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Introduction

The Kenyan economy is at a major crossroads as it wades through this first decade of the 21st century. Caught up in a historically crucial political and economic transition, the country's economic strength and resilience continue to be tested. This paper reviews the Kenyan economy's performance, challenges and opportunities as it transits from former President Moi's 24-year reign to the new ruling party, the National Alliance Rainbow Coalition. The coalition is led by President Mwai Kibaki who took over the country's leadership at the end of December 2002.

1. A Brief Historical Overview

Kenya has had a relatively short and bumpy existence as a nation. In only 100 years since it was created as a British colony, the country has travelled through a difficult political and economic terrain, including a bloody resistance to colonial rule which culminated in the Mau Mau armed uprising of the 1950s. Kenya has also been through a prolonged struggle for democracy as the first two post-independence political regimes of Kenyatta and Moi failed to establish truly democratic political and economic institutions. It has just managed to survive the economic crisis of the 1980s and 1990s, which were a result of gross economic mismanagement, unbridled corruption, loss of international credibility and collapse of key infrastructural facilities.

Thus, the country sets off in the new millennium with heavy baggage inherited from the past. This baggage will weigh on the economy, adversely affect its prospects, and considerably shape the country's economic fortunes and challenges in the coming decade and beyond. This includes a severe budgetary crisis, heavy domestic and external public debt, endemic corruption and mismanagement of public resources, a stagnant economy, adverse effects of the on-going liberalisation and globalisation processes, reduced ability to attract

foreign investments, health and medical problems associated with the HIV/AIDS pandemic, poor relations with the donor community, collapse of the country's infrastructure, a non-conducive political environment, insecurity, and high levels of poverty and unemployment affecting a large proportion of the population. While the Kenyan economy remains the largest and most resilient in the region, its ability to cope with rising demands will be severely tested.

Kenya currently occupies 17th position as the poorest country in Africa (using per capita Gross National Product), and 180th out of 210 countries in the world (World Bank, 2002). With about 47% of the population living below the poverty line, 25% of an estimated 15 million labour force unemployed and another 25% underemployed, the country faces a daunting task in its efforts to improve the standards of living of the population, currently estimated to be below the 1970 level.

The numerous problems that the country carries over from the last two decades rule out a dramatic recovery of the economy at the beginning of the new century despite the recent welcome news that the International Monetary Fund (IMF), the World Bank and other bilateral and multilateral institutions are set to resume development assistance in 2003. This is due to the high international approval of recent measures taken in the country's anti-corruption crusade following the defeat of Moi's reign during which corruption was basically officially tolerated.

The next century will witness a large increase in Kenya's population with major implications on the economy, especially if the HIV/AIDS pandemic is controlled. According to World Bank projections, by the year 2025 Kenya's population will have more than doubled from its current 30 million to 73 million people. This will make Kenya the 4th most populous country in Africa and 19th in the world.

The anticipated rapid population growth is expected to be accompanied by a major shift of the population from rural to urban areas. Kenya's rate of urbanisation rose sharply in the last two decades. This process is expected to accelerate in the first half of the 21st century. Between 1980 and 1998, the proportion of the Kenyan population living in urban areas almost doubled from 16% to 31% (Republic of Kenya, 2002). If this rate is maintained, the Kenyan population living in urban centres will be between 60% and 70%. This in turn will pose a major challenge in terms of required

investments to create employment, transport, water and sewerage, health and education facilities. However, compared to many countries in Africa and the rest of the world, Kenya's level of urbanisation is low. For instance in Botswana in 1998, the proportion of the population living in urban areas was 68% while that of Algeria was 58%. The corresponding figures for South Africa were 50% and 44% for both Zambia and Benin (World Bank, 2002).

The country's production structures are also expected to undergo major changes in the first half of this century. One of the officially anticipated changes is the transformation of the country into a newly industrialising economy by the year 2020. While there is considerable scepticism about whether this change will take place, there is ample evidence from the South Asian experience in the last two decades that NIC status is an achievable feat within two decades, even for a country in Kenya's current economic situation. Many of south-east Asian nations embarked on industrialisation programmes with per capita Gross National Product (GNP) levels below those currently prevailing in Kenya.

