Exports of Merchandise	India	0.5	0.6	0.8
Country Share in World Imports of Merchandise	India	0.7	0.6	1.1
Country Share in World Exports of Commercial Services	India	n.a.	0.6	1.9
Country Share in World Imports of Commercial Services	India	n.a.	0.8	2.0

Sources: (1) For shares in GDP, World Bank (2005a),

(2) For shares in World Trade, WTO (2005).

It is distinct from Table 3 that, in the period 1990-2003 whereas the share of exports and imports in India's GDP was almost folded, the increase in share in its World commodities exports, equitably, was far less.¹¹⁴ Thanks to its achievement in the IT service sector, India's share in World exports of marketable services tripled in the same period. It would appear that in

¹¹³ Shares are for 2003. With newly revised GDP data for China showing higher levels of GDP, the shares would be somewhat lower.

¹¹⁴ Nordas, Hilegunn Kyvik (2004) "The Global Textile and Clothing Industry? The Agreement on Textiles and Clothing," Discussion Paper 15, Geneva, World Trade Organization.

India's, with the likely exemption of services the effect of greater incorporation is largely one-way and domestic, in the sense of its rising the rate of GDP growth and the share of trade in domestic GDP, slightly than India's more speedy GDP growth impelling global GDP growth significantly.¹¹⁵

2.3.2 Shares of India in Global GDP and its Growth

The methods of integration in Table 3 in effect commission the prospective for the growth of India to underwrite to growth in the World Economy - put another way, if these processes were zero, so that India is autarkic, then understandably their growth would have no outcome on the growth of the other countries of the World. But on the other hand, even if constructive, the measures do not essentially imply that the growth of India had or would have, momentous impact on global GDP growth or on the development of low and middle income countries (or alternatively to the growth of emerging Asia).¹¹⁶ Table 4, established on World Bank data¹¹⁷, enumerates the bearing in an accounting (not to be confused with causal) logic.

Table 2.2: Shares of India in Global GDP and its Growth

	Share in Global GDP (%)		Share in GDP of Low and Middle Income Countries (%)		Growth Rate of GDP (%)		Share in Growth of World GDP (%)		Share in Growth Rate of Low and Middle Income Countries (%)	
	1990	2003	1990	2003	1980-90	1990-03	1980-90	1990-03	1980-90	1980-03
INDIA	1.5	1.64	7.92	8.4	5.7	5.9	2.5	3.5	15.0	13.4

SOURCE: World Bank (2005),

Table 5 is from Jorgenson and Vu (2005) who adopted purchasing power parity built exchange rates.

¹¹⁵ MGI (2011) *India: The Growth Imperative*, Mumbai, McKinsey Global Institute.

¹¹⁶ Ananthakrishnan, Prasad and Sonali Jain-Chandra (2005) "The Impact on India of Trade Liberalization in the Textiles and Clothing Sector," Working Paper WP/05/214, Washington D.C., International Monetary Fund.

¹¹⁷ These data use exchange rates put together (using the so called Atlas method) by the World Bank and do not make adjustments for differences in purchasing power parity.

Table 2.3: India Shares in Global GDP

	Share in GDP of World (110 Economies) (%)		Share in GDP of Developing Asia (16 Economies) (%)		Growth Rate of GDP (%)		Share in GDP Growth of World (%)		Share in GDP Growth of Developing Asia (%)	
	1989-95	1995-03	1989-95	1995-03	1989-95	1995-03	1989-95	1995-03	1989-95	1995-03
INDIA	4.95	5.97	24.10	22.89	5.03	6.15	9.95	10.66	16.49	25.04

SOURCE: Jorgenson and Vu (2005)

A contrast of Tables 4 and 5 institutes that altering for purchasing power parities makes a significant difference to the shares of India in global GDP and growth.¹¹⁸ Still the two tables agree on the following:

- i. The shares of India (GDP levels and growth) have been cumulative over time. The two composed accounted for more than a sixth of global growth during 1990-2003 (Table 5), and as great as a third during 1985-2003 once alteration for PPP is done.
- ii. The comparative to India prices seem to be edging closer over time to world prices, ratifying once again the findings of Table 3 that India is assimilating into the World economy. The reviewed GDP data for India, which increased growth rates over 1993-04 compared to old data and also show that India was poised to be the World's 6th biggest economy in US\$ expressions strengthen this conclusion.

¹¹⁸ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

- iii. Surprisingly, this developing economy account for a large share of GDP and growth of low and middle income countries and of developing Asia.

The IMF distinguishes that policy makers in India are actively pursuing to strengthen India's global connections and to hasten its integration with the World economy. Accomplishment in these determinations would upsurge the role of IMF in the Indian economy. The report unequivocally refers to one of the apparatuses, India's import demand, concluded which this would come about.¹¹⁹

2.3.3 IMF projects India's GDP to pick up in 2015 to 6.4 per cent

After the World Bank's optimistic assessment of the Indian economy, the International Monetary Fund has elevated the country's growth forecast to 5.6% for 2014 from its earlier approximation of 5.4% on the back of operative policies and a rekindling of confidence following the general elections.¹²⁰ The multilateral financier cut the global growth forecast and that for emerging market economies as a whole. India has recovered from its relative slump, and, thanks in part to policy and a revitalization of confidence, growth is anticipated to exceed 5% again, and the post-election recovery of confidence in India also delivers a prospect for the country to embark on much-needed operational reforms.¹²¹

The World Bank said India is set to develop by 6.4% in 2015-16 after a 5.6% development in 2014-15, profiting from a 'Modi dividend', a direct orientation to the Narendra Modi-led administration at the center. In its apprise of the flagship World Economic Outlook boom, India's growth is anticipated to upsurge in the rest of 2014 and 2015 as exports and investment carry on to pick up and more than offset the effect of an uncomplimentary monsoon

¹¹⁹ Ananthkrishnan, Prasad and Sonali Jain-Chandra (2005) "The Impact on India of Trade Liberalization in the Textiles and Clothing Sector," Working Paper WP/05/214, Washington D.C., International Monetary Fund.

¹²⁰ Huang, Yasheng and Tarun Khanna (2003) "Can India Overtake China?," Foreign Policy, July-August.

¹²¹ MGI (2011) *India: The Growth Imperative*, Mumbai, McKinsey Global Institute.

on agriculture growth.¹²² India's GDP is projected to expand 5.6% in 2014 and 6.4% in 2015. The stance is slightly stouter for 2014 comparative to that in April 2014 WEO and unaffected for 2015. Improved enactment of mining, services sector and manufacturing pushed India's economic growth rate to a two-and-half year high of 5.7% in the April-June quarter. The finance office now anticipates ending the financial year with 5.8% growth.¹²³

Structural reforms should endure to aim at sinking near-term vulnerabilities and bolstering fiscal reforms, medium-term growth and an enhancement in investment climate should top India's agenda, besides eliminating infrastructure bottlenecks in the power sector and reforms in the labor and education sectors. The task for advanced and emerging market countries is to go beyond the common mantra of "structural reforms" and recognize which are most needed and which are administratively achievable. Conceivably, in general, the challenge for program makers is to re-establish assurance through a clear plan to deal with both the bequests of the crisis and the test of low potential development. The IMF censored world growth forecast to 3.3% in 2014, down 0.1% from the July estimate, and to 3.8% in 2015, down 0.2% from the earlier prediction. For developing economies as a whole, latent growth is now projected to be 1.5% lower than it was in 2011. The multilateral financier was cautious about inflation, saying it could endure elevated and reduce the chances of monetary acceleration. With the recent monetary constriction, disinflation will continue but inflation overall will persist high at 7.8% in 2014, declining slightly to 7.5% in 2015.¹²⁴

¹²² Nordas, Hilegunn Kyvik (2004) "*The Global Textile and Clothing Industry? the Agreement on Textiles and Clothing*," Discussion Paper 15, Geneva, World Trade Organization.

¹²³ NMCC (2005) "*The National Strategy for Manufacturing*" Draft Report of the National Manufacturing Competitiveness Council, New Delhi.

¹²⁴ MGI (2011) *India: The Growth Imperative*, Mumbai, McKinsey Global Institute.

2.4 The case of Russia

The grounds behind the recent crises in Russia are multiple and well recognized. During the 1992-1997 period, Russia attained only monetary equilibrium (minor inflation and a steadier exchange rate) and fractional structural reforms (privatization and liberalization). Nonetheless, the succeeding budget deficits, large by any ration, reveal a perpetual lack of fiscal modification. Large disclosure to short-term debt is the direct outcome of unsustainable financing of the shortfall. Furthermore, contemporary political crises in linking with shake-ups of countless government creations and social discontent have shaken investors' confidence. The predicament in Asia and uncomplimentary conditions in international markets for energy instigated Russia's underlying difficulties to surface more readily. Economic development in Russia was anticipated for years, but the economy persisted stagnant until what endangered to become a free fall in August 1998, when the government let the rouble depreciate severely, announced a 90-day moratorium on foreign debt and a reorganization of short-term government bonds.¹²⁵ Subsequent to that, in the third quarter of 1997 official indicators displayed the first signs of real growth, as GDP grew by 1 per cent (related with the third quarter of 1996) and by 0.8 per cent for the whole year. The accumulative decline in GDP between 1990 and 1996 amounted to over 40 per cent and was one of the most austere among the countries of the FSU (without those involved in military conflict).¹²⁶ The deterioration in industrial production decelerated in 1995-1996, and there were periods of retrieval in production. However, 1997 for the first time conveyed upsurges in industrial output in all quarters, as well as a 1.9 per cent intensification for the whole year (4 per cent and 5 per cent drops in 1995 and 1996, separately).

¹²⁵ Gregorio, J. (2010), "Monetary policy and financial stability: an emerging markets perspective", *International Finance*, Vol. 13 No. 1, pp. 141-56.

¹²⁶ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

Production in the prime industrial sectors (equipment, fuel, machinery and consumer goods) has been patchy over the last few years. Generally, the production of consumer goods revealed the largest upsurges in the 1995-1997 period. Energy production stalwartly depends on variations in world energy prices and on payment glitches both domestically and abroad. Generation of electricity and oil calmed during last two years.¹²⁷ However, in 1997 there was a severe fall in the output of natural gas (about 10 per cent in the third and fourth quarters), in part due to lesser domestic gas consumption in Ukraine (due to acute financial difficulties).

Agricultural production began growing only at the end of 1997 (by 0.1 per cent) following a rather distinct decline (8 per cent and 5 per cent in 1995 and 1996, correspondingly). Investment unrelenting to be very modest and, again, differences for different sectors do not allow the documentation of a clear trend. Nevertheless, main investment indicators persisted to be stable during 1997.¹²⁸ Conversely, without new capital formation it was clear that any development would be delicate at best. The Russian agricultural and industrial sectors still agonize from a lack of streamlining and a flawless ownership structure. Lax budget restrictions during the 1992-1995 period, together with voucher privatization (the only tolerable form of privatization from a political position), ensued in a slow (and indistinct) formation of ownership rights and in delayed reformation at the microeconomic level. The condition does not create a firm foundation for private investment, whether domestic or foreign. In fact, FDIs in Russia are rather emblematic and amplified in 1995-1997 only as big privatization tenders for foreign cash were shepherded to cover a fiscal gap.¹²⁹ Nevertheless, controversies among controlling groups

¹²⁷ Ibid

¹²⁸ Gregorio, J. (2010), "Monetary policy and financial stability: an emerging markets perspective", *International Finance*, Vol. 13 No. 1, pp. 141-56.

¹²⁹ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

wishing to obtain valuable state-owned properties serve to destabilize political support for privatization and reformers.

Russia's Financial-Industrial Groups (FIGs) fall into two groupings: industry-led and bank-led. FIGs are identified as legal entities that pool resources in order to trail economic or technological integration, with a view to upturn proficiency, competitiveness and jobs. FIGs were originally familiarized by presidential declaration in 1993. Consequently, a federal law of 1995 recognized the basis for FIG registration and actions. More largely, FIGs are holding companies linking financial institutions with enterprises (and vice versa). Conversely, due to budgetary complications, the government claims that it cannot afford to fund these reimbursements. On the other hand, the government holds shares in some FIGs. At present, "state" FIGs are stirring away from active state-led administration and are managing state stocks in trusts.¹³⁰ Many FIGs got government stakes in form of "loans-for-shares" privatization plan, under which the government approved them the right to accomplish state stakes in return for loans (which were feasibly never meant to be reimbursed). The influence of FIGs is difficult to measure, as most of their undertakings are not registered.¹³¹ The involvement to GDP of listed FIGs is equally vague, with approximations ranging from less than 1 percent to 10 percent of GDP.

