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STRUCTURAL ADJUSTMENT IN KENYA NEEDS TO BE EVALUATED

AUDIT REPORT NO. 3-615-85-8

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TABLE OF CONTENTS

	Page
EXECUTIVE SUMMARY	i
BACKGROUND	1
OBJECTIVES, SCOPE AND METHODOLOGY	4
FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS	5
Review Of Conditions Precedent, And Covenants	5
Unable To Trace The Use Of Dollars	9
Local Currency Was Used To Pay Liabilities Previously Incurred	11

EXHIBIT I - List Of Conditions Precedent

EXHIBIT II - List Of Covenants

APPENDIX A - List Of Report Recipients

EXECUTIVE SUMMARY

The Structural Adjustment Program Grant Agreement was signed June 25, 1983 in the amount of $30 million. This is the first year of a three-year $117 million program. The program's purpose is to provide balance of payment and budget support to the government of Kenya (GOK) while promoting the structural changes needed to reduce the underlying problems of the economy. The three-year program proposes to supply balance of payment support of approximately $109 million to address the underlying problems of the economy and to utilize the remaining $8 million to fund consultancies, studies, contracts, and microcomputer hardware and software to help implement policy reforms. The program is designed to respond to both short and medium term structural adjustment assistance needs.

The FY 1983 program was to provide foreign exchange of $28 million, and to finance $2 million for technical skills and consultancies to support implementation of structural adjustment policies. The Ministry of Finance and Planning is the GOK entity responsible for implementation of the program. The grant agreement contained seven conditions precedent and eight covenants related to structural adjustment.

The dollars were to generate the local currency equivalent of $28 million to cover deficit spending in the fiscal year ended June 30, 1983.

The purposes of the audit were to determine whether (a) A.I.D. provided resources were used in accordance with agreements, applicable laws and AID regulations; (b) the program was meeting its objectives as stated in program documentation; and (c) USAID/Kenya was adequately monitoring the project.

While balance of payments and budget support objectives were met by issuing a check to the GOK, we could not determine that the dollars and local currencies were used for agreed to purposes because the funds were commingled with other GOK funds. Our review shows that compliance with conditions precedent (CPs) and covenants which are related to structural adjustment was accomplished by assurances, promises and minimal evidence of actions completed as a basis for supporting the disbursement of $30 million. Most of the CPs were so vaguely written that any action could be construed as compliance (see Exhibits I and II). We do not believe this was a sound basis on which to build a three-year structural adjustment program.

Because this agreement and subsequent ones to follow are to support structural adjustment, we believe that an assessment should be made as stipulated in the project approval document to determine what structural adjustment has taken place.

This was to have been done prior to signing of the $20 million follow-on agreement in September 1984. USAID/Kenya indicated that an evaluation was made prior to the signing of the agreement. No documentation supporting the evaluation was prepared to support the conclusions drawn showing where and how structural adjustment had taken place. In our opinion, structural adjustment forms the basis of development in Kenya; therefore a formal indepth evaluation is justified and should be a prerequisite for funding future years (see pages 5 to 9). The evaluation should be fully supported with specific examples of where structural adjustment has and hasn't taken place.

Other matters addressed in this report are: we were unable to trace the use of dollars to verify compliance with agreement provisions (see pages 9 to 11); and control over the use of local currency for development purposes needs to be tightened so that AID can be certain that the funds are spent for the purposes agreed to. We were unable to determine how the local currency funds generated were spent because they were commingled with other GOK funds (see pages 11 to 12).

At the conclusion of the audit, we provided our preliminary observations in writing to the USAID for comment. Also, we sent a draft report to USAID for their written comments. Their views expressed in response to our preliminary observations and in response to our draft were duly considered, and where pertinent have been included in the report.

USAID/Kenya Comments

USAID/Kenya Director disagrees with our assessment of the structural program and stated in his response to our draft report the following:

Attached are USAID/Kenya comments on the draft audit.

