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A.I.D. Project No.615-0249
Dollar Appropriation No.72 111/21014
Budget Plan Code:GSSI-91-21615-KG13

FOURTH AMENDMENT

TO

PROJECT GRANT AGREEMENT

BETWEEN

THE REPUBLIC OF KENYA

AND THE

UNITED STATES OF AMERICA

FOR

KENYA EXPORT DEVELOPMENT SUPPORT (KEDS) PROJECT

DATED: October 26, 1994

A.I.D. Project No.615-0249
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FOURTH AMENDMENT TO PROJECT GRANT AGREEMENT FOR THE KENYA EXPORT DEVELOPMENT SUPPORT (KEDS) PROJECT

Dated: October 26, 1994

Between

The Republic of Kenya (hereinafter referred to as the "Grantee")

and

The United States of America, acting through the Agency for International Development ("A.I.D.").

Article 1: Purpose of Amendment

Due to Sections 599 and 547 of the U.S. "Foreign Operations, Export Financing and Related Programs Appropriations Acts for 1993 and 1994, respectively, certain types of assistance under the KEDS Project were no longer permissible. Thus, this Fourth Amendment to the above named Project Grant Agreement No. 615-0249 dated the 12th day of July 1991, as subsequently amended, is hereby entered into between the above named Parties to reprogram funds earmarked for: Export Processing Zones ("EPZ") Swap Funding Facility, EPZ Authority for a Trade Finance component, the firm-level Assistance (Export Development Fund), and Special Studies components of the KEDS project. This amendment also serves to delete Annex 2 (Project Grant Standard Provision) and substitute it with a new Annex 2. In addition, the Amendment serves to modify Attachment 1 to Annex 1 and Annex 2 consistent therewith.

Article 2: <u>The Project</u>

Section 2.1., Definition of Project, is deleted in its entirety and replaced with the following:

"(i) <u>Public Sector Component:</u> Assistance to the Export Promotion Programmes Office (EPPO) in the Ministry of Finance to assist the GOK in its efforts to improve the enabling environment for exports, to enhance dialogue with the private sector and to promote non-traditional exports. In addition, the Project will assist other GOK agencies, including the Export Promotion Council (EPC) and Horticultural Crops Development Authority (HCDA) to streamline export procedures and promote non-traditional exports.

(ii) <u>Firm-level Assistance Component:</u> Assistance to non-traditional exporters directly and through private sector trade and business associations to identify viable export markets, to produce internationally competitive products, to promote and sell products in established and new markets, to obtain information on changing markets, and to expand export production.

(iii) <u>Trade Finance Component:</u> Establishment of an Export Credit Guarantee (ECG) Facility for pre-shipment financing through a commercial bank to enable new and small-scale exporters without tangible collateral to purchase inputs required to fill export orders.

(iv) <u>Special Studies Component:</u> Special Studies undertaken through EPPO in the Ministry of Finance, the Export Promotion Council (EPC) in the Ministry of Commerce and Industry and selected private sector associations to identify and eliminate export bottlenecks in order to improve the enabling environment for non-traditional exports. Also, the Mission's annual program impact assessments will be undertaken to improve the overall effectiveness of the project activities.

Annex 1, attached, amplifies the above definition of the Project. Elements of the amplified description set forth in Annex 1 may be changed by written agreement of the authorized representatives of the parties named in Section 8.2 without formal amendment of this Agreement.

<u>The Foreign Operations, Export Financing and Related Programs Appropriations Acts of 1993 and 1994:</u>

No funds or other support provided hereunder may be used in a project or activity reasonably likely to involve the relocation or expansion outside of the United States, of an enterprise located in the United States if non-U.S. production in such relocation or expansion replaces some or all of the production of, and reduces the number of employees at, said Enterprise in the United States;

No funds or other support provided hereunder may be used in a project or activity the purpose of which is the establishment or development in a country other than the United States of any export processing zone or designated area where the labor, environmental, tax, tariff, and safety laws of the country would not apply, without the prior written approval of USAID; and

No funds or other support provided hereunder may be used in an activity which contributes to the violation of internationally recognized rights of workers in the recipient country, including those in any designated zone or area in that country.