Close ties amongst the business and government sectors in Russia (and other FSU countries) have a lengthy tradition. During Soviet days, government officials molded partnerships which controlled lucrative "black" markets. Certainly, the entire Soviet system had long functioned with a thriving unofficial market, supervised and controlled by groups of

¹³⁰ Gregorio, J. (2010), "Monetary policy and financial stability: an emerging markets perspective", *International Finance*, Vol. 13 No. 1, pp. 141-56.

¹³¹ Ibid

fraudulent officials, common criminals and black-marketers.¹³² (Russians first initiated to use the word “*Mafiya*” in the 1970s and 1980s to define the large networks of fraud inside regional and central government ministers.) Regional communist party heads often became overlords superintending criminal networks. Even currently some politicians are not exclusively free from such acquaintances. A number of deputies and high ranked government officials have even been murdered or incapacitated in gang-style killings. Some have run for office to dodge prison sentences.

2.4.1 Monetary Policy and Exchange Rate

In 1995, differing to the previous years, the Russian Government decided to shift from money-based to exchange-rate-based equilibrium and announced a changeability band for the rouble. The latter is alleged as a more effective stabilization apparatus, but for its operational it requires macroeconomic basics to be in order. In 1992-1994, both expansionist financial policies by the central bank (funding of the rouble zone till mid-1993, plus “customary” credits to agricultural and industrial sectors) and huge budget shortages monetized by the central bank served to fuel inflation.¹³³ In 1993, so-called ‘all-encompassing money’ (M2) improved by 287 per cent; currency in circulation rose by 540 per cent; and CPI inflation amounted to 843 per cent. In 1995, a decrease in budget subsidizations and the monetary deficit, together with a constriction of fiscal policy (all-encompassing money went up by 113 per cent compared to 217 per cent in 1994), abetted lower inflation to 131 per cent. In 1997, all-encompassing money and CPI inflation fell to 30 per cent and 11 per cent, respectively.¹³⁴

¹³² IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

¹³³ Cheng, C. K. (2006). “*Var analysis of Kenya’s monetary policy transmission mechanism: how does the Central Bank’s repo rate affect the economy?*” International Monetary Fund Working paper 06/300

¹³⁴ Mishkin, F. S. (2012). “Symposium on the Monetary Transmission Mechanism” *Journal of Economic Perspectives*, 9 (4):3–10.

After 1995, money demand looks to have at least steadied, and in 1997 it increased. The monetized portion of the Russian economy is still based on cash, although monetization is very modest (in 1995-1997, it stood at only about 13 per cent of GDP). (remonetization and demonetization are extremely unbalanced processes, and minor inflation in 1996-1997 does not spontaneously lead to a growth in money demand and remonetization of the Russian economy. On the other hand, in 1992 great inflation dropped money demand and monetization of the economy). Hence, any upsurges in money supply without growth in real output or at least in money demand lead to price hikes. Through 1994-1996, total savings persisted very limited, at 4 per cent of GDP. In 1997, fiscal indicators suggest transaction response in line with the growth in consumption and productivity, but diminished savings (3.4 per cent from 4.3 per cent of GDP in 1996).¹³⁵

Great external inflows helped to gentle down the rouble's nominal depreciation (21 per cent and 6 per cent in 1996 and 1997, separately, compared with 44 per cent in 1995).¹³⁶ The loss in external effectiveness is balanced by growing labour efficiency but also by the non-payment of wages and inter-enterprise debts. Moreover, exports entail mostly of primary products. In November 1997 (following the financial turmoil scattering from Asia), the authorities pronounced the spreading of the rouble fluctuation band to +/- 15 per cent, from 5 per cent. The new administration, together with a re-denomination of the currency (the tumbling of three zeros) went ahead on January 1, 1998. The band now had a lower limit of 5.25 rouble per USD and an upper limit of 7.15 rouble per USD. The mid-points of the band at 6.1 rouble per USD and 6.2 rouble per USD were set for 1998 and 1999, correspondingly, until a much broader band for fluctuations was set in August, 1998.

¹³⁵ Gregorio, J. (2010), "Monetary policy and financial stability: an emerging markets perspective", *International Finance*, Vol. 13 No. 1, pp. 141-56.

¹³⁶ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

In 1996-1997, an influx of foreign capital enhanced equity prices in Russia. The Russian Trading System Index improved in rouble terms from 197.9 to 396.9 during 1997. Since the real appreciation of the rouble, this symbolized a doubling of profits in USD. The number of companies registered on the Russian Trading System reached over 170 at the end of 1997, but most of the trade rests centred in two dozen 'blue chip' companies (majorly in oil, energy, and mining) accounting for one-third of the market capitalization. The equity market development is, nevertheless, hindered by serious organizational and regulatory deficiencies, in specific weak supervision and unreasonably decentralized share registries. Brawls between the CBR and the Federal Commission for the Securities Market over the former, and amongst financial groups to take control over the former (registering of equity trade), increase doubts as to the probabilities for any radical improvement in the condition. In the meantime, any crisis started by financial disorder in the world, as at present, will trigger the removal of capital by foreign investors and put pressure on the CBR foreign capitals and the rouble exchange rate.

2.4.2 Fiscal Policy, Deficit and Financing

Economic policy remains the frailest link in the chain when it comes to the equilibrium programmes in Russia. Originally, one should make a discrepancy between the performance of the federal budget and that of the general government budget. Revenue in the federal budget remains relatively perpetual - though it has deteriorated somewhat since reforms began (from 16.6 per cent to 12.1 per cent of GDP in 1992 and 1997, correspondingly). General government revenue weakened more sharply – from 41.6 per cent in 1992 to 31.8 per cent in 1997. (This is still, though, great compared with countries with a similar per capita income). Hence, one delinquent with the Russian budget lies in the level of spending and in impractical estimates of

budget revenue.¹³⁷ On the spending side, two burdens are the heaviest: the price of debt servicing borne by the federal government and regional budget grants to enterprises and municipal amenities.¹³⁸ At the end of 1997, the amount of wage arrears was projected at 49 billion roubles. The problem was predominantly acute in some regions.¹³⁹ For instance, coal miners demanded honorary wages valued at 3.6 billion roubles, but the government retained that only about a third of this sum could be well-thought-out as being owed by the state, the rest being a debt by (private) mines to miners. And the absence of transparent ownership structure, resulting from the privatization methods chosen, does not allow for proper assessment of government arrears.

Financing of the budget shortfall through the sale of vastly attractive government bonds (GKO & OFZ) to domestic and foreign investors helped decrease inflation and rise CBR reserves (USD 20 billion in mid-1997, but only USD 14 billion in May 1998). Procurements of GKO by foreign investors were higher than for Eurobond issuance. Total foreign holdings of domestic government papers can only be appraised. (Totaling to the official “S” account system for investment in government tabloid, so-called “grey account” schemes exist.) Statistics indicate that they held about 30-35 per cent of the marketplace in mid-1997 (about USD 14 billion). At the end of 1997, total public debt was not great in Russia compared to other countries: around 42 per cent of GDP or USD 200 billion (USD 130 billion and USD 70 billion in foreign and domestic borrowing, respectively). However, the average maturity of GKOs distributed is close to one year and can hardly be amplified. And variations in yields due to external and internal factors increase the cost of debt servicing, making short-term crediting problematic. The significance of the situation is demonstrated by the fact that the government must increase an

¹³⁷ Mishkin, F. S. (2012). “Symposium on the Monetary Transmission Mechanism” *Journal of Economic Perspectives*, 9 (4):3–10.

¹³⁸ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

¹³⁹ Gregorio, J. (2010), “Monetary policy and financial stability: an emerging markets perspective”, *International Finance*, Vol. 13 No. 1, pp. 141-56.

average 8 billion roubles (USD 1.3 billion) each week in the second half of 1998 in order to roll over existing GKO & OFZ debt as it develops.¹⁴⁰

In the fourth quarter of 1997, the Russian government reached agreement with the IMF to reschedule the reimbursement of debt constricted in Soviet times (Russia expected all liabilities of the Soviet Union). The deal rearranged USD 24 billion of principal payments over 25 years with a 7-year grace period, and USD 8 billion of belated interest over 20 years (Russia was gratified to make a down payment of USD 3 billion in December 1997). In September 1997, Russia also became a full member of the IMF. By August 1998, the situation deteriorated substantially.¹⁴¹

2.4.3 Foreign Trade and Balance of Payments

The gradual disassembling of the restrictive export system (quotas, centralized management, or taxes, licensing registration of contracts and fees) and the replacement of multiple exchange rates for the system of import limits (licensing) did not change foreign trade as much as one might have expected. A few factors affect the Russian balance-of-trade condition. Firstly, the break-up of inter-republican connections and of the Council for Mutual Economic Assistance (CMEA or Comecon) caused alteration of exports of main products (mostly energy) from the changeover countries to the rest of the world (ROW). Because of the (fractional) liberalization in foreign trade and the decreasing in the home market, general exports grew after 1992. Also, price liberalization in trade with the FSU countries improved the value of exports by 70 per cent from 1992 to 1997 (a 60 per cent intensification with respect to ROW).¹⁴² Secondly, imports, after dropping in 1993 to USD 44 billion, improved and started to upsurge. Interestingly, the growth was more pronounced in Russia's trade with the other FSU countries than in its trade with ROW

¹⁴⁰ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

¹⁴¹ Ibid

¹⁴² IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

countries (almost a 200 per cent versus 8 per cent in the 1992-1996 period). In 1997, the trends both in exports and imports changed. Stronger growth in imports (from ROW) and immobile exports (largely due to a drop in oil prices) together with higher interest payments contracted the current-account surplus from USD 11.7 billion in 1996 to USD 3.3 billion in 1997.¹⁴³

At USD 30 billion, the Russian net capital outflow in 1994 was the uppermost in the whole 1992-1997 period. Though the “faults and lapses” position in the equilibrium of payments would lead us to be cautious in drawing assumptions. The capital outflow ensued mainly from a large capital flight out of Russia, but also from a fall in expenditures, rising remuneration payments, and a persistent build-up of inter-enterprise arrears.¹⁴⁴ The latter factor was particularly significant for the energy products supplied to the FSU countries. On the other hand, capital outflow signifies not only capital flight from Russia, but also forestallments for import, often illegal (circumvention of duties and taxes, non-fulfilment of governmental regulations or evading other ‘bottlenecks’ in trade). There was also a rising “shuttle” import financed exclusively by cash transactions. The inflow of foreign direct investments raised, but stayed uncertain relative to the country's size (It did, though, double from USD 1.7 billion in 1995 to USD 3.7 billion in 1997). In 1997, the total balance of payments improved, presenting a surplus of USD 16.4 billion (a deficit of USD 22.7 billion in 1996), as a huge short-term capital inflow took place.¹⁴⁵

2.4.4 The Debt Burden

Clearly the debt burden issue was principal on the minds of all experienced interlocutors, who really did their ultimate to depict the situation and its causes impartially. Some 3.5 billion dollars

¹⁴³ Mishkin, F. S. (2012). “Symposium on the Monetary Transmission Mechanism” *Journal of Economic Perspectives*, 9 (4):3–10.

¹⁴⁴ Gregorio, J. (2010), “Monetary policy and financial stability: an emerging markets perspective”, *International Finance*, Vol. 13 No. 1, pp. 141-56.

¹⁴⁵ Mishkin, F. S. (2012). “Symposium on the Monetary Transmission Mechanism” *Journal of Economic Perspectives*, 9 (4):3–10.

will have to be repaid in late 1998, and 17.5 billion dollars in the course of next year. None of our partners was in a position to state the total level of public and private debt with accuracy. One provided the total as about 150 billion dollars, while another placed the figure at up towards 180 billion.¹⁴⁶ A third apprehended that, of that sum, only about 25 billion was still in Russia and the rest in safe havens overseas. About 70 billion dollars in debit were said to have been congenital from the Soviet Union, a sum which in the meantime is to have fully-fledged to about 100 billion. Government appropriating since the restoration of Russia was stated at about 50 billion dollars; and it was said to have been used fundamentally to cover budget deficits over the years, or to have vanished.¹⁴⁷

It would be incorrect to view all Russian banks as being in the same frantic situation. Big banks specifically are in trouble, as they had, so to express, placed all their eggs in the GKO, or basket, government bond. Minor banks, particularly in the provinces, have, invested much more in productive resources and may consequently be in better shape. If, the government chooses the inflationary path, these smaller banks will of course also be affected through an attrition of their fiscal assets. There has consequently been a tendency in the provinces and in provincial banks, since the August events, to distance themselves from the centre.¹⁴⁸

There are three core reasons why an already flimsy tax collection can be enhanced only marginally under the present situations. Firstly, people are too poor to be overtaxed on their income.¹⁴⁹ Income levies are in any case less than 10% of total proceeds. Secondly, the barter economy accounts for almost half of the economy, in specific in dealings between companies.