> "Given the nature of these comments, I am sure you will agree that the draft audit will require a stem-to-stern overhaul if it is to accurately reflect the true nature of the program assistance activity itself and the thinking that lay behind its creation and implementation. The draft audit in its

present form significantly distorts the purpose of this assistance and is imprecise in its understanding of the dynamics of the program and of its strategic and tactical relation to our overall development objectives in Kenya."

RIG/A/N Response

The thrust of our report is to show that, in our opinion, very little structural adjustment resulted from the $28 million grant because the agreements were weak and required virtually no action. Where the agreements required specific action no means was provided to enforce it. We are not implying that structural adjustment is bad. In fact to the contrary we agree that it is extremely important which is why we are critical of not requiring more for the money. In the following paragraphs we have presented mission comments and our response to significant issues which we have not addressed specifically in the report.

USAID/Kenya Comments

USAID stated that the background section of the draft report appears to have been selectively edited to cast the least favorable light on the progress of structural adjustment during the period 1980-1984. The project paper states that progress has been more rapid and more uniformly positive. At the same time, progress is still far short of what is economically necessary for structural adjustment to occur. For example the project paper indicates (a) new import regime was introduced in October 1981 (b) significant upward movement in producer prices for agriculture (c) fiscal and monetary performance has improved (d) GOK has undertaken large positive adjustments to exchange rate (e) slowdown in GOK financial participation in commercial investments has occurred (f) good performance in raising energy prices (g) more comprehensive measures to promote structural adjustment. USAID feels that the report presented a prejudicial approach which attempts to characterize events based apparently on a deliberate omission of available information.

RIG/A/N Response

Our intent wasn't to deliberately omit information. We found no examples or evidence to support such words as perfomance

improved, significant upward movement, slowdown, or good performance. These were general statements made in the project paper which were not quantified. Therefore we were unable to determine how these general statements show that structural adjustment has been more rapid and uniformly positive from June 1981 until the project paper was written in June 1983.

USAID/Kenya Comments

USAID felt that the report ignored one major accomplishment of the program, namely that budget and balance of payment support goals were met. USAID felt that such a major omission contributed to further negative bias in the overall tone of the report.

RIG/A/Nairobi Comments

We are not sure the intended goals of the budget and balance of payment support were met because we could not determine how the dollars were used and we found that local currency designated for some of the budget line items agreed to was not spent. We looked beyond the mere issuing of the check which would have met the goals had not strings been attached.

BACKGROUND

By 1979 foreign exchange shortages and budgetary imbalances had emerged as key constraints limiting Kenya's growth to unacceptably low levels and restricting Government's ability to carry out its development program. Foreign exchange budgetary constraints and an ineffective government acted interdependently to lower the growth rate of the Kenyan economy. Periodic application of strict measures to control balance of payments deficits and unrealistic pricing controls also resulted in reduced use of industrial capacity and shortfalls in tax revenues. The Government's ability to implement long-range policies in both the industrial and agricultural sectors were and are limited. Basic structural changes in both sectors became, and remain, essential to achievement of long-range improvements in the foreign exchange and budgetary situations. In 1980, in response to this critical and unacceptable situation, the Government undertook, with donor encouragement and support, a major program to reorient growth to make better use of local resources and conserve on foreign resources, including commercially imported energy, and imported capital goods.

The Government identified the following areas that would help to achieve structural adjustments:

-- restructuring of the trade regime and system of incentives to industry;

-- reforms in pricing, marketing, research, extension, and land utilization in agriculture;

-- fiscal and monetary policies that restrain the level of Government expenditures, narrow the deficit, limit the total expansion of credit and increase the share to the private sector;

-- more flexible and realistic interest and exchange rates; a wage policy that promotes expansion of employment;

-- an improved balance between recurrent and development expenditures; better planning and implementation of development projects; less direct Government participation in commercial investments; and more effective monitoring of debt;

-- a diminished role for the public sector in production and distribution and greater reliance on the private sector; better monitoring and improved performance of public enterprises;

-- realistic energy pricing and greater attention to problems of deforestation and erosion;

-- stronger efforts to lower the rate of population growth by reducing fertility.