Bumpers and Lautenberg Amendments and Policy Determination 71:

Grant funds may not be used for any testing or breeding, feasibility study, variety improvement or introduction, consultancy, publication, conference, or training in connection with the growth or production in Kenya of an agricultural commodity for export which would compete with a similar commodity grown or produced in the United States unless: (a) such activity addresses food security in a developing country and will not have a significant impact in the export of agricultural commodities of the United States; or (b) research activities are intended primarily to benefit American producers;

Further, grant funds may not be used for feasibility or prefeasibility studies for, or project profiles of potential investment in, or support in establishment of facilities specifically designed for the manufacture, for export to the United States or to third country markets in direct competition with United States exports, of articles of textile and apparel articles, footware, handbags, luggage, flat goods, work gloves, leather wearing apparel, watches, import sensitive (i.e. affecting domestic sales of U.S. goods) electronic articles import sensitive steel articles, and import sensitive manufactured glass products; and

At the present time USAID/Kenya does not foresee any activities contrary to the above legislation; however, in order to ensure compliance, the Mission will require the institutional contractor to submit requests for assistance to potential leather, textile, sugar, palm oil, citrus or agricultural commodity exporters to USAID/Kenya for approval."

Article 3: Financing

Section 3.1 is deleted in its entirety and replaced with the following:

"Section 3.1. The Grant.

(a) To assist the Grantee to meet the costs of carrying out the Project, A.I.D., pursuant to the Foreign Assistance Act of 1961, as amended, agrees to grant to the Grantee under the terms of this Agreement an additional One Million Seven Hundred Twenty Eight Thousand United States ("U.S.") Dollars ($1,728,000). The total Grant comprising the original Agreement, the First Amendment, Second Amendment, and Third Amendment shall not exceed Six Million Seven Hundred Twenty Eight Thousand United States ("U.S.") Dollars ($6,728,000) ("Grant").

(b) If at any time USAID determines that its contribution to the project under subsection 3.1(a) exceeds the amount which reasonably can be committed for project purposes during the current or following U.S. fiscal year, upon written notice to the Grantee, USAID may withdraw the excess amount, thereby reducing the amount of the Grant as set forth in Section 3.1(a). Actions taken pursuant to this subsection shall not revise USAID's total estimated contribution to the project as set forth in Section 2.2(a), subject to the availability of funds to USAID for this purpose, and to the mutual agreement of the parties at the time of a subsequent increment, to proceed.

The Grant may be used to finance local currency and foreign exchange costs as defined in Sections 6.1 and 6.2 of this Agreement of goods and services required for the Project."

Section 3.2(b) is deleted in its entirety and replaced with the following:

"The resources provided by the Grantee and the private sector for the Project will be not less than the equivalent of U.S. $5.04 million including costs borne on an "in-kind" basis. This represents 25% of the total project costs."

Article 4: Conditions Precedent

Section 4.2., "Additional Conditions Precedent," is deleted in its entirety.

Section 4.3., "Notification," is deleted in its entirety and replaced with the following:

"When A.I.D. has determined that the conditions precedent specified in Section 4.1 have been met, A.I.D. will promptly so notify the Grantee."

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Section 4.4(b) is deleted in its entirety.

(a) Attachment 1 to Annex 1, "Summary of Project Costs by Expense Category and Source of Funding," is hereby deleted and the attached, "Attachment 1 - Annex 1 (Fourth Amendment)" is substituted in its stead.

(b) Annex 2, (Project Grant Standard Provision) is hereby deleted in its entirety and the attached Annex 2 is substitited in its stead.

Other Terms and Conditions:

Except as amended herein, all other terms and conditions of the Project Grant Agreement, as amended, shall remain in full force and effect.

IN WITNESS WHEREOF, the Grantee and the United States of America, each acting through its duly authorized representative, have caused this Fourth Amendment to be signed in their names and delivered as of the day and year first above written.

REPUBLIC OF KENYA

BY: ______________________

NAME: B. K. Kipkulei

TITLE: P/S FINANCE

UNITED STATES OF AMERICA

BY: Kiertisak Toh

NAME: Kiertisak Toh

TITLE: Acting Director

ANNEX 1

AMPLIFIED PROJECT DESCRIPTION

A. Project Overview

The KEDS Project consists of four interrelated components to facilitate development of the export sector. The planned mix of public and private sector Project activities encompasses technical assistance, training, commodities, analytical research and finance activities.

