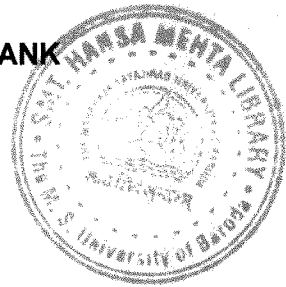


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**"A CASE STUDY OF EMPIRICAL PERFORMANCE OF THE WORLD BANK
AND ITS EFFICACY IN ECONOMIC DEVELOPMENT OF KENYA"**



A Ph.D. THESIS SUMMARY SUBMITTED TO

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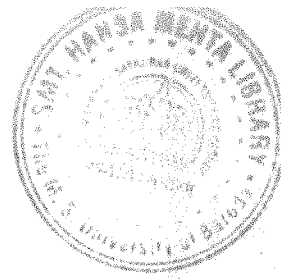
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"A CASE STUDY OF EMPIRICAL PERFORMANCE OF THE WORLD BANK AND ITS EFFICACY IN ECONOMIC DEVELOPMENT OF KENYA"

1 INTRODUCTION OF THE STUDY

The World Bank came into existence in 1945 as an out come of Bretton Woods Conference of 1944. The main objective of the World Bank was the reconstruction and development of economies of the member countries. It has 184 member countries, Kenya being one of them which joined the World Bank in 1964. The challenges of the World Bank are to reduce poverty, improve the standard of living and spur economic growth and development in member countries.

The World Bank supports the efforts of developing country's government to build schools and health centers, provide clean water, sanitation and electricity, and fight diseases and to protect the environment. Since the 1970s, loans for infrastructural investments have come down. Its present development strategy lays more emphasis on investments that can directly affect the welfare of the poor people of the developing countries by increasing their productivity and standard of living. Towards this end the World Bank, it has been financing projects for agriculture and rural development, infrastructure, education, health, low-cost housing, drinking water and sewerage less developed countries³

2 THEORETICAL FRAMEWORK

The famous American Marshall plan and the emergency of the growth models in the late 1940s advocated for specialization, foreign trade, capital accumulation and increased productivity being the fundamental determinants of economic

growth. When a large sum of funds is given to least developed countries, it is expected to have positive and significant impact in reduction of poverty therefore spurring economic development. The United Nations Monetary and Financial Conference at Bretton Woods, New Hampshire, USA, as we view it nowadays established the underlying principles of aid in 1944 in an assembly of 44 nations. This meeting later led to the establishment of the International Bank for Reconstruction and Development (World Bank) and the International Monetary Fund (IMF).

The end of the Second World War marked the birth of growth models that recognized the need for foreign capital. The Harrod Domar (1947) "two gap" model and Rostow's (1953) "take off" theory influenced the public policy particularly with regard to foreign aid and its objective to boost the economies of the less developed countries to self-sustainable growth rates. Rosenstein (1961) argued that the objective of international programme aid for less developed countries is to accelerate their economic development up to a level where a satisfactory rate of growth can be achieved on a self-sustaining basis. When this point is achieved by the developing countries they can substitute external aid by local saving. This was the first formal argument in favour of foreign aid. Rosenstein believed that each dollar of foreign resources in the form of aid would result in an increase of one dollar in total savings and hence investment. He postulated that aid should be continued until underdeveloped countries could mobilize a level of capital formation sufficient for self-sustaining growth. However, he argued that foreign capital inflow should be within the limit of absorptive

capacity of the developing countries. Therefore the basic goal of aid is to provide in each underdeveloped country a positive incentive in order to increase its rate of growth. Paul Rosenstein Rodan (1961) in his big push theory recommended a flow of foreign aid of heroic proportion in order to push the developing countries out of poverty trap.

The original Harrod-Domar model that assumes only a savings constraint on growth was modified in the sixties in the influential Chenery and Strout (1966) two-gap model. Chenery, and Strout observed the two-gap model, which provides a theoretical framework within which the role of World Bank aid and foreign capital is recognized. They are of the opinion that the less developed countries face two key growth constraints, firstly inadequate savings to finance their desired levels of investment, secondly they lack enough foreign exchange to purchase all necessary imports required for the growth and development of their economy. They identified three phases of development, during the first phase, due to the shortage of financial resources, investment levels are below the rate required to achieve targeted growth. It is concluded that the inflow of foreign capital, which is scarce in less developed countries, is the engine of growth and development. The role of foreign aid where the World Bank is the highest contributor we believe springs logically from this analysis.