Between 1979 and June 1981, progress in both articulation and implementation of these policies was slow, uneven, and at times negative. Since June 1981, the GOK still has not effectively focused on the tough issues, particularly on the institutional side, such as less public interference, rationing, and regulation; less direct public production and distribution; greater exposure of both private and public enterprises to market forces and to domestic and international competition. There will not be a strong turnaround, particularly in industry and manufacturing, until these measures are taken. As long as the GOK rations foreign exchange and as long as inefficient parastatal enterprises are insulated from market forces that would impel them to adjust or contract, structural adjustment will take place at best slowly. Further, as long as the farmers and businesses must subsidize the price controls imposed by the GOK, little progress will be made.

Both the International Monetary Fund (IMF) and World Bank programs have become much broader and more comprehensive in scope since the beginning of 1982. They demonstrate, along with the GOK's own policy announcements, an increasing focus on the institutional (as opposed to price and macro-policy) impediments to structural adjustment. Adherence to these programs is a necessary condition for structural adjustment to take place. The programs are not yet sufficiently implemented to ensure that structural adjustment will take place.

Major reforms, particularly on the institutional side, need to be taken. Both the IMF and the World Bank believe the reforms will take several years. During this time, substantial external assistance will be needed to (a) sustain the economy; (b) ease the political and economic strains generated by the structural adjustment process; and (c) augment the technical and institutional capacity to formulate and implement policies. In March 1983 the IMF entered into a $165 million Stand-By Agreement. The World Bank is implementing a $130 million Structural Adjustment Loan. Additional balance of payment support is being provided by major bilateral donors.

The United States has been responsive to Kenya's need by providing funds to assist with balance of payments and budget support to implement the structural adjustment program. During the period 1980-82 the United States provided more than $35 million through one program grant and three related Commodity Import Programs (CIP). The United States also provided $47 million of PL 480 Title I assistance.

The strategy for structural adjustment assistance is complicated by a basic dilemma: short-term assistance in response to critical budget and balance of payments needs is a prerequisite to longer term structural change. Yet the provision of such short-term assistance in the absence of significant policy or institutional reforms may undermine prospects for the desired structural adjustment.

On June 24, 1983, the Project Agreement Approval Document (PAAD) for project No. 615-0213 was approved in the amount of $30 million which represented the first year of a three-year $117 million program. The program's purpose was to provide balance of payment and budget support to the GOK while promoting the structural changes needed to redress the underlying problems of the economy. The three-year program proposes to supply balance of payment support of approximately $109 million through grants, and to utilize the remaining resources to fund consultancies, studies, contracts, and microcomputer hardware and software to help implement policy reforms.

The fiscal year 1983 program was to provide foreign exchange of $28 million, and to finance $2 million for technical skills and consultancies to support the implementation of structural adjustment policies. The program grant agreement was signed June 25, 1983. The Ministry of Finance and Planning (MOFP) is the GOK entity responsible for implementation of the program. The grant agreement contained seven conditions precedent and eight covenants which are listed in Exhibits I and II to this report.

Disbursement of funds under the grant were to be made by USAID/Kenya in one installment pursuant to the GOK's request for disbursement. Funds were not to be used to finance military, guerrilla, or paramilitary requirements of any kind including the procurement of commodities or services for those purposes, or luxury and other goods listed in the GOK's Import Licensing Schedule II.B. dated November 1981. Further, all amounts provided under these grants were to be free of taxes and fees.

The grant agreement stipulates that the Kenyan shilling equivalent of $28 million was to be made available within 90 days of the signing of the agreement to fund the prior year's rural development, agricultural development, rural enterprise, and family planning programs.

According to the PAAD, annual obligations would be contingent upon USAID reviews of Kenya's balance of payments and budget position, the current economic situation, progress in policy reform implementation, and other donor program assistance.