¹⁴⁶ MGI (2011) *India: The Growth Imperative*, Mumbai, McKinsey Global Institute.

¹⁴⁷ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

¹⁴⁸ Mishkin, F. S. (2012). "Symposium on the Monetary Transmission Mechanism" *Journal of Economic Perspectives*, 9 (4):3–10.

¹⁴⁹ Gregorio, J. (2010), "Monetary policy and financial stability: an emerging markets perspective", *International Finance*, Vol. 13 No. 1, pp. 141-56.

One interlocutor retained that only one-fifth of all transactions are in cash, while another said that the worth of all businesses in Russia amount to three times the amount of money in flow. Additionally, barter delivers a poor basis indeed for statistics, without which economic policies become remarkably difficult to shape.¹⁵⁰

The tax authorities now wish to present a new programme meant to streamline the system, effortlessness the taxes on profits from 35% to 30% in order to kindle production, keep a better check on the doings of the tax supervision and discipline tax evasion more sternly.¹⁵¹ They hope in this way to be able to upsurge tax revenue by 10% in 1999 over 1998 (and preserves that tax collection in October 1998 was up by 5.67 billion roubles over that in September). Nevertheless, they have not yet been able to introduce the more modern system of dispersing VAT on an accrued rather than cash basis. This is a major shortcoming. A third reason for poor tax collection is a shadow economy, which some of our interlocutors claimed represents about 45% of the official one.¹⁵² Though not healthy from the tax collection and budget deficit points of view, such a large shadow economy would nevertheless suggest that the Russia's real economy may not be as ailing as official figures would indicate.¹⁵³

¹⁵⁰ MGI (2011) *India: The Growth Imperative*, Mumbai, McKinsey Global Institute.

¹⁵¹ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

¹⁵² Gregorio, J. (2010), "Monetary policy and financial stability: an emerging markets perspective", *International Finance*, Vol. 13 No. 1, pp. 141-56.

¹⁵³ Mishkin, F. S. (2012). "Symposium on the Monetary Transmission Mechanism" *Journal of Economic Perspectives*, 9 (4):3-10.

CHAPTER THREE

IMPACT OF MONETARY POLICY ON DEVELOPING COUNTRIES

3.1 Introduction

The chapter explicitly looks at the impact of IMF Structural Adjustment Policies in developing economies particularly with regard to the social development. Of interest to look at will be the education, health and agricultural sectors¹⁵⁴.

When SAPs were first familiarized in the early 1980s, no measures to shield the poor and susceptible groups in developing societies were openly integrated in their policy with the supposition that any negative social control would be of a short-term environment. The social special effects of policy reforms, have since then developed a rallying point for the critics of SAPs, and the degree of these effects is gaining acknowledgement even among the international financial institutions and regulating developing countries.¹⁵⁵ Many critics have appealed that the IMF has positioned most of the burdens of market-based adjustment on susceptible groups in member states. During the extensive structural adjustment programs of the 1980s, the IMF repeatedly required member countries to reduce government expenditure. Governments retorted by cutting back on programs that the deprived, women, children, and other susceptible groups heavily depend on e.g., health care, food subsidies, and education¹⁵⁶.

In Africa, the reform process, together with the enactment of SAPs, has had an overwhelming effect on the delivery of social services such as education and healthcare. Reductions in government expenditure have created constraints in the provision of these amenities, leading to a deterioration in social welfare. Since SAPs affected on each facet of life

¹⁵⁴ Reed, David (ed). 1996. *Structural Adjustment, the Environment, and Sustainable Development*. London: Earthscan Publications.

¹⁵⁵ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

¹⁵⁶ Werner, D., 1994, 'The Economic Crisis: Structural Adjustment and Healthcare in Africa', *Third World Resurgence*, No. 42/43, pp. 10-17.

in the pertinent countries, it affected authority in a way no other policy package had done previously. It's argues that the reforms conveyed upon by SAPs led to a waning in the healthiness of most women in Kenya. Further, it's claimed that SAPs, an obligation on developing countries by the Bretton Woods institutions, violated the rights of Third World societies through the denial of access to healthcare, which is a basic human right.¹⁵⁷

3.2 Impact of IMF/World Bank Structural Adjustment Policies

The World Bank, the International Monetary Fund (IMF) and other major lenders have played a very substantial role in modelling the development of Third World countries. Their structural adjustment loans (SALs), originated in the 1970s and 1980s as a way of reformation the economies and political institutions of borrowing nations, have been the subject of much discussion.¹⁵⁸ While comprehensive economic policies are essential to achieve economic stability and development, critics have not only examined the efficiency of SALs, but have also surveyed the supplementary social and environmental impacts. Negative social impacts of structural adjustment (SA) have been identified and are being addressed. Due to the universal usage of SA in the Third World, environmental effects must be examined in order to either moderate the adverse impacts or encourage the constructive ones. Recognizing the links between social, economic, and environmental factors in society is necessary in moving towards sustainable development¹⁵⁹.

¹⁵⁷ World Bank, 1994a, *Adjustment in Africa: Reforms, Results and the Road Ahead*, Washington DC, World Bank.

¹⁵⁸ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

¹⁵⁹ Mosley, P., F. Noorbakhsh and A. Paloni (2003), 'Compliance with World Bank conditionality: Implications for the selectivity approach to policy-based lending and the design of conditionality', paper presented at the *United Nations University/WIDER conference on 'Sharing Global Prosperity'*, 6-7 September 2003, Helsinki, Finland

3.3 Effects of IMF on Education

Macroeconomic amendment and education are closely connected through the budgetary apparatus. The level of capital available for education may be linked in principle to the success of the macroeconomic transformations, and lack of attainment may lead to further deterioration in expenditure on education. Economic amendment and budget reformation reduce public spending on education; and decreasing budgets for education may upset the quality and quantity of the graduates of the education system, which will have a destructive impact on macroeconomic development and adjustment. Not only the macroeconomic selections, but also the micro varieties, was considerably influenced by adjustment plans, and the effect has been, on the whole, undesirable.¹⁶⁰

To forecast the effect of adjustment reforms on education is challenging. Nonetheless, given the international capability, the forecasts for education in Africa appear to be depressing, if not miserable. In general, early indication of attainment of structural adjustment policies was restricted to middle-income states, and countries whose own dimensions for negotiation and policy analysis were satisfactory, but this was not so in the poorer and weaker states of Africa, particularly the sub-Saharan African countries. The amendment policies that do not implicitly take into justification the education sector tend to treat education not as a venture bustle in human capital that increases production, but as a sector of public expenditure, and public disbursements has to be reduced in all sectors, as well as education. In fact, the hostile impact is established to be 'heavier' on education than on other segments.¹⁶¹

The seclusion and quantity of the effects of reforms are problematic and difficult, not to speak of disparity between the effects of World Bank structural adjustment programmes and

¹⁶⁰ World Bank, 1994a, *Adjustment in Africa: Reforms, Results and the Road Ahead*, Washington DC, World Bank.

¹⁶¹ Reed, David (ed). 1996. *Structural Adjustment, the Environment, and Sustainable Development*. London: Earthscan Publications.

those of IMF equilibrium policies, as they are most often existing as a package of reforms.¹⁶² Some of the research appraised here, conversely, implemented sophisticated methodologies and tried to separate the effects of adjustment on education. It has been established that the adverse effects of adjustment policies on education are likely to be very austere. Deterioration in public investment, in gross employment ratios and in eminence of education, predominantly at primary level, have been established to be strongly associated with adjustment policies. Adjustment leads to congestions on public budgets in most sectors, including education. The effect on education may indeed be weightier than on others¹⁶³.

Total public spending on education in present and, more precisely, in real prices is found to have deteriorated in some countries during adjustment. The declines are more definite in terms of per student expenditures. The relative importance given to education in the expansion framework - spending on education as a percentage of GNP, and as a percentage of total government spending - has been found to deteriorating in a large number of countries. Within education, it may be tranquil during the adjustment course to reduce public spending on primary education than to condense that on higher education, for the obvious reason. Hence basic education and mass education platforms such as literacy programmes may be more sternly affected than higher education. Higher education may get 'protection' from the governments, the bureaucracy and legislators¹⁶⁴.

Further, within education, the principal budgets may be forfeited in favour of recurring budgets. Buildings, equipment, furniture and so forth may be merchandised off in favour of additional teachers. Within the recurring budgets, because of the compressions of teachers'

¹⁶² IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

¹⁶³ Reed, David (ed). 1996. *Structural Adjustment, the Environment, and Sustainable Development*. London: Earthscan Publications.

¹⁶⁴ World Bank, 1994a, *Adjustment in Africa: Reforms, Results and the Road Ahead*, Washington DC, World Bank.

unions, etc., teachers' remuneration bills tend to be less affected. Even when fiscal cost-cutting is effected, the salaries of teachers and other staff cannot be cut for various causes - in fact, they may even rise (in current market prices at a rate less than inflation), and schools and colleges may even be opened without the essential buildings and equipment.¹⁶⁵

The most serious fatality may be quality of education, and venture in those inputs that have a stronger relationship with eminence, such as textbooks and other teaching-learning resources. The axe cascades on the petty amounts being capitalized in teaching-learning materials, including classroom supplies in primary schools, books and journals in collections, consumable material in laboratories and other quality-improvement platforms in secondary schools, colleges and campuses¹⁶⁶. There is reason to trust that the delivery of materials and supplies will drop more than the whole budgets, and this will cause more harm to educational development. As King confirm, efforts to rise recurrent spending on textbooks are 'stymied at times by overall spending ceilings discussed with IMF or World Bank economists'.¹⁶⁷ Quality of education may worsen with an amplified number of students per teacher, bargain numbers of books, etc. Dropout and repetition rates may escalate. During the course of adjustment, short-duration education and crash programmes may be preferred to long-duration education courses, short-term training platforms to long-term training, unqualified teachers to trained teachers, etc. The percentage of young, inexperienced, temporary and unqualified teachers may increase. All this will have serious adverse effects on the quality of education in the long run.¹⁶⁸

¹⁶⁵ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

¹⁶⁶ King, K. (2005b) 'Re-Targeting Schools, Skills and Jobs in Kenya: Quantity, Quality and Outcomes', *International Journal of Educational Development*, 25: 423-435.

¹⁶⁷ Ibid

¹⁶⁸ ibid

An equally important concern should be impartiality in education. Given the propensities of increased cost recovery, equity will also be affected. An important result of the adjustment policies is outline of more measures for cost recovery.¹⁶⁹ Measures such as students' fees have been presented even at the primary level (for example in Malawi, and recently in Tanzania), although recent deliberations on cost recovery are confined to post-primary levels of schooling. Student fees and student loans are the two most favored processes of cost recovery. Some even recommend full cost recovery, principally at the tertiary level of education. As such actions are introduced, and direct and indirect grants in education are subject to cuts, admittance to education may be seriously restricted, and disproportions may increase in terms of lower enrolment rates for women and other weaker sections of the populace.¹⁷⁰

Adjustment policies openly and tortuously contribute to restoration of the market mechanism in general and privatization of education in specific directly, as adjustment policies specifically comprise of privatization and marketization, and indirectly, through a decrease in government subsidies. As public budgets for education shrink, privatization will affect growth, with all its ill effects. Private enrolment and private investment will upsurge, but the increase will not poise the decrease in public investment, and as a result social investment in education will be less than optimum.¹⁷¹ Governments and private initiative feel that this is the best time to sell any argument in favour of denationalization. As a result, even morally and constitutionally illegal institutions - for example, the capitation-fee colleges may find support. There may be powers with vested interests that try to abuse the situation characterized by adjustment policies, and the growth in capitation-fee colleges may be qualified to these forces. Secondly, similar

¹⁶⁹ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

¹⁷⁰ Cerutti, Furio, *Global Challenges for Leviathan: A Political Philosophy of Nuclear Weapons and Global Warming*, Lanham, MD: Lexington Books. 2007,

¹⁷¹ Manda, D. K. *and the Labour Market in Kenya*, Discussion Paper 6, Nairobi: Kenya Institute for Public Policy Research and Analysis (KIPPRA). 2010. *Globalisation*

forces also help in the growth of private education institutions that rely mostly not on private finances, but on those from the public exchequer: this can be termed as 'pseudo-privatization'. Charitable or non-governmental organizations that rely profoundly on government funds also belong to this category.¹⁷²

Under restructuring, registration rates, school quality and priority for educational investment hurt, and there are problems to an increase in internal efficiency. At the same time there is a need for purposeful effort to preserve allocation to education, for the reallocation of resources - including the targeting of public subsidies - and for cost recovery. The role of the private sector will increase¹⁷³. It is not only the human and financial inputs into education and the education process that are forfeited: the productivity of the education system may also be exaggerated, given the high levels of educated joblessness. This may result in a bigger 'brain drain' - an outflow of an educated labor force, and an intensification in the qualifications demanded for jobs.¹⁷⁴ In all, short-run pragmatism seems to control public policy-making during the adjustment process, and the long-term socio-economic welfares of public investment do not seem to carry any weight¹⁷⁵.