Although extensive bilateral and multilateral aid programs that aim to reduce poverty and promote economic growth have started after Second World War, there is still no compelling evidence that recipient countries have made economic progress during the last five decades. Foreign aid particularly the World Bank aid

has been and continues to be a controversial issue till date. In our present study we will assess whether there is evidence for the positive effect of World Bank aid on economic growth or not. If there is, under which circumstances these positive effects of aid occur. Furthermore, if there is counter evidence about World Bank's foreign aid effectiveness, what are the possible explanations for this aid failure? "In the general sense... the majority of aid does indeed 'work'. It succeeds in accomplishing its developmental goal through contributing positively to the recipient countries' economic performance. This does neither imply that aid works in every count nor in all situations. Its performance differs by country to country and by sector to sector. On the basis to mitigate poverty, even the aid, which accomplishes its objectives, cannot be considered totally satisfactory (Cassen and Associates, 1994)

The moral imperative behind aid is reflected in many valued based systems of thought. Most major religions call on their followers to aid the poor. In Islam *Zakat*, an obligation to give to those in need is one of the pillars of the religion. The Christian tradition of the jubilee calls on creditors to write off debt. Whether motivated by human rights, religious values or economic reasons World Bank aid or foreign aid in general has played a crucial role in eliminating mass poverty, hunger, avoidable diseases and deaths and spurring economic growth in less developed countries.

3 STATEMENT OF THE PROBLEM

Why should we be interested in the World Bank? Yet there is terrorism, racism, nuclear weapons, and emerging economic powers of Asia haven't we got enough to occupy us? Yes, but what of the plight of the 1.3 billion people living in absolute poverty on less than \$1 a day? What is the plight of 52 percent of the population in Kenya living below \$ 2 a day? Their health is as extremely bad as their living standards, and until their poverty is reduced their health will not get better. More than forty years later since independence in 1964 these challenges continue to haunt Kenyans. The World Bank's mission statement is "to reduce poverty, and improve living standards by promoting sustainable growth and investment in people". For economists and policy makers concerned with economic development and mitigation of poverty in Kenya, knowledge about the World Bank is important. How is the World Bank performing? Have the economic policies, projects initiated by the World Bank improved the human development, living standards, infrastructure and agriculture of Kenya? Have projects funded by the bank succeeded in achieving its efficacy?

World Bank Aid effectiveness has been a major issue among policy makers and researchers. After the success of the famous American Marshall Plan, more attention was paid to the development of developing countries. Therefore present study which focuses on the analytical and empirical analysis of the role of the World Bank aid in economic development of Kenya is an attempt to fill up the crucial lacunae in the effectiveness of World Bank aid and official development assistance in economic development of Kenya. In a developing country like

Kenya where rapid economic growth has taken a center stage, such study analyzing the efficacy and performance of the World Bank assumes a vital significance not only for politicians and policy makers in Kenya but also the World Bank and the donor community at large.

Policy makers, academicians, researchers, politicians and Kenyan citizens are bound to be interested in knowing as to where and what the World Bank aid is financing and how is it performing in terms of achievement of its efficacy.

Choosing Kenya as a case study is interesting unlike other African countries, which are poverty stricken because Kenya is the only country which has never gone into war, enjoyed peace since independence yet still it has not attained a developed country status. Poverty has not decreased and many people have slipped into abject poverty. What is more disappointing is the fact that in spite of remarkable increase of foreign aid particularly from the World Bank, Kenya has not been able to make a dent on poverty. Recently Kenya has been seeking debt relief from the Paris club and other donors because Kenya is in a debt trap or debt overhang situation.

According to the World Bank report (2005) 52 percent of the Population in Kenya lives below two dollars a day. The report also shows that the people are much poor than 25 years ago ²⁷. Having the above economic and poverty scenario of Kenya calls us to carry out a research of this type to find out whether the existing financing of programs and projects by the World Bank through the Government of Kenya do reach the vulnerable section of the society. The research being an

empirical analysis will assess how the financed projects are performing and whether the World Bank has achieved the efficacy or not. The plethora of cross section studies in the aid effectiveness literature cannot capture accurately the diverse heterogeneous characteristics of the countries included in the sample. Emanating from this contention the macro economic impact of aid is most likely to vary significantly from country to country and this prompted us to study an individual country in our case Kenya. Many studies take African as homogenous continent; which is erroneous.