The KEDS Project will provide support to the newly-formed Export Promotion Programmes Office (EPPO) and other agencies in the Ministry of Finance to assist the GOK in its efforts to improve the export environment, to enhance dialogue with the private sector, and to expand non-traditional exports. KEDS will provide technical assistance, training and commodities to make the EPPO an effective export promotion and policy unit, and to make the EPPO the direct link between private sector exporters and the GOK. The KEDS Project will also work with other GOK agencies, including the newly-legislated Export Promotion Council (EPC) and the Horticultural Crops Development Authority (HCDA) to streamline the export process and promote exports in non-traditional sectors.

Technical assistance will be provided to non-traditional exporters directly and through private sector trade and business associations to identify promising export markets; to produce internationally competitive products; to promote and sell products in established and new markets; to obtain information on changing markets; and to expand export production. The KEDS Firm Level Assistance Component will finance a Private Enterprise Management Unit (PEMU)- The PEMU will oversee the provision of technical assistance and training, and will manage the Export Development Fund (EDF), a facility for providing firm level advisory services in a variety of areas.

The KEDS Project will provide trade financing through the Export Credit Guarantee (ECG) facility to be established through a commercial bank in Kenya. The ECG facility will allow small and new exporters without tangible collateral/security to obtain short-term pre-shipment financing necessary to meet export orders. The facility is also expected to reduce the level of collateral required for short-term trade financing by sharing the perceived risk with the commercial bank. By raising the comfort level of the commercial bank, the facility will eventually enable the small and new exporters to access trade financing through transaction-based as opposed to asset-based lending.

Finally, the Project will finance key studies which will be undertaken through private sector associations and the Ministry of Finance. The purpose of these studies will be to determine ways by which export bottlenecks, whether caused by government policy, the general trade regime, lack of information, poor implementation, inaccessibility to foreign exchange or other constraints, can be removed to improve the overall environment for Kenyan exports. Studies funded under KEDS will complement work being carried out or planned, through the MOF, other GOK agencies and private sector organizations funded by USAID, the UNDP, the World Bank, ODA, the AfDB and others. Special Studies on annual program and environmental impact will also be undertaken to assess the project impact on the Kenyan economy.

B. Project Goal, Purpose and EOPS

The goal of the KEDS Project is to increase employment and foreign exchange earnings in Kenya on a sustainable basis. Employment and foreign exchange generation have been identified, both by the GOK in several of its policy and strategic planning documents and by the international donor community, as two main problems facing the Kenyan economy as it moves towards the new century. There is a growing consensus that only in the context of an outward looking economic development strategy can Kenya generate productive employment opportunities for its growing labor force. The KEDS Project will support the extension of Kenya's structural adjustment program into the area of export promotion as a crucial component of the shift from an inward to an outward looking strategy.

The purpose of the Project is to increase non-traditional exports. This will be accomplished through increased investment in the export sector and development of a more favorable trade environment. Analysis has shown that Kenya's traditional export sector, while it has a critical role to play in both employment and foreign exchange generation, will simply not be able to grow at the rate needed to meet the goals that the GOK has set for itself on both employment and foreign exchange earnings. KEDS will help Kenya to expand non-traditional exports by facilitating the rapid implementation of key policy changes; by improving the policy and regulatory environment for exporters in the economy as a whole; and by enhancing the speed and scope of the private sector response to this changing environment with efficient export investments. In the context of continued implementation of the structural adjustment program as agreed to in the 1990-1992 Policy Framework Paper; sustained donor support, especially by the World Bank; and continued buoyant performance by Kenya's traditional export earners, the KEDS Project will be able to achieve its goal and purpose.

KEDS achievements will include up to one million jobs created and up to $770 million in additional foreign exchange earnings by the end of the decade.

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End of project status indicators will consist of:

* 55 percent increase in foreign exchange earnings from manufactured, horticultural and other non-traditional exports.
* 6 percent increase in non-traditional exports relative to traditional exports.
* Geographical diversification of exports and export markets--Exports to EEC reduced by 3 Percent.

c. **Project Components**

1. Public Sector Component

The KEDS Project will finance technical assistance, training and commodities to improve GOK trade policy analytical capabilities, and to assist with the implementation of new export incentive programs through the EPPO in the Ministry of Finance. KEDS, through the EPPO, will also provide technical services, short-term technical assistance, and limited training and commodities to the Export Promotion Council (EPC) in the Ministry of Commerce and Industry.

The Public Sector Component technical team will oversee technical assistance to the Export Promotion Council. The Public Sector team will also provide primary oversight and management for the Studies Component of KEDS.