All these effects may be only in the petite term. In the extensive term, economic development may help education, refining, among other things, competence in education. But education is a long-term bustle, and perhaps cannot be fetched back onto the rails in a short period of time when funds are obtainable, once it has gone off the trajectories owing to paucity

¹⁷² King, K. (2005b) 'Re-Targeting Schools, Skills and Jobs in Kenya: Quantity, Quality and Outcomes', *International Journal of Educational Development*, 25: 423-435.

¹⁷³ *ibid*

¹⁷⁴ PC (2012) *Report of the Special Group on Targeting Ten Million Employment Opportunities per Year*, New Delhi, Planning Commission

¹⁷⁵ Cerutti, Furio, *Global Challenges for Leviathan: A Political Philosophy of Nuclear Weapons and Global Warming*, Lanham, MD: Lexington Books. 2007,

of resources.¹⁷⁶ Moreover, the world's experience of these substances is very limited, and the 'long-term outcomes [of adjustment policies] are yet to be observed'. Some of the adversarial consequences may be due to the circumstance that policy changes under adjustment are guided by politically aware rather than efficiency deliberations.

However, it may be that the cuts imposed on education budgets would be more severe but for the adjustment policies, as these policies are resorted to because of severe economic difficulties.¹⁷⁷ In other words, one may argue that the austere economic difficulties may have forced the government to cut its expenditure on education drastically, that the adjustment policies helped in dropping the cuts and that, 'without some form of adjustment, the situation would have been worse'.

3.4 Effects of IMF on Trade liberalization

Free trade between states is intended to enable specification into the field where most efficiency can be attained and thereby increase aggregate output. The total welfare for all participants would be amplified as the goods can be redistributed using trade, allowing each country to reach a higher consumption level than what would have been conceivable in autarky. This assumes that the terms of trade are set established on the relative production cost of different goods and services.¹⁷⁸

Numerous different writers have defined structural adjustment (SA) as a conscious change in the fundamental nature of economic associations within a society¹⁷⁹. Reed adds that these changes should “ensure continued growth,”¹⁸⁰ while Mohan points out that SA redesigns the economies of the Third World to be more market-oriented. Killick elaborates that the

¹⁷⁶ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

¹⁷⁷ Ibid

¹⁷⁸ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

¹⁷⁹ Reed, David (ed). 1992. *Structural Adjustment and the Environment*. Boulder, CO: Westview Press.

¹⁸⁰ Mohan, Giles et al. 2000. *Structural Adjustment Theory, Practice and Impacts*. New York, New York: Routledge.

‘conscious’ characteristic means that it is “a result of the operation of policy, not a change that occurs spontaneously through the market as a response to changing demands and opportunities” Additionally, he defines adjustment policies as “devices deployed to achieve the desired adaptation and to enhance the economy’s tractability”¹⁸¹. Lastly, the World Bank outlines adjustment basically as institutional reforms and government policy¹⁸². The term structure denotes to how a society employs assets, produces goods, and allocates goods and income¹⁸³. The political arrangement, legal framework, execution agencies, conventional patterns of social organization, civic administration, and even demographics of a nation all form a country’s institutional base, which, collective with its productive system and physical infrastructure, are all parts of the nation’s structure

A lot of developing countries use export tariffs in order to preserve goods that are important for the population or to safeguard certain industries and their employees. Tariffs on exports are said to have the adverse effect of discouraging the natural development of the export sector, leading to a misallocation of properties. By eliminating the tariffs, resources will be rearranged to the sector where they get the highest return¹⁸⁴. Import tariffs are kept to dismay the population from purchasing imported goods and thereby shield domestic production. Elimination of import rations and protective barriers are expected to make the domestic market more competitive and run more proficiently.¹⁸⁵ “The neo-liberal paradigm proposes that a system of taxation and subsidy is inefficient, and as such the approach desired in a structural adjustment package is that of lowering taxes to rise individual incentive and to eradicate subsidies to raise

¹⁸¹ Killick, Tony. 1993. *The Adaptive Economy – Adjustment Policies in Small, Low-Income Countries*. Washington, D.C.: World Bank.

¹⁸² World Bank. 2013. World Bank website, accessed on March 30, 2013.

¹⁸³ Killick, Tony. 1997. *The Adaptive Economy – Adjustment Policies in Small, Low-Income Countries*. Washington, D.C.: World Bank.

¹⁸⁴ Killick, Tony. 1993. *The Adaptive Economy – Adjustment Policies in Small, Low-Income Countries*. Washington, D.C.: World Bank.

¹⁸⁵ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

efficiency through greater competition.”

As quotas and tariffs on imports are eradicated, this will also result in a reduction of customs’ revenues, widening the budget deficit. The stiffened competitiveness achieved by the lower price on imports powers domestic industries to become more efficient in order to be able to preserve up with the new competition. Not all firms are able to survive with the new conditions and as a result many of them are forced out of trade.¹⁸⁶ There will be a consequent adverse effect on employment as firms find themselves unable to contend within the new conditions and with subsidized agricultural goods from overseas. Finished goods, no longer manufactured within the country will have to be imported, transferring resources that could be used for debt-servicing.

Currency depreciation is usually required prior to aid negotiations. The exchange rate is perceived as the most important instrument for macro-economic reform, affecting essential supply and demand relations within an economy.¹⁸⁷ By devaluating its currency the country expects to attract more investment by reducing the real overheads of production and labour.

Basically there is a broad accord that aiming for higher economic growth in programme states is good though there are some concerns on the capability of some countries in translating a higher rate of growth to higher standards of living¹⁸⁸. A latest report on chronic poverty, with reference to urban poverty in Ethiopia, states that enhanced macroeconomic management in the mid-1990s did not result in a drop in poverty, on the contrary the urban household welfare deteriorated during this period¹⁸⁹. Other studies go further by pointing out the discrepancy between components of SAPs and the longer term growth policies of the programme countries. For instance the public sector management component promotes cuts in public expenditure and

¹⁸⁶ Ibid

¹⁸⁷ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

¹⁸⁸ Bijlmakers, L., 2003, *Structural Adjustment: Source of Structural Adversity*, Leiden, African Studies Centre.

¹⁸⁹ Stewart, F. (1994), ‘Are adjustment policies in Africa consistent with long-run development needs?’ in van der Geest, W. (ed) *Negotiating structural adjustment in Africa*, London: James Currey and Heinemann.

often this takes place in terms of slices in education, health and other pro poor social disbursements¹⁹⁰. It is hence suggested that as the core aim of aid and development loans is improvements in standards of living in the beneficiary countries, the circumstances attached to aid and loans should take these objectives into account and undeniably the effectiveness of the related programmes should be appraised in terms of improvements in standards of living¹⁹¹.

One significant negative of SAPs, which arose shortly after they were first adopted and has persisted since, concerns their effect on the social sector. In health, SAPs distress both the supply of health services (by holding on cuts in health spending) and the demand for health services (by plummeting household income, thus leaving people with less money for health). Research has shown that SAPs policies have decelerated down improvements in, or aggravated, the health status of people in countries implementing them. The results testified include worse nutritional status of children, augmented incidence of infectious diseases, and higher infant and maternal mortality rates¹⁹².

The immediate result of currency devaluation is a price increase in domestic prices of food, drugs and most inputs for manufacture as the market adjusts to the new conditions. The inflationary propensity associated with price increases is inhibited using tight restrictions on money supply. “The idea is fundamentally that of the so called ‘monetarists’, whereby diminutions in the rate of growth of the money supply results in declines in the rate of growth of the price level.¹⁹³ This theory was adopted by many industrialized economies in the late 1970s and early 1980s, but was hastily abandoned as a major economic strategy due to the effects of

¹⁹⁰ KING, K. (2005b) ‘Re-Targeting Schools, Skills and Jobs in Kenya: Quantity, Quality and Outcomes’, *International Journal of Educational Development*, 25: 423-435.

¹⁹¹ Stewart, F. (1994), ‘Are adjustment policies in Africa consistent with long-run development needs?’ in van der Geest, W. (ed) *Negotiating structural adjustment in Africa*, London: James Currey and Heinemann.

¹⁹² Noorbakhsh, F. (2003) ‘Spatial Inequality and Polarization in India’, University of Nottingham, *CREDIT Research Papers*, No. 03/16.

¹⁹³ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

decreases in aggregate demand and the subsequent presence of mass unemployment. However, it has persisted as an important policy instrument of structural adjustment programs.”¹⁹⁴

As money making is restrained while the relative value of money is reduced, the value of the total money supply within an economy will be abridged, as will the value of everything within that economy in form of foreign exchange.¹⁹⁵ The goal of attracting investment is achieved by the prospect of lower costs of labour and production for those investing. The amendment in the cost structure of certain industries, substantial to currency devaluation, leaves businesses.

3.5 Effects of IMF on Health

Many regulating countries reduced public spending for the social sector as a ratio of central government spending or as a ratio of GDP or even in total monetary terms. For example, the World Bank’s (1994) study showed that Tanzania abridged health expenditure as a percentage of GDP from 1.3% in 1981-1986 to 0.6% in 1987-1990. Equally, health expenditure as a percentage of GDP in the Gambia cut down from 2.3% in 1981-1986 to 1.5% in 1987-1990, while education expenses as a share of GDP fell from 4.6% in 1981-1986 to 3.3% in 1987-1990. In Burkina Faso, health spending as a share of GDP fell from 0.7% to 0.6% between the same periods¹⁹⁶.

Furthermore, the mean for health expenditure for all African countries with large growth in macroeconomic policies fell from 1.5% to 1.4% during the period between 1981-1986 and 1987-1990¹⁹⁷. This evidently controverts the argument that SAPs did not affect social expenditure. New investments in human resource development in regulating, developing nations have also been affected by the decrease in capital and development expenditures because of the

¹⁹⁴ *ibid*

¹⁹⁵ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

¹⁹⁶ Mincer, J. (1958) ‘Investment in Human Capital and Personal Income Distribution’, *Journal of Political Economy*, 66: 281-302.

¹⁹⁷ World Bank (1997) *Adjustment Lending in Sub-Saharan Africa: An update Report No.16594*.

massive political and social sensitivities of reducing current overheads. During periods of fiscal severity, governments find it easier to cut capital expenditure than to reduce current expenditures (especially wages and salaries). Conceding or cancelling a capital-intensive public project is a much softer selection than laying off government workers. Consequently, a sharp cut in capital expenditure as a percentage of GDP has been noticed in most of the regulating countries. The general impact of reduction in social sector spending has been the worsening in health services, mainly community-based primary care and preventive services. Standards of education deteriorated as a result of the decline in the physical infrastructure of schools, shortage of education materials and books, and the deterioration in the real wage of teachers which forced many of them to quit the job or to migrate¹⁹⁸.

A 1992 World Bank Report demonstrates that the implementation of SAPs had a negative effect on a variety of groups. These groups comprise women who form the majority of the poor in society, but who are ironically the critical providers of health at home. This is predominantly the case among female-headed households. The effect of Structural Adjustment Programmes (SAPs) in both rural and urban areas. It is manifest that the poor have suffered disproportionately from the effects of economic deterioration and the structural adjustment measures¹⁹⁹. Economic deterioration and SAPs hit women harder than men. Being accountable for the well-being of their families, women found it difficult to manage increased burdens of disease and hunger. The cost-cutting policies resulting from implementation of the SAPs also affected women more than men as women dominate the less skillful work force. As a group, women are less educated and their contribution in formal employment is low. With SAPs came the rationalization of formal

¹⁹⁸ Mosley, P., F. Noorbakhsh and A. Paloni (2003), 'Compliance with World Bank conditionality: Implications for the selectivity approach to policy-based lending and the design of conditionality', paper presented at the *United Nations University/WIDER conference on 'Sharing Global Prosperity'*, 6-7 September 2003, Helsinki, Finland

¹⁹⁹ Wallace, H. and Kanti, G., 1990, *Healthcare of Women and Children in Developing Countries*, Oakland.

sector employment, leading to the retrenchment of the less skilled class, mainly women. Cost-sharing policies in education and the healthcare sectors also affected women unfavorably. The elimination of subsidies in the agricultural sector, and the subsequent high cost of inputs as well as low revenues on farm products, also undesirably affected the living standards of women and children²⁰⁰.