OBJECTIVES, SCOPE AND METHODOLOGY

Audit objectives were to determine whether (a) AID-provided resources were used in accordance with agreements, applicable laws and AID regulations; (b) the program was meeting its objectives as stated in program documentation; and (c) USAID/Kenya was adequately monitoring the project. Audit work was performed in Kenya during the period March to July 1984 and covered the period June 1983 through June 1984. Due to GOK delays both in arranging meetings with responsible officials and in getting us access to partinent records, the field work took longer than anticipated.

Our audit included (a) a review of USAID/Kenya's project records and files, (b) discussions with USAID/Kenya personnel, appropriate GOK and Central Bank of Kenya officials, and members of the Fertilizer Advisory Committee. We also made other verifications as considered necessary.

The major focus of our audit was on the GOK's compliance with conditions precedent and covenants. Other audit areas included the utilization of AID funds for dollar and shilling payments and for technical assistance. The review was made in accordance with the Comptroller General standards for audit of governmental programs and accordingly included such tests of the program, records, and internal control procedures as we considered necessary in the circumstances.

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

Balance of payment support and budget support were provided by issuing the GOK a dollar check and requiring the GOK to generate the shilling equivalent of the dollars. However, we were unable to determine what the dollars were spent for and we found that the local currency was not used to fund only development projects in approved areas.

The conditions precedent (CPs) included in the grant agreement, in our opinion, were a weak basis on which to build a structural adjustment program designed to support significant and critical policy changes within the GOK. Specifically, we found that: (1) the GOK had not formally addressed two CPs; (2) USAID had not formally acknowledged or responded to letters which the GOK submitted in response to the CPs; (3) notice on two of the CPs was received after the disbursement of funds; (4) promises on two of the seven CPs had only been marginally met; and (5) only limited action has been taken with regard to the covenants.

Review of Conditions Precedent And Covenants

Formal Notification Not Made - We found no evidence that USAID ever responded to the GOK letters acknowledging that the CPs were satisfied. USAID's only formal acknowledgement that the CPs had been met was an immediate cable to Washington dated June 28, 1983, advising them that the Director and Regional Legal Advisor had determined that the CPs had been met.

USAID was provided evidence indicating that certain actions were taken relative to CPs 1 and 3 prior to signing the agreement, however, the GOK made no formal response specifically addressing CPs 1 and 3.

According to AID Handbooks, an Implementation Letter or some sort of formal correspondence should be issued to acknowledge that the CPs had been met. Regional legal advisors agreed.

USAID/Kenya Comments - USAID stated that it is incorrect to assert that the GOK made no formal response addressing CPs 1 and 3. USAID indicated that the CPs were addressed in a letter dated May 30, 1983.

RIG/A/Nairobi Response - The grant agreement was dated June 25, 1983, 25 days after the Ministry letter was received. We assume that a CP included in a grant agreement only becomes a CP on that date and, therefore, must be responded to.

Timing For Implementation Of CPs - The time frame for implementation of the CPs was less than two working days from the date the agreement was signed. The Program Assistance Approval Document (PAAD) was signed on Friday, June 24, 1983. The program grant agreement was signed on Saturday, June 25, 1983. A cable was sent to Washington on Tuesday, June 28, 1983 indicating that the CPs had been met. Funds were transferred to the Federal Reserve Bank of New York for the account of the Central Bank of Kenya on June 29, 1983.

In the case of CPs Nos. 2 and 4, the letters from the Ministry of Finance stating that actions had been taken were dated June 29, 1983. This was the day after USAID/Kenya notified AID/W that the conditions were met and three days after the USAID Director and Regional Legal Advisor had reviewed the actions taken to satisfy themselves that the CPs Nos. 2 and 4 had been met. The funds were disbursed prior to June 30, 1983, to keep the GOK within the IMF ceilings for budget deficit and domestic lending to government.