Day-to-day management of the KEDS Public Sector Component will be provided through the Export Promotion Advisor attached to the MOF. Her/his responsibilities will include overall management of the KEDS EPPO, EPC and Studies activities.

The KEDS Public Sector Component will consist of highly qualified technical assistance consultants located within the Ministry of Finance, working directly with counterparts in the EPPO. The consultants will work with other relevant officers and advisors in the MOF, particularly those working on the Tax Modernization Project, in all aspects of export promotion to strengthen the EPPO as the MOF's key export promotion agency.

KEDS assistance will consist of a long-term Export Promotion Advisor (4 years), short-term technical assistance, commodities and training. The Export Promotion Advisor will serve as the lead technical consultant and will be assigned to the Project for four years. The Export Promotion Advisor's overall objective will be to work with GOK counterparts to promote the growth of non-traditional exports. Promotion will take several forms. These will range from ensuring that relevant GOK agencies and the private sector are aware of GOK export promotion programs, to providing the GOK with up to date information and recommendations on means to streamline trade processing requirements.

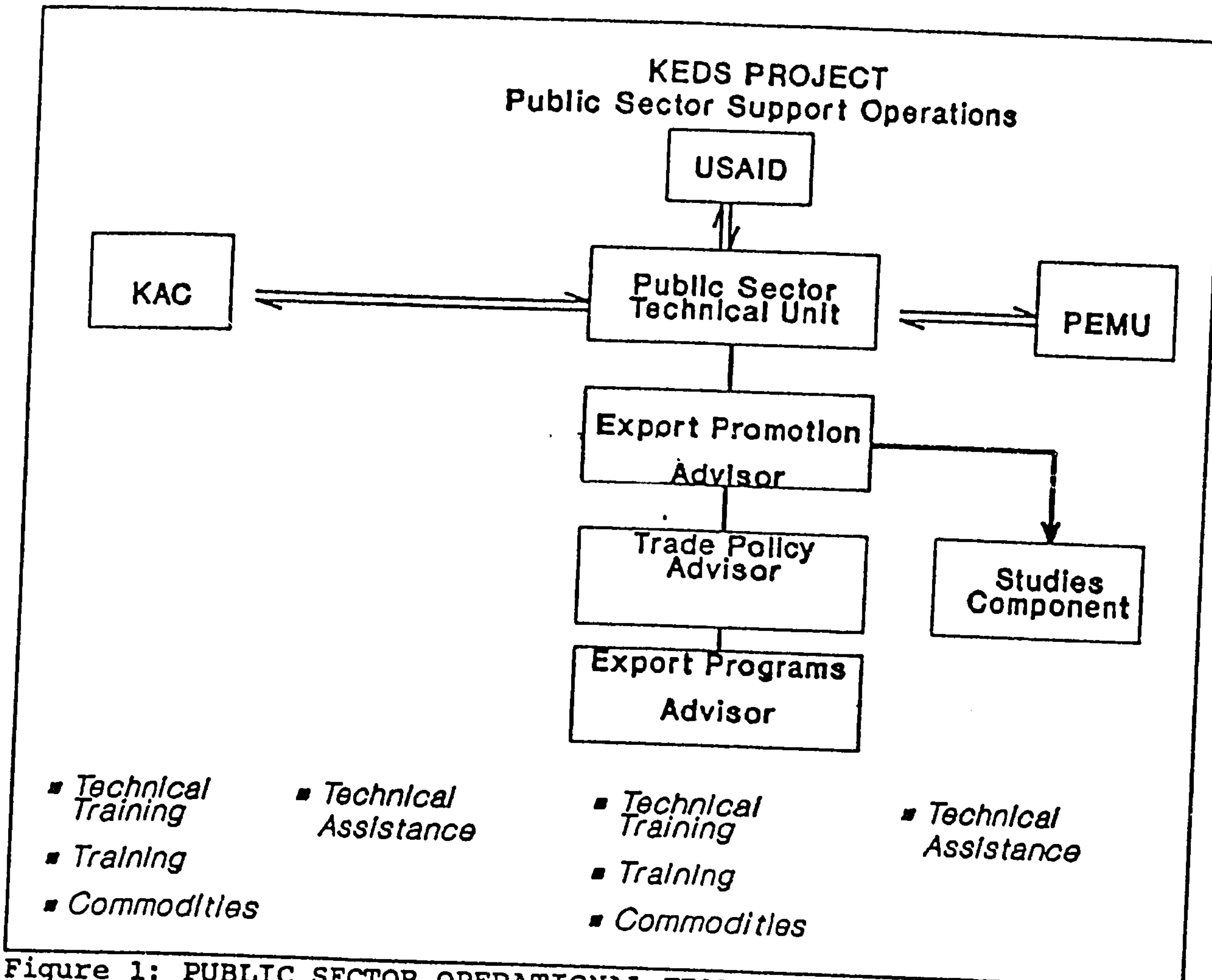

Figure 1: PUBLIC SECTOR OPERATIONAL FRAMEWORK

The Export Promotion Advisor will coordinate the Public Sector Assistance activities to assist in the smooth functioning of the EPPO. The Export Promotion Advisor will work with MOF counterparts to assure responsiveness to private sector needs both on individual applications and through the KEDS Advisory Committee (KAC) on industry wide needs. The Export Promotion Advisor will recommend program changes and procedures; liaise with USAID/Kenya and other donors to coordinate export support activities; and prepare needs assessments, training activities, and scopes of work in both EPPO and EPC activities.

He/she will advise the EPPO and the MOF's Economic Secretary on policy changes that will remove anti-export biases, establish technical guidelines and procedures on ratio estimation, analyze trade performance statistics (in light of specific trade promotion programs and projects), recommend staff members for additional academic education, and oversee the planning of studies.

The Advisor's GOK counterpart will be the Head of the EPPO. The Advisor will ensure that appropriate GOK counterparts are available to work with all consultants in order to carry out short-term technical assistance. The Export Promotion Advisor will oversee the purchase of commodities. Finally, the Advisor will coordinate the short-term EPC technical assistance provided under KEDS.