Evaluation at the country level yields a more accurate and complete picture of the outcome of the Bank's assistance programs than do evaluations of individual programs or projects. Evaluation needs to capture critical dimensions of country assistance programs, as the World Bank has been dramatically altered over the past decades, with the objective of making it more effective in supporting the global fight to eradicate poverty.

4 OBJECTIVES OF THE STUDY

The above exposition of our key focus on the statement of the problem leads us to formulate the objectives of the research study. The Major essence of this proposed research study is to examine the role and contribution of the World Bank to the Kenyan economy and to assess the performance of the World Bank and its efficacy in the economic development of Kenya. This will be analyzed by sector wise performance and project wise analysis at national level. The following are the objectives of the proposed research work:

1. To assess whether the World Bank has spurred growth and economic development in Kenya.
2. To assess whether the World Bank aid contributes to increasing aggregate welfare, measured by infant mortality and the Human Development in Kenya.
3. To find out whether the World Bank has improved the infrastructure facilities.
4. To evaluate whether the World Bank has fostered development of the agricultural and industrial sector in Kenya by supplying them with investment capital.
5. To assess whether the World Bank aid has positive impact on economic growth when there is sound macroeconomic policy in Kenya
6. To find out whether the World Bank aid affects the government expenditure.

5. HYPOTHESES OF THE STUDY

Hypothesis means a non-obvious statement that makes an assertion or it can be an underlying proposition or statement that can be supported by argument and evidence. Quite often a research hypothesis is a predictive statement capable of being tested by scientific methods that relates to an independent variable to some dependent variable. The hypothesis describes two relationships on the independent and dependent variables. The hypothesis enables the researcher to test relationship of a doubtful statement. From the above logic the following are the hypothesis of the study:

1. The World Bank has spurred growth and economic development in Kenya



2. The World Bank aid contributes to increasing aggregate welfare, measured by infant mortality and the Human Development (HDI), in Kenya
3. The World Bank has contributed to the development of infrastructure like power, irrigation transport and telecommunication in Kenya.
4. The World Bank has spurred development of agriculture and industrial sector by providing investment capital in Kenya.
5. The World Bank aid has positive impact on economic growth when there is a sound macroeconomic policy in Kenya
6. The World Bank aid contributes to the increase in the total public expenditure in Kenya.

6. RESEARCH METHODOLOGY AND DATA COLLECTION

The present study has proceeded through two kinds of analysis: descriptive and quantitative analysis. Descriptive analysis of various projects financed by the World Bank is carried out using secondary data collected from various reports and economic reviews published by the institutions in Kenya and other international institutions such as the World Bank, International Monetary Fund United Nations development programme etc. This research work being built upon secondary data survey makes use of theoretical and historical framework of the World Bank with a major intention of capturing the model of World Bank aid in economic development and the evolving role of the World Bank playing development agency. We carried out tabular analysis using percentages, ratios and tables so as to achieve the objectives of the study. The empirical input

enables us to examine the data collected and conclusively say whether the World Bank has performed satisfactorily and its efficacy realized in the economic development in Kenya or not.

Quantitative analysis is carried out after collection and compilation of the required secondary data by applying statistical regression models to capture the functional relationship of World Bank and foreign aid in economic development of Kenya. We have employed a familiar technique for testing hypothesis, the ordinary least square (OLS) Regression method. The statistical significance of the estimates of the selected variables has been scrutinized by applying t-statistic. The results have been tested at 0.01, 0.05 and 0.10 per cent level of significance for two tailed tests. R^2 has been computed to know the proportion of variations in the dependent variable explained by the independent/explanatory variables. The significance of R^2 has also been checked by applying F-statistic by duly making suitable adjustments in respect with the regression model. We have also used the D.W to enable us identify the degree of auto-correlation in the regression equation. We have interpreted the results accordingly and made the necessary inference. The main element of this method is that it not only makes it possible for us to identify the degree of association among variables but also enables us to predict at what rate dependent variables change per unit change in the value of independent or explanatory variable. It also enables us to test the validity of influence by individual parameters on dependent variables. In addition it allows us to know degree of presence or absence of auto-correlation

among residual variables (which is the difference between estimated and actual values of dependent variables). The regression sample runs from 1980 to 2004 and our case study is Kenya. The model tests the performance and efficacy of the World Bank and official development assistance in the economic development of Kenya; this model covers the period of 1980 to 2004.