However, for this industrial transformation to take place, a radical change in the country's economic governance and political leadership is required. The critical role of focused and visionary leadership in rapid transformation and development of an economy is one of the lessons that has emerged from the Asian experience in the last three decades of the 20th century. Therefore, Kenya's dreams of industrialisation within the first two decades of the 21st century will depend on whether a conducive political environment is created in the first few years. The constitutional review process and creation of a cohesive political identity among the new leadership stand prominently as obstacles to this situation.

For Kenya and many other African countries to effectively address problems inherited from the 20th century, especially poverty and unemployment, significant progress in industrialisation must occur within the first three decades of the new century. Unless this happens, the struggle against these and other socio-economic problems will be difficult and prolonged. Nonetheless, it would be wrong for countries like Kenya to single-mindedly focus on industrialisation at the expense of other sectors. Adequate attention on the tertiary or service sector could positively impact on the overall development process.

The services sector has been a pillar of the Kenyan economy in the last 40 years. The sector has clearly demonstrated its potential and catalytic role in the economy. The country's comparative advantage in some of the service sub-sectors, particularly tourism and transport, shows that the sector is as crucial in both short-term and long-term economic recovery, a necessary condition for industrialisation. Estimates show that by the second half of the 1990s, Kenya's service sector accounted for about 55% of GDP per year and 60% of the total wage employment on average (Republic of Kenya, 2000).

However, for Kenya's key service sectors to continue to play a leading role in the national economy, deliberate efforts must be made to maintain and enhance their global and regional competitiveness through strategic investments. South Africa will continue to pose a major challenge to Kenya's tourist and transport services, two of the country's main service exports. Since the lifting of international sanctions against South Africa following the collapse of apartheid, South Africa has strongly encroached on some tourist resources which were formerly the forte of Kenya.

Recent plans to establish a direct rail link from Durban to Kampala if realised would deal a severe blow to the lucrative northern transport corridor currently dominated by Kenyan transport facilities—harbour, rail and road. Both the Mombasa port authorities and other providers of various transport services will need to radically improve their efficiency in terms of reduced costs, delays and provide better security for goods to avoid losing a large chunk of their business to South Africa. Kenya's economic dominance in eastern Africa will be considerably eroded in the first decade of the new millennium, partly due to the entry of South Africa in the region, and partly due to the relatively higher economic growth rates achieved by Uganda and Tanzania. In order to progress, Kenya must be willing to learn from the main lessons of the last four decades. One of the lessons learnt is the need to undertake economic, political and social reforms without undue delays. Effective implementation of economic and political reforms has become an indispensable strategy for rejuvenating national institutions and systems for rapid progress.

Another lesson is that without a conducive political environment, very little progress can be made in the socio-economic arena. Politics of patronage and ethnicity have been revealed as a debilitating factor in the development process because of their tendency to create an environment conducive to corruption, mismanagement and other forms of economic mis-governance. A

recent example of this is Cote d'Ivoire. As a bright example of economic and political stability in Africa in the post-independence period, Cote d'Ivoire's stability quickly eroded towards the end of 1990s. This culminated in the country's first military takeover in December 1999. It was largely a result of ethnic tensions created by the regime to curtail the political freedom of some personalities, based on ethnic factors.

2. Nature and Causes of Kenya's Economic Problems

There is a consensus that the economy has been facing its worst crisis in the last seven years, forcing the then Minister of Finance, Mr. Simeon Nyachae, to admit in 1998 that "*the country's economy was in the intensive care unit*". Immediate indicators of Kenya's economic crisis were clear from its weak budgetary position—available resources could not meet recurrent national expenditure, thus leading to the failure of government institutions to pay for services rendered. Additionally, payments were delayed, and key institutions including educational and health facilities were under-financed. Two expenditure items alone—wages for civil service and servicing of public debt—take up about 70% of the total available revenues, leaving key government functions either unfunded or inadequately funded.

Other aspects of the national economic crisis included collapse of key infrastructural facilities, making the country's business environment highly unattractive and expensive; stagnation in economic growth, below 2% annual growth rate of GDP for the last few years; crisis in key economic sectors notably tourism, manufacturing and agriculture; loss of confidence from the donor community on which the economy had become highly dependent; failure to attract either domestic or foreign investments; wanton looting of the economy by government officials; and the financial sector crisis.