These efforts to mitigate the negative social significances of structural adjustment programs, principally on the poor, are mainly comprised of retaining “social safety nets and crucial public expenditure, such as education and health”²⁰¹ and include “activities that sought to foster income-generation through small-scale enterprises”²⁰². Alternative way that the World Bank has sought to curtail the adverse social impacts of adjustment is by evening the distribution of the burden among the economic classes. For instance, lower subsidies on fertilizer and seeds could be offset by higher producer prices²⁰³. World Bank funding of social safety nets and the shield of public spending on basic social services increased intensely from 5% of the adjustment loan in FY 1984-86 to 50% in FY 1990-92²⁰⁴.

3.6 Effects of IMF on Agriculture

The production of goods plays a central role in a financial prudence structure. All merchandises are either tradable or non-tradable goods. Tradable goods are “all goods that do or can get into trade as exports or imports,” and include mainly the agriculture, mining,

²⁰⁰ Aina, T., 1996, *Globalization and Social Policy in Africa: Issues and Research Directions*, Dakar, CODESRIA

²⁰¹ World Bank. 2002g. World Bank website, accessed on March 21, 2002. www.worldbank.org/cdf/cdf-faq.pdf.

²⁰² Reed, David (ed). 1992. *Structural Adjustment and the Environment*. Boulder, CO: Westview Press.

²⁰³ World Bank. 1998. *Global Development Finance*. Washington, D.C.: World Bank.

²⁰⁴ World Bank. 2002h. World Bank website, accessed on March 30, 2002. www.worldbank.org/html/extdr/pb/pbadjustlending.htm.

manufacturing²⁰⁵ sectors, and some service industries such as tourism and shopping²⁰⁶. Non-tradables include everything else; the most essential non-tradable goods include the utilities, construction sector, and government and other services such as education, health, and defense²⁰⁷.

During the 1980s, equilibrium and adjustment packages were introduced in many developing countries in an effort to stop further deterioration in standards of living²⁰⁸. The term ‘adjustment’ refers to a series of macro-economic and structural measures that were promoted in the first example by the Bretton Woods institutions - the International Monetary Fund (IMF) and the World Bank - to reinstate internal balances and increase the role of market force in the economy.²⁰⁹ Adjustment policies thus denote the various mechanisms designed to reduce disparities in Third World economies, both on external accounts and in domestic reserve use. Adjustment habitually involved cutbacks in government expenditure. Subsequently, real government expenditure per capita fell in over half the countries of the unindustrialized world in the period 1980-1984²¹⁰. The effect of adjustment measures on local economic conditions varied widely as did the degree and reliability of their implementation. In sub-Saharan Africa, SAPs were implemented in only a minority of countries during the late 1970s, but by the end of the 1980s, utmost countries were officially involved²¹¹. In Africa, fiscal restructuring was a major component of the process of globalization.

²⁰⁵ NMCC (2005) “*The National Strategy for Manufacturing*” Draft Report of the National Manufacturing Competitiveness Council, New Delhi.

²⁰⁶ Cornia, G.A. and G, Helleiner (1994) (eds), ‘*From adjustment to development in Africa: Conflict controversy, convergence, consensus?*’, New York: St Martin’s

²⁰⁷ Killick, Tony. (2011). *The Adaptive Economy – Adjustment Policies in Small, Low-Income Countries*. Washington, D.C.: World Bank

²⁰⁸ Denmark, 1995, ‘Structural Adjustment in Africa: A Survey of the Experiences’, Report prepared by the Centre for Development Research, Copenhagen, for the Danish Ministry of Foreign Affairs

²⁰⁹ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

²¹⁰ Cornia, G., et al., eds., 1987, *Adjustment with a Human Face*, Vol. 1: *Protecting the Vulnerable and Promoting Growth*, New York, Oxford University Press

²¹¹ Streefland, P., et al., 1998, *Implications of Economic Crisis and Structural Adjustment Policies for PHC in the Periphery*.

3.7 Conclusion

The degree to which responsiveness to social impacts of adjustment has really improved the lot of the poor is ambiguous. However,²¹² argues that further loans to alleviate the social impacts of adjustment for the most poor and susceptible groups only adds to a country's debt burden and furthermore, "possibly served more of a political purpose in giving adjustment the appearance of a human face" rather than really making a modification²¹³.

The change of assertiveness in the World Bank from regarding debt reduction as firmly a matter of economic growth to a more holistic view of long-term development and sustainability has been a slow one. This is demonstrated by the change in terminology and indicators that are dignified over the years. In the 1995 *World Development Report (WDR)*, "the main criterion used to categorize economies and broadly differentiate different stages of economic development is GNP per capita"²¹⁴. The subsequent year's WDR, however, stated that "indicators have been redesigned to deliver a core set of standard indicators covering the same three development themes: people, the economy, and the environment"²¹⁵. Latter year's WDR announced the division of World Development Indicators into five main sections: environmental sustainability, human capital development, private sector development, macroeconomic performance, and global links.²¹⁶This is significant because, since macroeconomic indicators are no longer the only things on the radar screen, it may signify a change in the neoliberal framework of the World Bank.

²¹² Rich, Bruce. 1994. *Mortgaging the Earth: The World Bank, Environmental Impoverishment, and the Crisis of Development*. Boston: Beacon Press.

²¹³ Rich, Bruce. 1994. *Mortgaging the Earth: The World Bank, Environmental Impoverishment, and the Crisis of Development*. Boston: Beacon Press

²¹⁴ World Bank. 1995. *World Development Report 1995: Workers in an Integrating World*. Washington, D.C.: World Bank.

²¹⁵ World Bank. 1996. *World Development Report 1996: From Plan to Market*. Washington, D.C.: World Bank.

²¹⁶ World Bank report, (2000/2001).

The joint IMF-World Bank Highly-Indebted Poor Countries (HIPC) Initiative is partially in rejoinder to the Jubilee 2000 movement, and other organizations that have called for the lessening or forgiveness of unindustrialized countries' external debts. HIPC permits eligible country members to be eligible for "exceptional assistance with the objective of achieving debt sustainability over the medium term". Qualified countries include those that are pursuing IMF/World Bank-supported programs of adjustment and reform with a virtuous track record as of the year 2000.²¹⁷

²¹⁷ World Bank. 2000/2001. *World Development Report 2000/2001: Attacking Poverty*. Washington, D.C.: World Bank.

CHAPTER FOUR

CRITICAL ANALYSIS OF MONETARY POLICY IN KENYA

4.1 Introduction

This chapter presents the data that was found on the role of monetary policy on economic growth in Kenya. The research was conducted among interviewees were from ministry of foreign affairs, ministry of planning and development, ministry of finance, ministry of agriculture and livestock, ministry of health, ministry of roads and finally ministry of education. In this chapter, data is presented using non-text methodologies such as tables, pie charts and graphs. The data was evaluated quantitatively using the Statistical Package for Social Sciences (SPSS). The analysis was done as per questionnaires that were cast-off to collect data. Data was categorized in terms of demographic statistics and the role of monetary policy on economic growth in Kenya. Personal information was generated to establish various individual characteristics since this has an effect on the nature of responses given and comprehension of research questions.

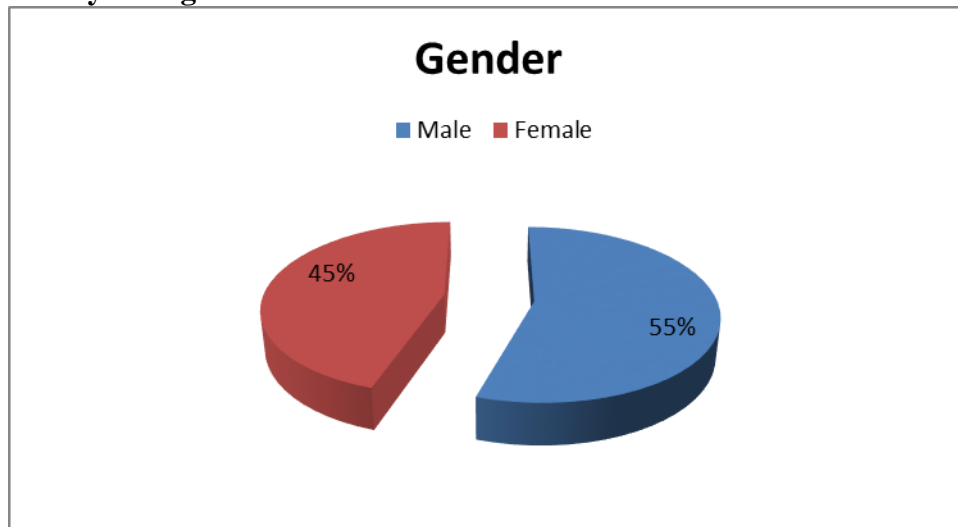
Between 1990 and 2010, Kenya received a cumulative total of US\$9.3 billion in external development aid. Bilateral assistance, received by Kenya from external governments, made up about 49 percent of the total aid inflows. Multilateral donors, comprising intergovernmental organizations contributed 48 percent. International NGOs active in the country funded the balance. Of the multilateral donors, the UN system contributed 35 percent of the total inflows during this period.

4.2 Demographic Information

This segment provides the demographic information of the respondents. This includes the age, gender, work experience and the rank of the respondents.

4.2.1 Gender

Figure 4.1: Analysis of gender



Source: Own Computation, 2014

The respondents were asked to show their gender, this was expected to guide the researcher on the conclusions regarding the congruence of responses to the gender characteristics. The results as in the table below show that a majority of the respondent were male at 55%. To this extent, the findings can be generalized on the male respondents.

4.2.2 Distribution of Age Group

Figure 4.2: Distribution of Age Group

Years	Frequency	Percent	Cumulative Percent
60 Yrs >	20	20	19
50-59	19	19	39
40-49	25	25	62
30-39	26	26	88
18-29	11	11	100
Total	100	100.0	

Source: Researcher 2014

The results presented in Table 4.2 show that a large proportion of 25.5% the respondents were aged from the ages of 30 to 39 years; this was followed by a significant percentage 24.5%

that had also attained ages from 42 to 49 years, while 19.6%, 18.6% and 11.8% are for above 60 years, 50-59 years and 18-29 years respectively. The age composition shows that most of the respondents were of the 30 to 39 years and therefore had rich experiences, could also appreciate the importance of the study, while those below the age of 30 were not conversant enough with information on the role of monetary policy on economic growth in Kenya since they have more experience.

4.2.3 Distribution of Level of Education

Figure 4.3: Distribution of Level of Education

Level of education	Frequency	Percent
postgraduate	30	30
undergraduate	57	57
diploma	10	10
Certificate	3	3
Total	100	100

Source: Own Computation, 2014

The respondents were asked to indicate their level of education; this was in order to help the researcher judge the ability of the respondent to answer the questions as was set in the study. From the table, 57% of the respondents said they had undergraduate degree. 30% had postgraduate degree, 10% said that they had they were diploma holders while 3% said that they were certificate holders. These findings indicate that majority of the staff in the in the government ministries, have undergraduate degree. A significant number had also attained post graduate level of education. This implies that majority of the respondents had adequate skills to respond to the questions asked in the study.

4.2.4 How many years in current position

Figure 4.4: Length of Service in the Current Job

Years	Frequency	Percentage
3yrs and below	7	7
3 to 5 years	15	15
5 to 7 years	61	61
Over 7 years	17	17
Total	100	100.0

Source: Researcher 2014

The researcher sought to establish the years that the respondents had been in the positions stated. Table 4.3 presents the findings on the duration of respondents work in the present capacity. From the figure, 61% indicated that they had been in the present capacity for 5-7 years. 17% indicated a period of over 7 years. 15% indicated a period of 3-5 years while 7% indicated a period of less than 3 years.

4.2.5 How many years in Organization

Figure 4.5: Years in Organization

Years	Frequency	Percentage	Cumulative Percent
1-3 years	3	3	3
3-5 years	11	11	14
6 -15 years	68	68	82
Over 15 years	18	18	100.0
Total	100	100	

Source: researcher 2014

Table 4.4 above presents the findings on the duration of the respondent's working in the organization. From the figure, 68% said that they had worked for the organization for a period of 6-15 years. 18% of the respondents said that they had worked for a period of over 15 years. A percentage of 11 also said that they had worked for the organization for a period of 3-5 years and

3%, 1-2 had worked for between 1 and 3 yrs. These findings indicate that majority of the staff at in the organization; have worked for a period of 6-15 years.