7. DATA SOURCES.

Past studies of aid effectiveness were mostly based on cross-section data only few studies used time-series data from individual countries. We believe that single country time-series analysis is more useful, as it can capture country-specific features that may not be found in a cross-sectional analysis. The data used is secondary data, which we have scrutinized thoroughly before being applied for empirical investigation. The data used in our study is based on the World Bank world Development indicators 2006. In order for this study to be accurate a reliable data has to be collected. Data provided by the national sources differ significantly from those found in international sources such as the IMF and World Bank. After a rigorous analysis of our topic of study data from the World Bank and Government of Kenya was selected appropriately. The World Bank data is more reliable as these are collected directly from the donors who have better recording system than Kenya. Although these data are mostly collected from national sources, the World Bank does internal consistency counter checks and supplements the data from the Kenyan source with their occasional sectoral studies. The variables used are the GDP per capita, Official

Development Assistance (ODA) the World Bank Assistance (IBRD and IDA), Total national population, money supply, inflation, Infant mortality, and total government expenditure. Our study has adopted the recent empirical studies which have been carried out on the effectiveness of foreign aid and most notably the study by the World Bank by Burnside and Dollar (1997) and the basic model of Chenery and Strout (1966). The Chenery and strout (1966) is considered the core theory, it was reprinted by the World Bank publication in 1979 retaliating its importance and its relevance in the rationale of the World Bank aid. Interpretation of the data will take the form of tables, charts, graphs, diagrams, figures, estimates, percentages, ratios, statistical models like least ordinary squares, mean, and others for clarity purposes.

8. LITERATURE REVIEW

The most important intend of literature review is to substantiate the rationale of the present research study by providing an overview of historical point of view to highlight the research trends and offer a critique to the research problem. The methodology employed guide the direction of the study, which aims to fill the lacunae into the existing knowledge and examine the relationship and performance of the World Bank aid and foreign aid in economic development. The most important objective of this research study to survey numerous literature is to enable us to develop the model that is presented in chapter seven Empirical analysis.

We have examined, Chenery and Strout (1966, E. Mason and R. Asher (1973), Bereket Habte Selassie(1984), Mahendra Pal (1985), Jonathan E Sanford (1989), Bade Onimode (1989), Vyuptakesh sharan (1991), Ankie Hoogvelt; David Phillips etc (1992), Bevan, D.P. Collier and J.M. Gunning (1993), Sengupta (1993) Gabriel Kosgey Lagat (1994), Walle and Timothy (1996), Burnside and Dollar (1997), Joseph E. Stiglitz (1999), Collier and Dollar (2002), James Njeru (2004), Kingsley Banya; Juliet Elu, (2001), The World Bank (1998), James Njeru (2004) and etc.

9. LIMITATIONS OF THE STUDY

The study is limited to the performance of the World Bank aid in economic development of Kenya during the study period of 1980 to 2004. There are some limitations of our study as the number of explanatory variables is not exhaustive. We do believe that democracy influences economic development of the country but due to difficulties in its quantification it was not taken into consideration. We will have wished to include the social and political indicator as explanatory variables but it will have been very hectic quantifying them and thus distorting the inferences, which will be drawn from the empirical results. Kenya gained independence in 1964 but our study period is from 1980 to 2004.

10. CHAPTERS DESIGN

The entire research study is divided into eight chapters. Brief outline of the thesis is as follows:

Chapter One: It is an Introduction. The chapter discusses the background of Kenya, background of the study, research methodology, objectives, hypotheses, scope, limitation of the study and literature review.

Chapter Two: The chapter discusses the origin of the World Bank, its establishment, membership and its structure so as to understand how the World Bank was formed and its objectives.

Chapter Three: The chapter underscores the financial structure and lending policies of the World Bank in Kenya.

Chapter Four: World Bank financing in Human Development in Kenya.

The chapter analyses the World Bank projects in human development in Kenya.