Kenya's economic performance has experienced sharp contrasts in the last four decades. Between the 1960s and mid-1970s, Kenya was regarded as one of the few examples of a well-managed and dynamic economy in sub-Saharan Africa. During this period, the economy recorded real average GDP growth rate of about 6.5% per annum between 1963 and 1972. This period also enjoyed macro-

economic stability with low levels of inflation, relatively stable balance of payments and budgetary positions in addition to high international credit-worthiness. However, the oil crisis of the 1970s dramatically changed the country's course from a high economic performance record to a stagnating economy in the 1980s and 1990s, except for the short commodity boom period of 1976–1978. The exceptionally high coffee and tea prices during this commodity boom helped the economy recover and experience a strong resurgence which raised the GDP growth rates to over 7% from a low rate of about 1% recorded in the 1973–75 period. The oil crisis of 1973 marked the beginning of instability in the balance of payments and the budgetary position, increasing levels of unemployment, inflation, external and internal public debts and low national GDP and sectoral growth rates. These were to be a common feature of the economy in the 1980s and 1990s.

The 1980s saw Kenya officially embrace economic reforms in the context of the World Bank and International Monetary Fund supported Structural Adjustment Programmes (SAPs). However, the implementation of the reforms for most of the 1980s was half-hearted, and did not lead to the expected recovery. The 1980s were thus characterised by major fluctuations in the GDP growth rates, macro-economic instability, declining foreign investments, rising public indebtedness, and deteriorating relations with donors. The deterioration in the economy's performance was continued in the 1990s despite the fact that there was more serious implementation of SAPs, especially after the donors suspended aid to Kenya in November 1991, citing poor implementation of economic and political reforms. In the last three years the economy has achieved GDP growth of the national population leading to a sharp decline in the welfare of the Kenya population (Republic of Kenya, 2001).

Comment [Jlr1]: Not clear

The last three decades can therefore be considered as the “lost decades” in the socio-economic development of many sub-Saharan African countries. Most of these countries, including Kenya, have persistently suffered a general economic stagnation, such that at the end of the 1990s, the plight of the masses was worse than in the early 1960s. It is especially significant when compared with the socio-economic progress made in some Asian countries in the Far East and other regions of the world. Some key economic features of the Kenyan economy today therefore include a low per capita income of less than US \$ 300; high poverty levels with almost 60% of the population living below the poverty line by the end of 2001; low saving rates among households and governments; poor nutrition and

health status of a large proportion of the population—high mortality rates, and high prevalence of chronic and infectious diseases; high levels of unemployment and underemployment affecting about 50% of the country's labour force; underdeveloped infrastructural facilities; political instability and tensions; high levels of inequality, where the richest top 20% control close to 60% of the GDP while the poorer have less than 3%; dependence on the donor community; chronic budgetary deficits due to expenditure being higher than revenue; persistent balance of payments deficits; and inflationary pressures.

2.1. Declining performance of key sectors

The economic growth rate in the period 1999/2001 has been less than $\frac{1}{5}$ of the annual growth rates recorded in the 1960s and early 1970s. This poor performance is spread across most economic sectors, with the agriculture and manufacturing sectors registering less than 2% growth rates during that period (Republic of Kenya, 2001).

The volume of production of key agricultural commodities, for example coffee, cereals and milk has fallen significantly in recent years due to a number of factors ranging from adverse weather conditions, marketing constraints, price disincentives, mismanagement and political interference leading to rapid impoverishment of households and regions that have depended on agricultural activities. Tourism, which is another key sector, has not yet recovered from the adverse effects of the politically instigated tribal clashes. The crisis first triggered by 1997 Likoni ethnic clashes in the coastal region, a key tourist attraction, has since been aggravated by worsening insecurity in many parts of the country and the dilapidation of the country's infrastructure. Between 1996 and 1997, tourism earnings dropped from KShs 25 billion to KShs 22 billion respectively, hence rendering many unemployed.