4.3 Overview of IMF policies in Kenya

Kenya's engagement with IMF dates back to 1970s. The engagement has involved lending by the IMF to the country, based on the arrangement that the country would implement structural adjustments.²¹⁸ Generally, IMF policies centre on high currency reserve levels, low one-digit inflation rates, reduction in government budget deficits, reduction in government expenditure on the social sectors, ceilings on the overall national resource envelope and privatization of parastatals.²¹⁹

A severe financial crisis that the country faced in 1980s made it challenging for the government to finance most of its growth policies. In enactment of this financing, the Kenya government commenced on a number of structural reforms aligned with the IMF's policy conditionalities: privatization of parastatals, financial sector reforms, reduction in government spending and civil service reforms.²²⁰ The structural adjustment programs that have been implemented by the Government of Kenya with the funding of the IMF have been under the lending frameworks, consisting of the Trust Fund, improved structural adjustment facility (ESAF), and poverty reduction and growth facility (PRGF).²²¹ The policies which have been implemented under these frameworks are deliberated in the sub-sections below.

²¹⁸ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

²¹⁹ Kimanja L.M (2011). "Impact of monetary policy on exchange rate in Kenya"

²²⁰ Benjamin Maturu (2006). "Channels of monetary policy transmission in Kenya"

²²¹ Cheng, C. K. (2006). "*Var analysis of Kenya's monetary policy transmission mechanism: how does the Central Bank's repo rate affect the economy?*" International Monetary Fund Working paper 06/300

4.3.1 The Trust Fund

The first structural adjustment loan loaned out by Kenya Government from the IMF, under the Trust Fund, was in 1975. This was activated by the financial imbalances created mainly the terms of trade jolts. Worsening economic situations forced the government to return to the IMF in 1982 for the second structural adjustment credit under the fund. Although the economy steadied between 1982 and 1984, little or no progress was made toward structural adjustment. While there were design and timing glitches, the lack of compliance was ultimately due to inadequate commitment. The unsatisfactory implementation led to a pause in adjustment lending and nearly four years passed before another attempt.

4.3.2 Enhanced Structural Adjustment Facility (ESAF2)

The government implemented SAPs in the framework of a wide range of reforms through the publication of Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth under the funding of the IMF. Kenya experienced a key economic transformation during the period 1993-95. Direct controls on domestic prices, external trade, internal marketing, and the exchange system were eradicated, and the interest rate and exchange rates were left to be determined by market dynamics. The government budget shortfall (excluding grants) was reduced from 11.4 percent of GDP in 1992/93 to 2.5 percent in 1994/95; money supply growth was brought under control and confidence in the banking system was reinstated. Nevertheless, economic reforms slowed in 1995, and some impediments occurred. The budgetary targets for the first half of 1995/96 were not encountered, mainly because of large off-budget disbursements, and the restructuring of key parastatals was overdue.

The Government of Kenya and the IMF arranged the Policy Framework Paper in 1996 for the IMF restructurings that were planned for implementation in the period 1996-98. The economic program for 1996-98, supported by the ESAF finances, was focused on the following key areas: consolidation of the fiscal adjustment; avoidance of the recurrence of misuse of public funds; privatization and restructuring of the public sector; and further development of outward-looking competitive markets. The basic medium-term macroeconomic goal was to raise the economic growth rate to about 6 percent by 1998; to uphold inflation at 5 percent throughout the period; and to lower the external current account deficit, excluding official transfers, to about 0.8 percent of GDP.

4.3.3 Poverty Reduction and Growth Facility (PRGF)

The ESAF was rechristened the PRGF in 1999. The Government of Kenya subscribed to the PRGF in 2000, and embarked on the groundwork of the PRSP at the same time. The PRSP was led by the Interim Poverty Reduction Strategy Paper (IPRSP) released in 2001. A new government was voted in December 2002. The government prepared ERS in 2003 to provide the structure for economic recovery for the period 2003-2007.²²² The ERS became the new PRSP. The PRSP 2004 indicates that the ERS took into account existing government policy documents, mainly the PRSP and NARC's Manifesto and Post-Election Action Plan. The development of ERS was also a result of wide-ranging discussions with stakeholders. The stakeholders included trade unions, civil society, parliamentarians, financial institutions, professionals, development partners, industrialists, ASALs, and government.

²²² Kimanja L.M (2011). "Impact of monetary policy on exchange rate in Kenya"

4.4 IMF Current Fiscal Policy

According to the IMF official papers from October and July 2008, the Government's 2008/09 budget is aiming at a budget deficit of 5.3 percent of GDP, which comprises an increase in public investment. Although the IMF staff supported the importance on public investment, the IMF favored targeting a lower fiscal deficit of 4.5 percent of GDP.²²³

Table 4.4: Fiscal deficits in Kenya

	2007/08 IMF Estimate	2008/09 Govt. IMF Budget Projection		2009/10 IMF Projection	2010/11 IMF Projection
Fiscal Deficit As a % of GDP	4.8	5.3	4.6	3.8	3.8

Part of the Government's expected fiscal deficit of 5.3 percent of GDP is to be financed by the floating of an international bond for improved infrastructure investment. The IMF is suggesting that the measures for domestic debt and external debt be combined for a total debt-to-GDP ratio to serve as the new medium-term fiscal anchor. The 2008 Budget Strategy Paper envisioned a gradual reduction of the public debt-to-GDP ratio to 35 percent over the medium term, an objective that IMF staff braced.²²⁴ The authorities stressed that while overall spending (relative to GDP) would weaken over the medium-term, the composition would shift toward development spending, in particular to address urgent infrastructure requirements.

²²³ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

²²⁴ Benjamin Maturu (2006). "Channels of monetary policy transmission in Kenya"

In order to help achieve its core goals of keeping inflation under 5 percent per year and keeping deficit expenses contained, the IMF uses two important monetary goals to constrain the amount of deficit financing that the government can involve in.²²⁵ The first target is a ceiling or limit in the amount of credit that will be accessible in the economy in the year, called Net Domestic Assets (NDA) or net domestic credit. This inadequate amount of available credit must be shared between the government sector and the rest of the economy, including private sector companies. The second target is a floor or basic required level of international hard currency reserves at the central bank or within the domestic banking system, called Net International Reserves (NIR).²²⁶

Often the IMF will either lower the ceiling on available credit (NDA) or raise the surface requirement on reserves (NIR), or both, as a way limiting the available credit that the government can access for engaging in shortfall spending. In Kenya's case, they will tighten both targets over the subsequent few years.²²⁷

²²⁵ Maturu, B.O., K Kethi and I. Maana, (2010) "A New Keynesian Phillips Curve for Kenya", Central Bank of Kenya Working Paper Series, Working Paper

²²⁶ Cheng, C. K. (2006). "*Var analysis of Kenya's monetary policy transmission mechanism: how does the Central Bank's repo rate affect the economy?*" International Monetary Fund Working paper 06/300

²²⁷ Kimanja L.M (2011). "Impact of monetary policy on exchange rate in Kenya"

Table 4.5: Net Domestic Assets (NDA) and Net International Reserves (NIR) in Kenya

	June	June	June	June	Sep	Dec	Mar	June
	2005	2006	2007	2008	2008	2008	2009	2009
Net Domestic Assets (NDA)								
In Billions of Kenyan Shillings								
Domestic Credit	466.3	521.7	607.1	712.8	693.6	767.6	820.6	864.4
Domestic Credit	466.3	521.7	607.1	712.8	693.6	767.6	820.6	864.4
Avail for Government	112.3	117.9	157.2	132.7	158.2	185.7	172.6	171.9
Avail for Rest of Economy	354	403.8	450	580.1	535.4	581.9	647.9	692.5
Ratio of Credit Available to Government vs Total	0.24	0.23	0.26	0.19	0.23	0.24	0.21	0.20
Net International Reserves (NIR)								
BOK Net Foreign Assets in Millions of US \$	1,212	2,159	2,357	2,896	3,067	3,078	3,089	3,192
NDA/NIR Ratio	0.09	0.05	0.07	0.05	0.05	0.06	0.06	0.05

The latest data from IMF official papers project that over the next few years, the IMF will have Kenya lower the upper limit on available credit (NDA) while raising slightly the required ground for international currency reserves (NIR), thereby embracing away possibilities for greater “fiscal space” which could enable a greater investment in health systems in order to address HIV/AIDS and TB. The data point out that the levels for NIR are intended to upturn still further to \$4.1 billion in 2009/10; 4.6 billion in 2010/11; 5.1 billion in 2011/12; and \$5.78 billion in 2012/13.²²⁸

4.5 Monetary Policy Indicators in Kenya

Inflation below 5 percent per year lingers to be the overall monetary policy objective. Recent measures to tighten fiscal policy were in the right direction in the face of high money growth and

²²⁸ Maturu, B.O., K Kethi and I. Maana, (2010) “A New Keynesian Phillips Curve for Kenya”, Central Bank of Kenya Working Paper Series, Working Paper

inflationary pressures and more steps are instantly needed to prevent second-round effects of higher fuel and food prices.²²⁹ Political unpredictability took a toll on economic activity and aggravated inflationary pressures in early 2008. First quarter GDP constricted by 1.3 percent (year-on-year), with tourist arrivals down casted by over 50 percent and most sectors hampered by interruptions to supply chains and displacement of productive resources.²³⁰ The resulting shortfalls compounded inflationary pressures rising from an earlier accommodative fiscal policy as well as from rising international food and fuel prices. Inflation for the official headline consumer price index (CPI) was 26.5 percent in July (year-on-year).²³¹

Table 4.6: Monetary Policy Indicators in Kenya

	2005/06 Estimate	2006/07 Estimate	2007/08 Estimate	2008/09 Projection	2008/09 Projection	2008/09 Projection	2008/09 Projection	2008/09 Projection
Inflation Annual average %	11.1	10.4	18.5	14.5	5.0	5.0	5.0	5.0
Reserve Money Growth End of period %	14.0	17.5	19.6	15.0	14.6	14.1	14.1	14.1

The IMF supports the centering of fiscal policy around a decrease in the growth of stand-in money. According to the IMF,²³² “Monetary policy was tightened in June 2008 to address escalating inflationary pressures. For much of 2007/08, reserve money growth had surpassed the authorities’ target and private sector credit growth had also remained robust.” In early June, the Central Bank Rate (CBR) was raised by 0.25 percent to 9 percent in reaction to continued

²²⁹ Maturu, B.O., K Kethi and I. Maana, (2006) “A New Keynesian Phillips Curve for Kenya”, Central Bank of Kenya Working Paper Series, Working Paper

²³⁰ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

²³¹ Maturu, B.O., K Kethi and I. Maana, (2010) “A New Keynesian Phillips Curve for Kenya”, Central Bank of Kenya Working Paper Series, Working Paper

²³² International Monetary Fund. 2008. *The World Bank and the Agricultural Sector in Kenya*. Operations Evaluation Department Report No. 18088, Washington, D.C.

inflationary pressures.²³³ The government explained that the June increase in the CBR signaled their intention to let market rates rise. Staff stressed the need to employ decisively all available instruments, including appropriate term-deposit auctions and foreign exchange (FX) reserve sales, to slow reserve money growth to stop “second round” effects of higher fuel and food prices; in this regard, the planned introduction of the CBK’s own bills could provide a further useful instrument. Conversely, reserve money growth has remained above the level that the CBK and staff had deliberated consistent with the envisaged decline in inflation during 2008/09.²³⁴

According to the Central Bank of Kenya’s “Monthly Economic Review” on economic developments through August 2008, reserve money improved by 18.9 percent in the year to July 2008 compared with 17.6 percent growth in a similar period in 2007. The amplified expansion in reserve money was held as bank reserves and currency outside banks improved by 30.4 percent and 12.0 percent correspondingly, compared with 16.5 percent and 18.3 percent in 2007. The amount of reserve money in July 2008 was Ksh 152.6 billion or Ksh 5.7 billion above target. The excess was held in bank reserves (Ksh 3.7 billion) and currency outside banks (Ksh 2.0 billion).²³⁵

4.3 Contribution of Monetary Policy to Kenya’s Development

Kenya has been getting monetary funds from international monetary agencies. Kenya has been a beneficiary of monetary funds for economic growth since its existence. This has been in the form of tied aid, grants, project aid and huge inflows intended to keep the foreign exchange reserves at a safe level to cope with industrialization related liberal import policy.²³⁶ Fiscal policy has