Chapter Five: World Bank financing of infrastructure development in Kenya.

The chapter highlights the World Bank projects in the infrastructure sector in Kenya.

Chapter Six: World Bank financing in Agricultural sector and Industrial sector in Kenya

Chapter Seven: Empirical analysis of the World Bank financing in the economic development of Kenya.

Chapter Eight: Conclusion: Findings, Policy Recommendation and Suggestion for Further Research. It contains summary of the study which includes findings, conclusion, Policy Recommendation and suggestion for further research.

11. CONCLUSION

We conclude by making following observations based on our findings.

It has been more than six decades since the Bretton Woods conference that set up the World Bank as the foundation stone of a new international economic order in the aftermath of the Second World War. The role of the World Bank has evolved as time changed and at the moment the major mission of the World Bank is the reduction of poverty and spurring economic growth in the less developed countries. In present study we have attempted to analyze analytically and empirically the effectiveness and performance of the World Bank aid and the official development assistance in economic development of Kenya. The findings in this confirmed that World Bank has spurred economic development of Kenya. We established a very strong statistical association between sound economic policies and the performance of the World Bank aid and foreign aid in Kenya in our period of study. The study has presented ample evidence that with sound track record of macroeconomic policy management that is by keeping inflation modest, prudent fiscal policy and good financial policy World Bank aid can spur economic growth. Our results emphasize that greater World Bank aid is beneficial to economic growth on condition of stable macroeconomic policy environment. Our study is consistent with the evidence, which have been established by the famous study of the World Bank of Burnside and Dollar, who generally concluded that AID/GDP ratio is significant determinant of economic growth only in combination with good economic policy stability.

The main objective of the World Bank is the eradication of poverty; therefore consumption in very poor sections of the society is not necessarily bad thing per

se. In this view the World Bank aid may be supporting the consumption of below poverty households, which leads to reduction in infant mortality and improvement in human development as well as improvements in other social parameters. Therefore World Bank aid may support growth in long term basis, which is not picked up by econometric studies but extremely pertinent in mitigating poverty in the society. World Bank aid and foreign aid as a whole is financing public sector at a margin. Therefore this puts the overall quality of management at a centre stage to the effectiveness of the World Bank.

At present, not only has its role changed substantially, but the extent and scope of its activities have extended far beyond what was then planned. World Bank today is very different from the organization conceived at Bretton Woods in 1944. Its mission has changed from post World War II reconstruction and development to worldwide poverty alleviation. World Bank started its operations in financial year 1960, since then it has financed a numerous projects. The present research study thus believes that economic development is a prolonged and complex process, which has to be stimulated by several interacting factors. Indicators underlying economic development of which some were taken for analysis in the present study have generally received emphasis in policy of the World Bank namely; human development, agriculture and industry, infrastructure and economic policies. The development of these areas is taken to be either precondition or concomitant of economic development. Although the World Bank projects in Kenya invested almost exclusively in physical infrastructure in its early

days, its focus has broadened to include significantly more human development lending.

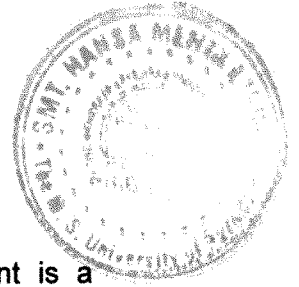
A major expansion of the World Bank's work financing in Kenya of human development took place in the late 1980s and late 1990s, and the World Bank is now the largest external financier of health and one of the largest supporters in the fight against HIV/AIDS in Kenya. The World Bank's role in universal health in Kenya has evolved through a better understanding of development which the bank now sees as a holistic, comprehensive and multidimensional task that should balance the strengths of the market with other institutions and focus on human development. This approach reflects, in part, a new paradigm of academic thought that development is the process of expanding the real freedoms people enjoy a concept set forth by Amartya Sen. Therefore we concluded that the World Bank aid is positively related to human development hence economic development of Kenya. Thus it is our strong belief that the World Bank aid contributes to increasing aggregate welfare measured by infant mortality and human development indicators. The present research confirmed the hypothesis that the World Bank aid has positive impact on economic growth when there is a sound macroeconomic policy in Kenya.