The manufacturing sector has also continued to record growth rates lower than that required for the stated goal of attaining a newly-industrialised country (NIC) status by the year 2020 (Republic of Kenya, 1997). For this goal to be realistic, the sector must attain a sustained growth rate of more than 10% per annum over a long duration, compared with the less than 3% achieved over the past decade. Due to a generally unfavourable investment climate, the Kenyan economy has suffered from low domestic and foreign investments for most of the last two decades (Republic of Kenya, 2001). Despite impressive economic and financial liberalisation

implemented since 1993, the country has failed to create a sufficiently attractive environment for investors because of high levels of corruption, lack of transparency and accountability in the management of national economy, dilapidated infrastructure, growing levels of insecurity, and broad political and ethnic tensions. Continuing tension between Kenyan authorities and the donor community have acted as an obstacle in the efforts to attract foreign investments. This has been a result of slow implementation of economic and political reforms and failure to undertake convincing measures to curb corruption.

2.1.1. Causes and effects of the crisis

The country faces a wide range of economic problems, which pose a potential threat to the national social and political order. These problems include short-term macro-economic problems among others, which will require medium and long-term solutions. The key underlying challenges include poverty, unemployment, corruption and mismanagement of public resources. Political and governance factors have also contributed to Kenya's economic problems. For instance, wanton or unbridled corruption has not only led to the loss of a large proportion of budgetary government resources every year; it has also adversely affected the country's ability to attract direct foreign investment. The budgetary crisis today is also largely a result of corruption.

2.2. Moi's economic legacy

Corruption and mismanagement thrived during Moi's 24-year reign, significantly contributing to the country's economic stagnation. When President Moi assumed power in 1978, Kenya had a population of 15 million with a moderate per capita income of about US\$ 350. Only about 30% of the population were living below the poverty line at that time. By the end of 2002 when he handed over power to Narc's (National Rainbow Coalition) Mwai Kibaki, the population had more than doubled to about 32 million despite the daily devastating loss of about 700 to the HIV/Aids pandemic. By 2003, nearly 60% of the population was living below the poverty line. The per capita income had stagnated at US\$ 325. In the past three years, it declined by about 1.3% a year, while the GDP grew by a mere 1.1% against an average population growth rate of about 2.3% (Republic of Kenya, 2002).

2.2.1. *Glaring failures*

One of the biggest failures of the Moi regime was its inability to effectively use its immense human resources. The labour force of those aged between 15 and 64 years rose from 7.2 million in 1978 to more than 16 million by the end of last year. Unfortunately, only 33.3% of this labour force was in wage employment, with about 50% either unemployed or grossly underemployed. This led to despondency among both the young and old, many of whom queued daily outside foreign embassies for a chance to leave the country. Internal and external factors combined to transform the once high-growth and dynamic economy of the 1970s into a stagnant sub-Saharan economy wallowing in depression, poverty, insecurity and general hopelessness.

The real GDP growth rate over the last four years of the Moi era (1997–2001), was a mere 1.1% a year, a poor shadow of the country's real GDP growth rate of 6.2% a year for the period 1976–1987, just before Moi took over the country's leadership. The low economic performance of the period 1997–2000 continued in 2002.

The Central Bank of Kenya's October 2002 monthly *Economic Review* indicates that the GDP growth rate for the first seven months was 0.7% (Central Bank of Kenya, 2002). One of the factors behind the collapse of the economy was gross mismanagement of the agricultural sector. A look at trends in some key agricultural commodities tells the story. Coffee was the leading foreign exchange earner for Kenya in the 1960s and 1970s. At the start of Moi's regime, production stood at 84,300 tonnes. By the end of 2001, coffee production had fallen by 35.2% to 54,600 tonnes due to corruption in government and quasi-governmental institutions dealing with the commodity, as well as falling prices for coffee exports. This resulted in massive impoverishment of the population who depended on coffee for their livelihood. Similar trends have occurred in many other key cash crop sectors except for tea, sugarcane and horticultural products, whose production has continued to rise (Republic of Kenya, 2002).