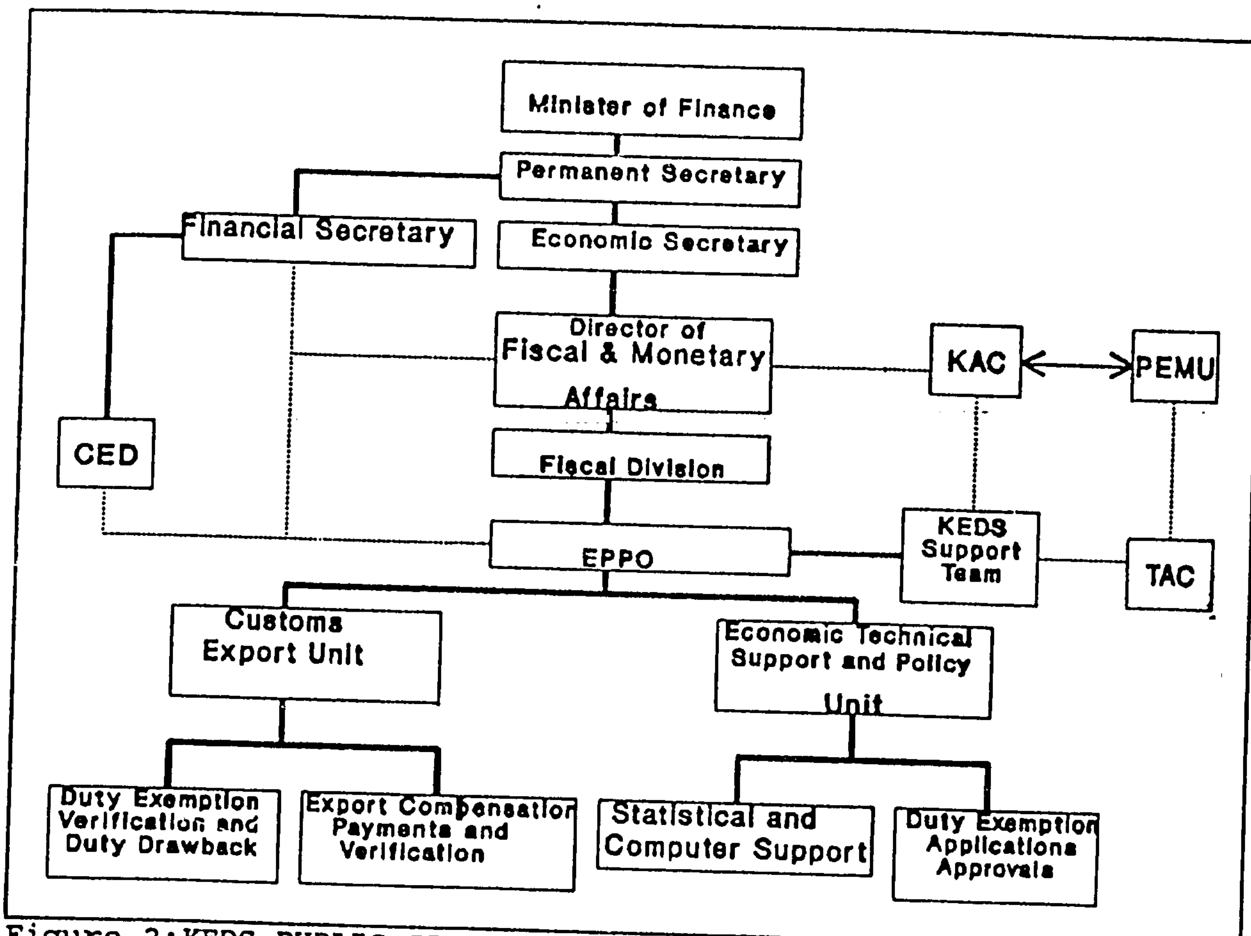

Figure 2:KEDS PUBLIC SECTOR ASSISTANCE ORGANIZATION

One of the initial tasks of the Export Promotion Advisor will be to design and carry out a baseline survey for the MOF on current policies, regulations and rules, and their effects on trade, while monitoring changes in the trade regime during the course of the Project. The Advisor will work closely with the PEMU technical team to assist them with the Firm Level Assistance baseline survey and impact assessment monitoring mechanisms.

An Export Programs Advisor will be funded for one year under the KEDS Project as a continuation of USAID support to the Ministry of Finance. This PASA position with the United States Treasury will have been financed for the first year before KEDS start-up through Mission Private Enterprise Development funds. The Export Programs Advisor is charged with assisting the MOF to develop and administer the duty exemption, duty drawback and export processing programs to promote exports and verification procedures. (Although this position may be considered part of the Public Sector Component, the cost and related person-months are not included in the Public Sector Component. They are included in the Mission Support Component.)

Short-term technical assistance will also be provided to the EPPO through the KEDS Public Sector Component. Consultants will examine various trade constraints in detail and recommend appropriate policy changes. Short-term assistance to the EPPO will also include management information systems development, and training on the maintenance of program performance statistics, trade statistics, and monitoring and verification procedures. EPPO training and institutional needs assessments, and procurement of computer hardware and software will also be provided. A specialist will prepare recommendations on the coordination and sharing of database information among government entities and private sector associations on export-related data, and means for accessing international data relevant to the EPPO's export promotion programs.