Money supply a parameter for sound macroeconomic policy and financial deepening is positively and highly significant in economic development in Kenya. This implies that the macroeconomic and policy control variables are correctly signed and statistically significant supporting the findings of Burnside and Dollar (1997, 2000), which supports the contention, that aid is effective where there is

sound macroeconomic policies. The development of the financial sector has a vital role to play in establishing a more broad-based foundation for economic growth. The sign for inflation is negative as expected.

High inflation has negative impact on economic development therefore low inflation appears to be conducive for spurring higher economic growth. In this research we argue that the World Bank step up infusions of money which should be accompanied with economic policy reform as it more crucial to Kenya's prospects for development success.

Lessons learned from forty six years (1960-2004) of World Bank development experience in Kenya suggest that investments in infrastructure and physical capital, macroeconomic stability, liberalization, and privatization still matter however our emphasis is that development is multifaceted and our understanding of it must be broad and inclusive. A number of key elements, including economic growth and stability, investment in human development, physical assets, sound institutions and policies are obligatory to promote prosperity, reduce poverty, which will lead to economic growth and development. Reflecting on the World Bank projects in human development of Kenya we strongly contend that good health, nutrition, effective reproductive policies and health services are critical for allowing Kenya to break from vicious circle of poverty. All of these changes in the World Bank's mission have made health, nutrition, and population programs priorities for its work and for the wider development in Kenya. The World Bank's evolution in development research and thinking has been dynamic for example



the World Bank view suggesting that health important to development is a concept with long-lasting implications.

In the first decade of the 21st century, the World Bank sees itself enhancing its role in improving human development in Kenya by influencing the health policy debate and strengthening partnership with Kenya government. The World Bank has a prescription for health systems that it claims are adaptable, but we argue in this study that its policies vary little from country to country and are driven by economic outcomes. Ownership, equal partnership and better evaluations are key factors in the World Bank's attempt to sharpen its focus in order to achieve its efficacy in economic development of Kenya. The World Bank seems to be winning over some of its natural critics in the government of Kenya, but others remain unconvinced of the efficacy of its policies. The World Bank's priorities on health, education, water and sanitation, infrastructure, agriculture and industry is vital, however we argue that it requires better focus through enhanced selectivity, more rigorous evaluation of projects, and greater collaboration with government of Kenya and other agencies. We argue that in Kenya weak institutional capacity to deal effectively with regulatory problems in the private sector often causes government to become excessively involved in the direct provision of education, health services, infrastructure, and agriculture. Therefore in this present research work we contend that the efficacy and performance of World Bank in Kenya is built on four key pillars: adequate funding to properly outlined projects, informed decision-making, adherence to local priorities, and accountability. The rationale is

that public expenditure decisions made by a devolved government are likely to resonate well with a local constituency than those made by World Bank or central government. The form of World Bank may have changed but the concern for poverty reduction is still in the heart of the World Bank. The present research study has noted that participation is crucial in spurring growth.

In this research study we have tried to examine and test the validity of our hypothesis we have predicted earlier. Our findings and observations which prove that our hypotheses are valid and this enables us to draw the following conclusions.

1. The World Bank has spurred growth and economic development in Kenya
2. The World Bank aid contributes to increasing aggregate welfare, measured by infant mortality and the Human Development (HDI), in Kenya
3. The World Bank has contributed to the development of infrastructure like power, irrigation transport and telecommunication in Kenya.
4. The World Bank has spurred development of agriculture and industrial sector by providing investment capital in Kenya.
5. The World Bank aid has positive impact on economic growth when there is a sound macroeconomic policy in Kenya
6. The World Bank aid contributes to the increase in the total public expenditure in Kenya.

12. SUGGESTIONS FOR FURTHER RESEARCH

In the present research study we have focused on the performance of World Bank and its efficacy in economic development of Kenya during the period of 1980 to 2004. Further research may be undertaken from 1964 to the present period. We also suggest that there should be a study to assess particularly the Sectoral Adjustment loans which were started in the 1980s which have been perceived to have had negative impact on the poor in other Sub Saharan countries. There should be made an effort to study the impact of all foreign aid flow to Kenya since 1964 to the present time. There is high inequality in Kenya; there should be a study to assess the impact of World Bank aid in the eight provinces to establish whether or not the World Bank has been biased on particular provinces. There should also be a study to assess the impact of World Bank's technical assistance.

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