Recorded milk production declined by almost half during the Moi era from 270 million litres in 1978 to 137 million litres in 2001. During the same period, rice production fell by 46% from 35,800 to 19,300 tonnes, while seed cotton production virtually ceased, with its volume of production falling from 27,200 tonnes to a mere 500

tonnes. Partly due to considerable private sector participation, tea, sugarcane and horticultural production recorded increases during the period. Tea production recorded astounding growth from 93,400 tonnes to 294,600 tonnes as sugarcane production rose by 53.2% from 2,349,200 to 3,600,000 tonnes during the period. In the case of horticultural products, exports of fresh horticultural produce increased more than four-fold from 21,000 tonnes in 1978 to 95,200 tonnes in 2001. However, while sugarcane production increased during this period, the government failed to take advantage of an annual guaranteed sugar export quota for Kenya to the European market under the Lomé Convention. If they had, the sugarcane-growing region would have been radically transformed. The failure to do so was a result of gross negligence and vested interests of politically connected individuals who wanted to justify continued importation of sugar into the country for purely selfish interests.

Endemic corruption among Kenya's high-ranking officers had both direct and indirect adverse effects on the country's economic performance. It directly led to massive siphoning of public resources, depriving the public sector of essential resources and reducing its ability to deliver key services for effective economic operations. Recent studies on Kenya's public accounts show that in a typical financial year in the past decade, between 48–50% of the government's budgeted expenditure was lost through fraudulent procurement procedures and other forms of mismanagement. The country therefore had no infrastructure to assist in its efforts to alleviate poverty, create employment and generally expand the national economy. Estimates show that the country lost more than KSh 500 billion in the past five financial years through mismanagement of budgeted resources. In the Moi era, Kenya regularly featured in the top 10 most corrupt countries, according to Transparency International Indices. Formerly the most popular destination for foreign investors, it now struggles to attract foreign direct investment.

Recent regional statistics show that while Uganda was able to attract nearly US\$ 190 million a year, and Tanzania more than US\$ 280 million, Kenya could only manage below US\$ 50 million. This has cost the country dearly in lost opportunities, employment and growth over the past decade. The situation was aggravated by the failure to convince the donor community that there was a serious commitment to fighting corruption by establishing effective anti-corruption institutions. This led the International Monetary Fund

(IMF) and World Bank to suspend certain forms of lending to Kenya. This not only denied the country access to low interest credit facilities, but also seriously hampered private foreign investments. Manufacturers and service providers have also been hindered in their activities by the failure of the government to provide essential basic services such as adequate energy supplies, water, security, transport and communication facilities, undermining their competitiveness domestically, regionally and globally.

The poor performance can be largely attributed to the fact that during the Moi era, the economy was not accorded its rightful priority. An extensive political patronage system dominated appointments to key economic institutions and the general allocation of national resources. The politically instigated ethnic clashes of 1992/93 and 1997 were carried out purely for political reasons in spite of their obvious adverse implications on tourism and agriculture. Therefore, as Kenyans bade farewell to the Moi era in December 2002, the general feeling was that his government had largely failed the economy and would be judged harshly by history. Having inherited a vibrant and robust economy Moi's regime left a legacy of a tattered economy.

2.3. Poverty

Poverty is one of the underlying economic problems that clearly threaten social order and the rule of law. Whereas the National Poverty Eradication Plan published in the early 1990s officially recognises the magnitude and danger of the aggravating poverty situation in the country, the government has not yet demonstrated the political will required to implement necessary measures to significantly reverse the poverty trends. This attitude has been a common feature of Kenya's anti-poverty initiatives for most of the post-independence era (Ikiara & Tostensen, 1995). It is doubtful that even the much-heralded, recently launched Poverty Reduction Strategy Paper (PRSP) will make any significant change. Recent surveys indicate that about 13 million Kenyans live below the poverty line. This is defined as earning less than KSh 78 per day. The comprehensive national survey carried out in 1994 showed that 47% of Kenya's rural population was living below the poverty line, which had risen sharply since the mid 1970s, when the population living in absolute poverty was about 29% of the total population (4.2 million). Thus, the number of people living below the poverty line had tripled between mid 1970s and

1990s, from 4.2 million in 1974 to 12.6 million in 1994. It further deteriorated such that by 2000, an estimated 56% of the country's 30 million population was below the poverty line.