Conditions Precedent - Our review of GOK actions taken to implement the promises made to meet the CPs was less than optimal. USAID/Kenya acknowledged in the amendment to the grant agreement that the actions identified in the original agreement have not been fully implemented.

One example is No. 6. This CP requires assurance that new investments in the public sector will be reviewed for economic, financial and technical soundness and will be approved in accordance with an investment plan and external borrowing plan. In response to the CP, the MOFP stated in a letter dated June 24, 1983, that the GOK expects to have a public sector investment plan with budgets covering all 5 years of the development plan completed by the end of September 1983. According to USAID officials, the GOK did produce such a plan but it still leaves a lot to be desired. The FY 1984 PAAD amendment to the FY 83 program agreement, states that the Development Plan for 1983/84-1988/89 does not reflect curtailment or deletion of projects for which commitments have already been made.

Another example is CP No. 7. This CP requires evidence that the Government is taking steps to develop an integrated food security policy, to reduce the drain on public financing by the National Cereals and Produce Board and to study the management and organization of grain marketing. In response to this CP, the MOFP, stated in a letter dated June 24, 1983 that they had received an interim report of a study done by a consultant. Based on this report, the MOFP expected that some preliminary

policy decision could be made. The final report was to be completed by September 1983. According to USAID officials, the draft, though completed in October 1983, has still not been finalized and no changes have been made as a result of it.

Covenants - The program grant agreement contains eight covenants or expressions of intent on the part of the GOK to implement a series of actions crucial to the ultimate success of the structural adjustment process. While no evidence of implementation progress is required by agreement for disbursement of funds, actual progress in implementing the commitments was to be of vital importance in determining the nature and magnitude of future years' funding. The covenants are detailed in Exhibit II to this report. Examples of covenants with little positive action being taken were:

Covenant d. states that the GOK agrees to establish a special mechanism to manage planning, budgeting, monitoring and implementation of externally financed development programs. This covenant has not yet been met. USAID believes that the GOK is headed in the right direction with the establishment of a management information system within the MOFP as well as a project monitoring system within the Office of the President.

Covenant e states that the GOK agrees to establish a Monopolies and Prices Commission to review commercial practices, impose sanctions and review the effect of price controls on competition etc. This covenant also has not been met. A Monopolies and Prices Commission has not been established but is under consideration by the GOK. Technical assistance has been provided by the U.S. to study this option.

Covenant f. to review the fertilizer committee was not met. Although we held a meeting with the Fertilizer Advisory Committee and a USAID employee was in attendance, we do not believe that this meeting constituted a review of the effectiveness of the committee as required by the covenant. In fact the time period for the 6 month review had already passed.

Covenant g. to prepare strategies and mechanisms for divestiture of GOK interests in public enterprises has not been met. Although a task force has been studying the legal and budgetary implications of parastatal reorganization and possible divestiture the GOK has yet to divest itself of any parastatal. In fact, the GOK is creating more parastatals to import oil and control agricultural inputs.

Conclusion

The CPs to disbursement included in the grant agreement, in our view, were weak and required little more than promises. Words such as assurance, evidence, agrees to, require nothing but a promise. The CPs were vague which negated their impact on getting definitive action underway on the policy changes. Any action could be construed as compliance. In our opinion, this is a poor basis on which to get the GOK to make major policy changes. As a result, in our opinion, very little structural adjustment has taken place as a result of the $28 million grant.

Further, it would have been virtually impossible for the GOK to address CPs requiring more than promises on major policy changes in the less than two working days between the signing of the agreement and the disbursement.

The IMF has imposed certain monetary restrictions on the GOK. One purpose of this grant was to fill the void caused by the IMF's imposed austerity on the GOK. The grant was used to keep borrowing below a predetermined limit and therefore kept the GOK within stipulated levels.