²³³ Cheng, C. K. (2006). “*Var analysis of Kenya’s monetary policy transmission mechanism: how does the Central Bank’s repo rate affect the economy?*” International Monetary Fund Working paper 06/300

²³⁴ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

²³⁵ Kimanja L.M (2011). “Impact of monetary policy on exchange rate in Kenya”

²³⁶ Benjamin Maturu (2006). “Channels of monetary policy transmission in Kenya”

played very significant role in the economic development of Kenya. In the commencement, Kenya received very small aid from the rest of the world and international monetary agencies.²³⁷ Industrialization development began in Kenya after the late 50s and to fulfill the demand of passionate development activity, increased reliance on foreign resources became virtually unavoidable. In the economic antiquity of Kenya five-year planning scenario is also responsible for fiscal policy. Table below shows evolution of total aid to Kenya from the period 1980-2008.²³⁸

Table 4.7: Evolution of Monetary Policy to Kenya

	ODA at current prices US \$ Million	ODA at 2008 constant prices US \$ millions	Kenya's share	Kenya's share of	ODA as
			of developing countries ODA percent	Africa's ODA, percent	share of GNI, percent
Year	(2)	(3)	(4)	(5)	(6)
	393.44	934.42	1.2	3.8	5.84
1985	426.66	1093.96	1.3	3.5	7.16
1990	1181.29	1822.73	2.1	4.7	15.35
1995	731.36	923.71	1.2	3.4	9.18
2000	509.94	745.25	1.0	3.3	4.16
2002	378.05	561.78	0.7	2.1	2.84
2004	683.73	815.01	0.9	2.4	4.14
2006	1021.78	1161.76	0.7	1.3	4.33
2008	1527.85	1527.85	1.2	3.3	5.66

Notes and Sources: Economic Survey 2010

The study findings in table above indicate that percentage of Kenya's share of fiscal policy in comparison to other developing countries and the rest of Africa has been increasing in the recent years. Kenya's share of foreign aid directed to emerging economies all over the world increased from 0.7% in the year 2006 to 1.2% in the year 2008.²³⁹ Equally, Kenya's share of foreign aid directed to Africa improved from 1.3% in the year 2006 to 3.3% in the year 2008.

²³⁷ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

²³⁸ Maturu, B.O., K Kethi and I. Maana, (2010) "A New Keynesian Phillips Curve for Kenya", Central Bank of Kenya Working Paper Series, Working Paper

²³⁹ Maturu, B.O., K Kethi and I. Maana, (2006) "A New Keynesian Phillips Curve for Kenya", Central Bank of Kenya Working Paper Series, Working Paper

The increase in Kenya's foreign help can be attributed to the increasing need for financial assistance due to economic inflation that followed global economic recession whose peak was experienced in the year 2008.²⁴⁰ Kenya's relatively strong economic enactment during the 1970s waned over the following decade. Global downturn took its toll and the economy slowed under the pressures of lower international prices for Kenya's commodity exports and increased oil prices. Kenya's balance of payments difficulties led to the introduction of an adjustment programme supported by heavy borrowing from the international financial institutions.²⁴¹

4.4 Monetary Policy on Economic Growth by Beneficiary Sectors

The economic management sector received the largest proportion of external assistance between 1990 and 1993, and briefly in 1996. Transport infrastructure became the leading sector beneficiary of external assistance in 1995, while agriculture led in 1997 and health in both 1998 and 1999.²⁴² International aid within the economic management sector was targeted to budget support and management of reforms. The changes in the sectorial inflows partly reflect Kenya's relationship with the Bretton Woods Institutions, which have been key actors in the reform process. The health sector has gained prominence in recent years due to emerging recognition of the challenges posed by malaria and HIV/AIDS and the international response to these challenges²⁴³.

²⁴⁰ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

²⁴¹ Maturu, B.O., K Kethi and I. Maana, (2010) "A New Keynesian Phillips Curve for Kenya", Central Bank of Kenya Working Paper Series, Working Paper

²⁴² Benjamin Maturu (2006). "Channels of monetary policy transmission in Kenya"

²⁴³ Kenya National AIDS STRATEGIC PLAN. 2009/10 – 2012/13.

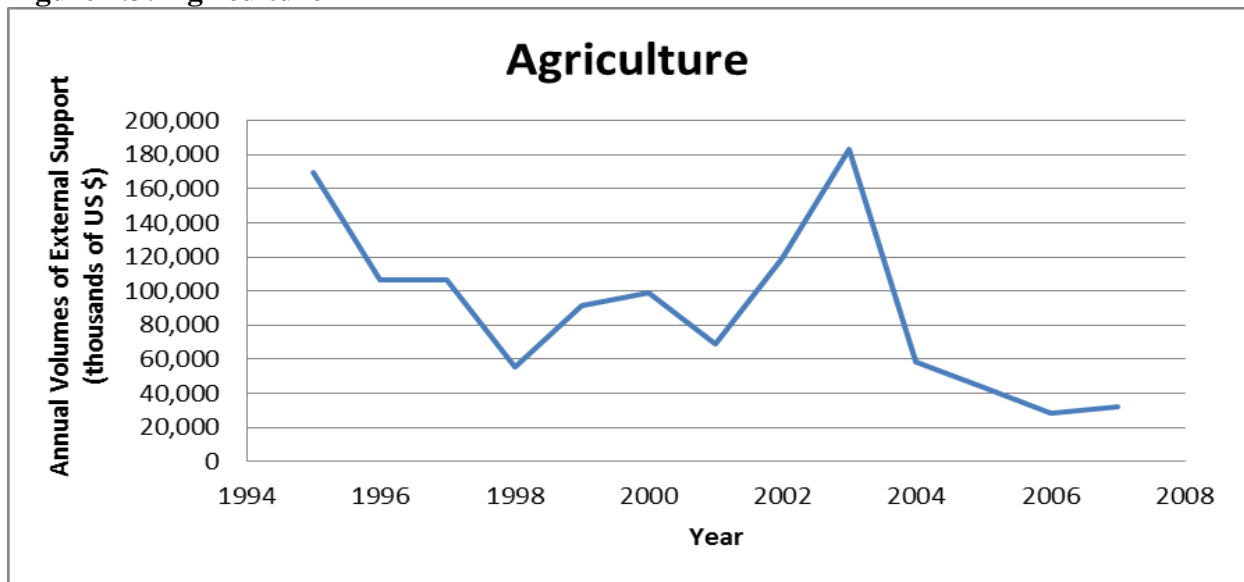
Table 4.8: Sector Focus Area

Sector/Focus Area	Annual Volumes of External Support (thousands of US \$)												
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2005	2010
Agriculture	169,809	106,680	106,699	55,503	91,388	99,170	68,842	119,121	183,081	58,247	43,609	28,045	32,194
Civil Society Development	3,259	6,872	5,369	1,307				6,519	6,576		2,798	3,924	6,387
Conflict Resolution											710	143	1,170
Economic Management & Policy	766,050	142,389	360,078	403,619	122,457	78,646	122,671	38,230	30,294	8,773	19,781	4,983	4,988
Education	70,947	46,380	66,976	21,583	16,606	57,748	72,222	41,915	39,023	42,919	27,136	36,873	15,840
Emergency Response/Disaster Management	5,695	8,586	97,559	145,845	55,617	66,712	48,360	62,823	73,784	73,159	215,113	129,359	71,294
Energy	28,305	26,505	20,479	899	1,906	2,321	1,951	475	26,752	44,581	14,731	91,936	48,559
Forestry and Environment	3,084	9,008	6,650	17,516	2,021	13,038	4,240	7,397	3,319		7,187	5,988	5,556
Governance and Public Administration	13,147	14,492	23,541	11,127	9,122	6,959	6,129	9,777	10,755	9,258	28,608	78,149	36,226
Health & HIV/Aids	72,608	70,859	57,037	16,354	35,682	68,365	63,637	68,241	101,705	93,738	51,372	63,054	87,010
Housing/Shelter(Rural Urban Development)	7,195	6,662	2,645	518	2,141	9,809	10,351	21,345	10,575	7,521	8,294	36,181	24,921
Infrastructure(Road and Communications)	120,633	183,390	61,395	22,539	55,012	119,838	61,289	99,162	43,997	78,104	56,329	36,773	11,705
Multisector	43,722	22,894	16,990	13,569	3,035	29,774	23,925	37,752	43,333	34,570	22,751	31,673	25,812
Natural Resource Management	27,528	33,232	43,098	37,655	44,168	4,279	22,618	26,207	34,675	7,013	2,446	4,104	3,121
Other sectors			1,032		35,361		406	365	1,590	4,399	23	33	574
Private Sector Development/Finance	30,107	32,572	13,587	4,516	12,869	74,004	10,618	21,375	10,271	10,646	19,920	6,878	16,638
Sanitation/Water	47,751	47,601	12,870	2,596	19,885	30,025	49,300	26,502	12,345	26,986	10,516	9,775	7,125
Social Protection	1,588	729	1,385	61		604	29,489		195		4,007	5,086	6,054
Vocational Training	1,536	11,448	3,712	3,604	5,632	7,383	4,600	4,277	3,921	2,803	55	112	58
Wildlife, Trade Hotels & Tourism	44,995	71,318	96,636	98,124	8,038	3,215	21,233	36,776	18,960	23,747	379	1,641	230
TOTALS	1,457,959	841,617	997,738	856,935	520,940	671,890	621,881	628,259	655,151	526,464	535,765	574,710	405,462
Sources: Development Cooperation Reports (various years)													

Table above shows a distribution of foreign Aid in different sectors from 1990 to 2010. The outcome shows that emergency response and disaster management was the leading sector in the years 2000 and 2001. The infrastructure, health (including HIV/Aids) and agricultural sectors, in that order in 2000 while in 2001, the order was energy, governance and health.²⁴⁴ The table also indicates that economic management and policy had the highest Aid in the 1990s. The extended drought in those two years had a direct bearing on the proportion of external assistance received as emergency response and disaster management.

²⁴⁴ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

Figure 4.3: Agriculture



Donor funds in Kenyan agriculture have not always been used in the most effective and accountable manner. A recent World Bank evaluation of its support to Kenya’s agricultural sector points to overall mixed success with regard to outcome, sustainability and institutional development. Poor design and inadequate borrower ownership were seen as the major shortcomings²⁴⁵.

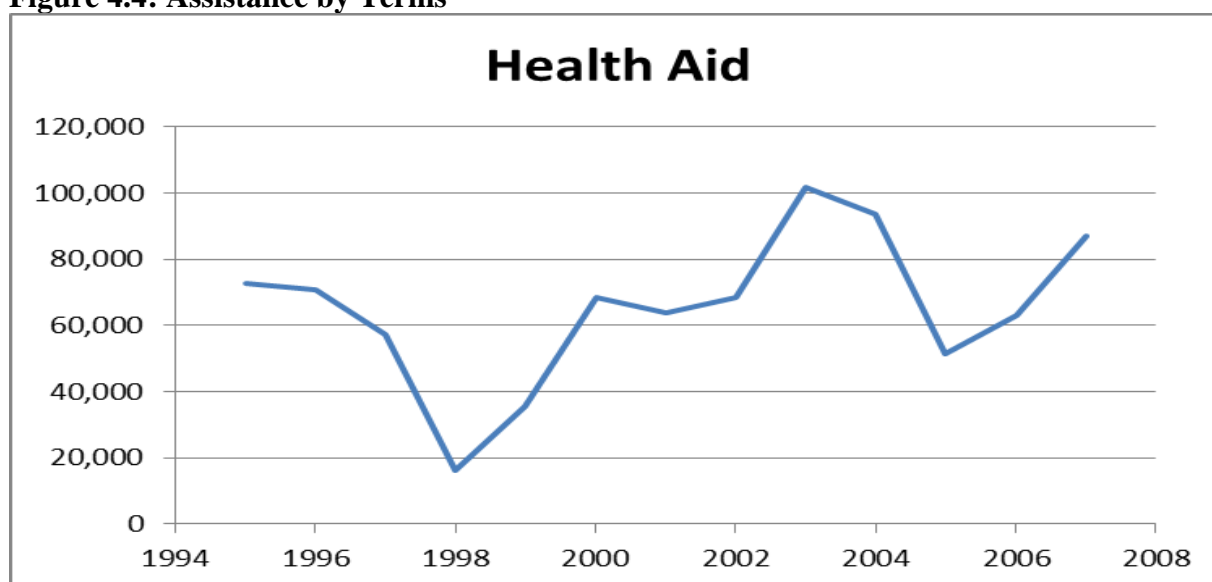
Donors particularly the IMF have long been involved in policy dialogue with government.²⁴⁶ Kenyans outside of government normally have not. Formal discussion with government on the policy issues of the day does not take place at the village level, in research fora, or even in parliament where the agriculture budget is passed in a matter of minutes. This allows government to use donors as a convenient whipping boy whenever unpopular policy reforms are undertaken. A large but silent majority of Kenyans benefit from the ongoing structural reforms.