The increase in absolute poverty can be observed from the rising number of people without adequate food and nutrition, or access to essential services such as education, safe water, sanitation, employment, health facilities and decent housing. By the early 1990s, 13 million Kenyans (about 56% of the population) had no access to safe water while 6 million lacked sanitation (UNDP, 1994). Some of the main causes of poverty in Kenya have been unequal distribution and inadequate access to land, low wages and low labour productivity, low labour absorptive capacity of the economy, leading to both open and hidden unemployment, inadequate spread of and access to basic social services especially education and health, poor implementation of development programmes, lack of focus and commitment to poverty reduction programmes, lack of effective social security policies and mechanisms (ILO, 1972; Ikiara & Tostensen, 1995; World Bank, 1994).

The ILO report of 1972 attributed the rising levels of poverty to low incomes of the majority due to low wages and low return to self-employment and other forms of family employment. Another factor was under-utilisation of the country's labour force, and its low productivity, partly reflecting poor training and deployment methods. Other causes of poverty highlighted by the ILO report were urban imbalances and international factors such as bias in technology transfer, export market restrictions, deteriorating terms of trade, tied aid and transfer payments abroad (ILO, 1972). Some studies highlighted the root causes of poverty in the rural areas as the failure to formulate comprehensive land policies and reforms, poor management of financial and delivery services, low technological capability, failure to exploit rural-urban linkages and the absence of an effective social security system for the majority population (Gsanger, 1994).

Lack of meaningful social welfare mechanisms had aggravated socio-economic pressures associated with the implementation of the structural adjustment programmes (SAPs), such as retrenchment, cost-sharing and removal of government subsidies. This served to entrench poverty to a growing proportion of the population, which was increasingly unable to access essential services such as education and health services. Lack of good governance and weak democratic institutions and practices were also seen as factors that entrenched

poverty in the country. Until the early 1990s, the single-party political system, authoritarian and intimidating in nature, did not allow free discussion of issues or formation of truly representative organs in the society. This caused difficulties for the poor to effectively raise their issues of concern with the relevant authorities (Ikiara & Tostensen, 1995). A review of past anti-poverty strategies in Kenya shows that policies that were formulated to deal with poverty in the four decades largely failed to reverse the impoverishment of the country's population.

2.4. Future prospects

The new government will face daunting challenges during its first year of leadership, but positive indications for further opportunities exist. If these opportunities are effectively capitalised upon, they could yield significant economic gains by the end of the year. One reason for the optimistic attitude concerning economic recovery is that for the first time in 40 years, economic issues appear to be a genuine priority in the national agenda. In the past, the focus on the economy was mainly rhetoric. The wanton corruption and general mismanagement of national resources bore testimony to this.

The enthusiasm with which the new administration has launched into measures to fight corruption has been like a breath of fresh air in the country's socio-economic and political arena. These measures could radically change the nature and volume of both domestic and external investment resources into the country with multiplier effects on the economy. The peaceful transfer of power that occurred has been warmly received by the Kenyan business community, foreign governments and business institutions. If this is followed by sustained efforts to reduce insecurity, the country's volume of domestic and foreign investment could increase by as much as threefold within the year. This would doubtlessly lead to economic growth and recovery.

Another factor in favour of the NARC government is the evident strong goodwill from the Kenyan population. If effectively used, this goodwill is likely to translate into real economic benefits in terms of increased productivity, trade and investment. A week after the installation of the new government, the shilling appreciated substantially against various international currencies from an exchange rate of about KSh 79.60 to KSh 77.30 to the US dollar. During the same period the Nairobi Stock Exchange (NSE) index improved by

over 86 points or by about 7%. These are indications of the positive attitude from the business community and the general population towards the current transition.

The same goodwill is evident from a cross-section of donors. Exploratory discussions between a number of donors and Kenyan officials indicate that as soon as the new government satisfies the conditions that the Moi government had failed to meet, the World Bank, the International Monetary Fund and several other multilateral and bilateral donors will be willing to resume aid and increase general economic support for the country. This will not only release funds that have been blocked by key donors, it will also help to attract bilateral official assistance and private foreign direct investments, which had fallen below US\$ 50 million annually in the last few years. While enactment of legislation for an anti-corruption authority and code of conduct for public service may be relatively easy for the new government, the privatisation of Telkom (K) Ltd may be more problematic and time consuming. The process of tendering and assessing potential buyers who are able and willing to pay an acceptable price could take time and thus delay the resumption of donor funding.

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