Because these agreements are for the purpose of supporting structural adjustment, we believe that an assessment should be made as to what structural adjustment has really taken place. The Project Agreement Approval Document (PAAD) states that annual funding would be contingent upon reviews of Kenya's progress on structural adjustment. Specifically, the PAAD designated $50,000 of FY 1983 consultancy funds to evaluate the program in October/November 1983. The evaluation was to examine progress on structural adjustment. To date, no formal evaluation has been made. USAID/Kenya has indicated that it made an in-house technical evaluation for the preparation of the new grant and concluded that structural adjustment is not moving in some areas. The evaluation was not documented therefore we could not determine to what extent structural adjustment progress was really analyzed.

In our opinion, a formal evaluation should be scheduled immediately and should be done independently from the Mission. We found that structural adjustment is not moving forward in such areas as pricing reforms, diminished public sector activities in production and distribution, and greater reliance on private enterprise. In fact, the government is taking over more control of oil imports and agriculture inputs. Pricing policies continue to reduce production and discourage private enterprise development.

We believe that structural adjustment is fundamental to AID's bilaterial assistance programs and should be studied closely and independently from those developing and implementing the programs.

RECOMMENDATION NO. 1

USAID/Kenya prior to approving the FY85 increment have a technical evaluation of the Structural Readjustment Program made to determine that progress has been made to redress the underlying problems of the economy as stipulated in the PAAD.

Unable To Trace The Use Of Dollars

We were unable to determine whether Article 6 of the grant agreement was complied with. Article 6 states that the funds provided shall not be used to finance military, guerrilla, or paramilitary requirements of any kind, including the procurement of commodities or services for those purposes, or luxury and other goods listed in Grantee's Import Licensing Schedule II.B. dated November 1981.

Program grant funds were disbursed in FY 1983 as follows:

(1) Upon compliance with all CPs to first disbursement, the Ministry of Finance requested disbursement of the grant into the Government account at the Federal Reserve Bank of New York.

(2) USAID telegraphically transmitted the request to AID/FM along with its certification that all CPs had been satisfactorily complied with.

(3) AID/FM electronically transferred the funds to the Government of Kenya account at the Federal Reserve Bank in New York.

(4) The Federal Reserve Bank telegraphically transferred the funds to the Government Account at Central Bank of Kenya.

(5) The Central Bank of Kenya credited the GOK Paymaster General Account with the equivalent shillings for use by the GOK in meeting June obligations.

Under the system for disbursing program funds, we were unable to determine what was purchased with the dollars transferred into the Government of Kenya account at the Federal Reserve

Bank of New York. This is because once these funds go into the GOK account at the Federal Reserve Bank, they are commingled with other dollars in that account. In essence, they have lost their identity at this point and it is impossible to determine what was purchased with the dollars provided under the program grant.

Conclusion

It was impossible to trace the use of dollars provided under the program grant because a special dollar account was not established specifically for the program grant. Without such an account, it was impossible to know whether Article 6 of the grant agreement has been complied with. In view of USAID's decision to fund the FY 1984 increment as a Commodity Import Program, the use of the dollar will be known. We are, therefore, making no recommendation.

USAID/Kenya Comments

The draft audit report takes issue with Article 6 of the Program Grant Agreement which precludes use of program funds "to finance military, guerrilla, or paramilitary requirements of any kind...." This standard A.I.D language is characterized by the draft audit report as "a provision that accomplishes nothing." It is unclear whether the draft audit report is suggesting that such language, which is normally required, should be eliminated from all agreements which involve cash transfers (given the inherent fungibility of money). Such a suggestion should in any case not be included in a draft audit report to USAID Kenya, but should be addressed to the Agency more generally, and a decision applied uniformly (Congress and the Executive willing) to AID cash grant programs worldwide.

In the existing circumstances, it should have been possible for the audit team to determine whether sufficient dollar purchases of an acceptable nature were made by Kenya during the relevant period to fully account for financing made available under the Program Grant Agreement. However, this apparently was not done. The text of the draft audit report indicates that the audit team members "were unable to determine whether Article 6 of the grant agreement was complied with." Whether this was the fault of the approach adopted by the audit team, or due to a lack of available trade statistics remains unclear.