²⁴⁵ World Bank. 2008. *The World Bank and the Agricultural Sector in Kenya*. Operations Evaluation Department Report No. 18088, Washington, D.C.

²⁴⁶ Benjamin Maturu (2006). “Channels of monetary policy transmission in Kenya”

In 2004, IMF also launched the Strategy for Revitalizing Agriculture (SRA) to build and elaborate on the ERS with respect to the agricultural sector. Implementation of the SRA has been largely successful. During this period, the sector went beyond the growth target that had been set of 3.1 percent to reach a high of 6.1 percent in 2007.²⁴⁷ As we had promised, all agricultural institutions including those of extension, research, inputs, credit and agro-processing have been revived. Consequently, the farming community has experienced an impressive turnaround in its fortunes.

Figure 4.4: Assistance by Terms

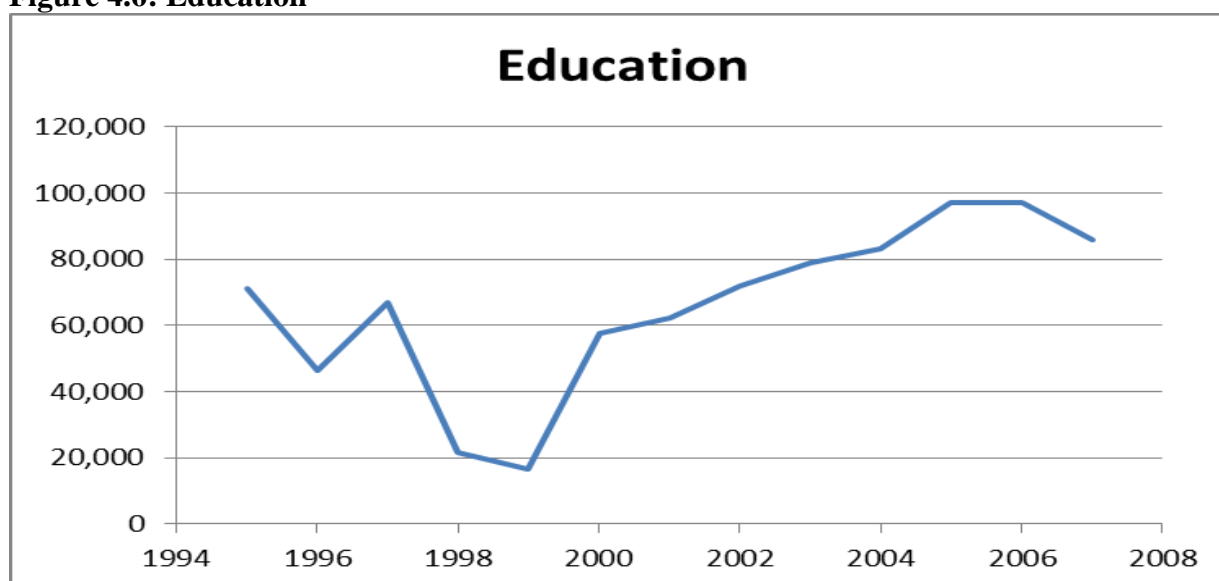


In 2003, health was the leading sector followed by emergencies and energy sectors. In that year, the health sector (including HIV/AIDS) received 21.5 percent of the total external assistance to Kenya, while the emergencies and energy sectors received 17.6 and 12 percent respectively.²⁴⁸ Agriculture received 7.9 percent. Although the education sector received a relatively low level of 3.9 percent, it promises to increase in 2003 with the introduction of the free primary education programme and the positive response of the donor community.

²⁴⁷ Maturu, B.O., K Kethi and I. Maana, (2010) "A New Keynesian Phillips Curve for Kenya", Central Bank of Kenya Working Paper Series, Working Paper

²⁴⁸ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

Figure 4.6: Education



There was little doubt that, following independence, the new government was committed to the funding of education, and in particular to the attainment of free and universal primary education.²⁴⁹ However, the government's capacity to finance education was constrained, most notably by the global oil crisis of 1975, and the post-1980 recession. Aid programmes at this time were focused upon skills development and particularly upon aiding the fledgling university structure. Project aid reflected the interests and expertise of the bilateral agencies and did not generally lead to a consistent externally funded programme. Reflecting the bias towards the higher levels of the system, enrolment rates at universities went from 1,910 in 1969 to 7,900 in 1979, and close to 40,000 by 1989.²⁵⁰

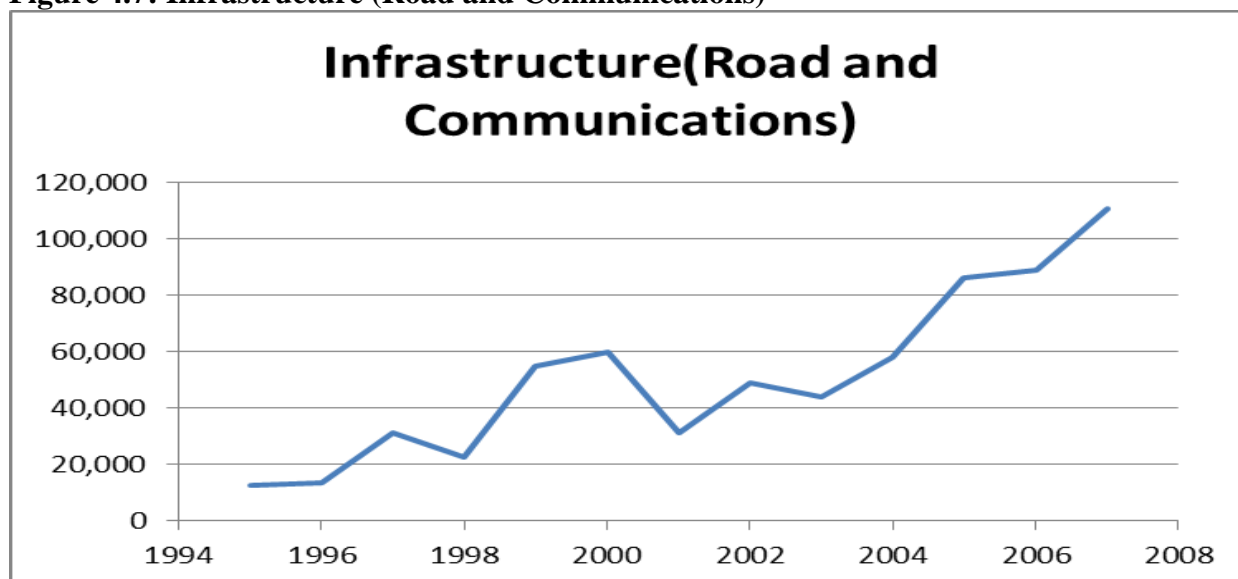
Aid to education in Kenya remained modest relative to the government's education expenditure, but it has nevertheless played an influential role at particular times. Between 1970 and 1995 the main foreign donors to education were UNICEF, UNESCO and

²⁴⁹ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

²⁵⁰ Maturu, B.O., K Kethi and I. Maana, (2006) "A New Keynesian Phillips Curve for Kenya", Central Bank of Kenya Working Paper Series, Working Paper

the World Bank, each of which placed a growing emphasis on the importance of basic education.²⁵¹

Figure 4.7: Infrastructure (Road and Communications)



Donors have played a big role in major infrastructural projects in Kenya, this include rehabilitation of the Northern Corridor that links Uganda and western Kenya to the regional and international markets will help to stimulate growth in one of Kenya’s poorest regions and throughout the East Africa region.²⁵² The first Super highway was a Support of African Development Bank and the Chinese government, rehabilitation of roads like Maai Mahiu-Lanet road. Other donor supports are concessioning of Uganda Railways jointly with Kenyan Railways will help to connect Ugandan markets with the port of Mombasa in Kenya. Assistance to improve access to southern Sudan will be important to foster trade between the countries. Support to upgrade other transportation corridors, the port of Mombasa, airports and cross-border infrastructure will also promote growth and regional integration. The government in 2007 established three autonomous roads authorities to manage the transportation network

²⁵¹ Kimanja L.M (2011). “Impact of monetary policy on exchange rate in Kenya”

²⁵² Maturu, B.O., K Kethi and I. Maana, (2010) ”A New Keynesian Phillips Curve for Kenya”, Central Bank of Kenya Working Paper Series, Working Paper

transparently and efficiently. An important objective of the authorities is to reform the policy and institutional framework governing the management, accountability, and financing of road construction and maintenance. Once the reforms are put into place, some KJAS partners will consider scaling-up financing for transport infrastructure.²⁵³ KJAS partners will also facilitate private sector participation in the financing, construction, and management of Kenya's road network and ports, including a toll-road concession of 77 kilometers in and around Nairobi. Private participation is expected to both mobilize additional financing and to improve the management of the network.²⁵⁴ Finally, in line with the Roads 2000 Strategy, KJAS partners will help improve and maintain the rural road network using approaches that encourage development of the local private sector and maximize employment opportunities. Recognizing that road accidents are a leading cause of death and injury in Kenya, KJAS partners will assist the government with measures to improve road safety.²⁵⁵ Because poor governance and corruption have led to the waste and misuse of resources for transportation infrastructure, special attention will be paid to procurement and financial management practices and to contractor performance in all partner-supported activities. In addition, Kenya will be encouraged to participate in a pilot Construction Sector Transparency Initiative that is based on experience with the Extractive Industries Transparency Initiative.²⁵⁶

²⁵³ Maturu, B.O., K Kethi and I. Maana, (2006) "A New Keynesian Phillips Curve for Kenya", Central Bank of Kenya Working Paper Series, Working Paper

²⁵⁴ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

²⁵⁵ Ibid

²⁵⁶ Maturu, B.O., K Kethi and I. Maana, (2010) "A New Keynesian Phillips Curve for Kenya", Central Bank of Kenya Working Paper Series, Working Paper

CHAPTER FIVE

SUMMARY OF FINDINGS CONCLUSIONS AND RECOMMENDATION

5.1 Introduction

This chapter presents summary of finding according to objectives of the study, conclusions and recommendation of the study.

5.2 Summary of Findings

Findings from this study suggest that for effective fiscal policy management, it is important that a central bank tackles the monetary policy transmission mechanism problem by finding adequate answers to three basic questions, namely, Does monetary policy impact on economic growth in Kenya? Which of the monetary policy transmission channels is most effective in affecting the economic growth? To what extent does monetary policy affect economic growth? What is the average amount of time taken for the full impact of a monetary policy shock on economic growth to materialize?

The study finds that economic development does not respond to fiscal policy shocks indicating that there are other factors that influence the economic growth in Kenya. The study also finds the interest rate channel followed by the credit channel to be the most operational channels in influencing economic growth. In the period under review, the monetary policy shock accounts for 14.98% of the inflation growth.²⁵⁷

5.3 Conclusion

According to reports by the International Monetary Fund (IMF) and the European Central Bank (ECB), many of the factors that led to the financial crisis in the United States created a similar crisis in Europe. Essentially low interest rates and an expansion of financial and investment opportunities that arose from aggressive credit expansion, growing complexity in mortgage

²⁵⁷ IMF (2011), *World Economic Outlook*, Washington D.C., International Monetary Fund.

securitization, and loosening in underwriting standards combined with expanded linkages among national financial centers to spur a broad expansion in credit and economic growth. This rapid rate of growth pushed up the values of equities, commodities, and real estate. Over time, the combination of higher commodity prices and rising housing costs strained consumers' budgets, and they began reducing their expenditures.

One consequence of this drop in consumer spending was a slowdown in economic activity and, eventually, a reduction in the prices of housing. In turn, the decline in the prices of housing led to a large-scale downgrade in the ratings of subprime mortgage-backed securities and the closing of a number of hedge funds with subprime exposure. Concerns over the pricing of risk in the market for subprime mortgage-backed securities spread to other financial markets, including to structured securities more generally and the interbank money market. Problems spread quickly throughout the financial sector to include financial guarantors as the markets turned increasingly dysfunctional over fears of under-valued assets.

5.4 Recommendations

Because of existence of inverse relationship between the monetary policy shock and economic growth in Kenya, the Central Bank of Kenya should formulate policies that reduce interest rates to desirable levels and still seek to achieve low levels of inflation. The results indicate that there are factors that affect economic growth other than monetary actions.

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