RIG/A/Nairobi Response

The program grant does not stipulate that the GOK can attribute purchases of an acceptable nature to account for the use of the AID grant. Our point is that if the grant restricts purchases to certain items then procedures should be established to enforce the provision. If the attribution concept was to be applied, it should have been as stipulated in the grant, and a report detailing the acceptable purchases should have been required.

Local Currency Was Used To Pay Liabilities Previously Incurred

Local currency funds, generated from the grant were not used for development purposes as intended. On August 1, 1983, the MOFP submitted a letter to USAID showing the projects they planned to finance with the local currency generated from the $28 million Structural Adjustment Grant. The letter states that the money was to be used by the GOK to meet June 24th to June 30th 1983 obligations. USAID agreed to finance the projects proposed in the August 1, 1983 letter. We found, however, that the amounts presented in the August 1, 1983, MOFP letter represent costs incurred throughout fiscal year 1983, not just June 1983 obligations.

In accordance with the grant agreement, the Kenya shilling equivalent of $28 million was to be made available within 90 days to fund rural, agricultural production, rural private enterprises and family planning development programs.

Local currency program grant funds were disbursed in FY 1983 as follows:

-- The Central Bank of Kenya credited a general cash account with the equivalent shillings to pay June obligations.

-- Disbursements from the general account were made based upon requests for disbursements received from the various ministries within their approved budgets.

All the money went into one account. There was no way of determining that AID funds were used to finance agreed upon projects. The only thing that could be done was verify that the total amounts were disbursed by the GOK for each budget account.

Based on a limited sample to verify that budgeted amounts agreed to were expended, we found that one project under the Ministry of Agriculture and one project under the Ministry of Transportation were not financed in the agreed amounts. The Rural Agricultural Education project under the Ministry of

Agriculture was to have been funded in the amount of Ksh 17.8 million[1/]. We found that no funds had been disbursed. Under the Rural Access Road program of the Ministry of Transportation a total of Ksh 38 million was to have been spent but only about Ksh 8.9 million was disbursed.

Conclusion

We found that local currency funds were not used for development purposes as intended. Furthermore, the funds were not spent on some projects in the amounts agreed to. There was no way within the established timeframe that the money made available to the GOK could be used for developmental purposes. At best, all that could be hoped for was that development expenditures equivalent to the funds made available had already been incurred during the prior fiscal year. This being the case, it made no sense to stipulate that the funds be used for development purposes. The agreement, in fact, provided budget support for all purposes and kept the GOK from falling in arrears on the IMF agreement by not having to borrow more to cover already incurred deficit spending.

We believe that the USAID should be candid in its agreements and not include covenants to fund developmental programs that can not be complied with. In our opinion, it misrepresents to Congress that local currency funds are being programmed for development purposes when in fact they were not.

RECOMMENDATION NO. 2

USAID/Kenya establish control to ensure that local currency generations are spent for development purposes as agreed. This control should be more than approving line items in the GOK budget.

1/Ksh13.25=U.S.$1.00.

EXHIBIT I

STRUCTURAL ADJUSTMENT PROGRAM GRANT

LIST OF CONDITIONS PRECEDENT

1. Evidence that since December 30, 1982 the Government of Kenya has continued to promote exports and simplify export documentation.

2. Evidence that the Government of Kenya has taken or has initiated all reasonable steps to meet the following conditions:

   a. At June 30, 1983, net domestic credit of the banking system does not exceed 24,794 million Kenya shillings.

   b. At June 30, 1983, net bank credit to the Government, net of tne deposits of the Cereals and Sugar Finance Corporation with the Treasury, and including any further use of Eurocurrency borrowing after June 30, 1982, will not exceed 7,032 million Kenya shillings.

   c. Public and publicly guaranteed external borrowing will be limited during the 18 months ending June 1984: on commercial terms in the maturity range of 1-12 years to US $150 million; and in the maturity range of 1-5 years to US $100 million.

3. Evidence that import schedule I has been sub-divided to establish a list of high priority imports for which unlimited foreign exchange is freely available, to include raw materials, spare parts and inputs required for agriculture and manufacture of export goods which are not available at competitive prices in Kenya.

4. Evidence that there will be no restrictions on the importations of and availability of foreign exchange for appropriate agricultural inputs, except that for agricultural chemicals, veterinary drugs, and fertilizers, there may be established a list of acceptable types, and that for fertilizers there my be established a minimum amount of foreign exchange in 1983/84. Such a minimum shall be high enough to provide 120 percent of the foreign exchange estimated to be required for basic fertilizer imports for 1983/84.

5. Regarding fertilizer, evidence that:

   a. There will be established a Fertilizer Advisory Committee consisting of two members from the Ministry of Agriculture, one member from the Office of the President, one member from the Ministry of Finance and five members from the private sector which shall advise and guide the Government and the private sector on:

      (i) Development of estimates of annual fertilizer requirements, both types and quantities, and periodic revision of those estimates following analysis of market trends.

      (ii) The system for establishing prices of fertilizers.

      (iii) The amount of foreign exchange required to finance needed imports.

      (iv) The identification of private sector firms and organizations that may be authorized to import and distribute fertilizer.

   b. Imports by the Government, whether obtained commercially or from a donor, will be sold by the Government to any licensed fertilizer dealer for distribution through channels available to that dealer.

6. Assurance that new investments in the public sector will be reviewed for economic, financial and technical soundness and will be approved in accordance with an investment plan and an external borrowing plan;

7. Evidence that the Government is taking steps to develop an integrated food security policy, reduce the drain on public finance by the National Cereals and Produce Board and study the management and organization of grain marketing.

EXHIBIT II

STRUCTURAL ADJUSTMENT PROGRAM GRANT

LIST OF COVENANTS

a. To implement further reduction of quantitative restrictions on imports as foreign exchange reserves permit, to make import licenses automatically available for all items included in import schedule I-A and to adjust duties to achieve appropriate levels of protection and to promote an overall gradual movement toward a more uniform tariff structure.

b. To continue to encourage exports, within the context of a flexible exchange rate system, by pursuing improvements in administrative procedures pertinent to exports and export incentives; and by expediting study of alternative means of export promotion;

c. To develop a plan to ensure that scarce budget resources are allocated to high priority investments and that investments of lower priority for which insufficient budget resources are available are either curtailed or terminated;

d. To establish a special mechanism to manage planning, budgeting, monitoring and implementation of externally financed development programs;

e. To establish a Monopolies and Prices Commission which will review commercial practices, will impose sanctions for practice in restraint of fair trade and will review the necessity for price controls on items for which there is determined to be sufficient internal and external competition in the Kenya market, giving top priority to consideration of the prices of fertilizers;

f. To review with USAID within six months, and again within one year, the effectiveness of the Fertilizer Advisory Committee that will be established in June 1983;

g. To prepare strategies and mechanisms for divestiture of Government's interests in public enterprises as recommended by the July 1982 "Report and Recommendations of the Working Party on Government Expenditures"; and

h. To make available within 90 days of this Agreement the Kenyan shilling equivalent of twenty-eight million United States Dollars ($28,000,000) to fund developmental programs in the approved Development Estimates in the areas of rural development, agricultural development, rural private enterprises and family planning.

APPENDIX A

List of Report Recipients

	No. of Copies
Field Offices	
USAID/Kenya	5
REDSO/ESA	2
AID/Washington	
AA/M	2
AA/AFR	1
LEG	1
GC	1
AA/XA	1
AFR/EA	1
M/SER	1
M/FM/ASD	2
PPC/CDIE	3
Office of Inspector General	
IG	1
AIG/A	1
AIG/II	1
IG/EMS	12
RIG/A/C	1
RIG/A/D	1
RIG/A/K	1
RIG/A/M	1
RIG/A/T	1
RIG/A/W	1
RIG/II/N	1