A needs assessment for EPC short-term technical assistance will be provided by the KEDS Public Sector team. It will be difficult to define the specific types of short-term technical assistance required by the EPC until a needs assessment is completed. The Export Promotion Advisor will work with EPC to set out the scopes of work for technical assistance to the EPC.

KEDS will provide short-term training courses both abroad and in Kenya. In-country seminars and workshops on topics ranging from promotion of GOK trade policies to streamlining GOK export approvals will be financed. Ten 60-day study trips to the U.S.A are budgeted for EPPO and EPC officials.

Commodity assistance for the EPPO will be provided on the basis of an initial technical assessment of the EPPO's specific needs. KEDS will finance the procurement of computer equipment for the EPPO and for the KEDS technical team. The Project will supply computers, software, printers and other essential office equipment to support the technical team and the EPPO. The computers will link with various GOK, private sector and international databases. KEDS will provide the EPC with a computer, printer, software and other office equipment.

Public Sector Component Inputs

KEDS Public Sector assistance will consist of the following:

- Long-term technical assistance to the EPPO (54 person-months);
- Short-term technical assistance to the EPPO (22 person-months);
- Short-term technical assistance to the EPC (9 person-months);
- Ten short-term (avg 60 days) training courses for individuals in the USA;
- A series of EPPO seminars (ten 1-day seminars)
- A series of EPC seminars (ten 1-day seminars) ; and,
- Commodities for the EPPO and EPC (approx. $115, 000) .

Public Sector Component Outputs

KEDS Public Sector assistance will result in the following:

- A functional EPPO as the key unit in the MOF export promotion drive;
- A staff well trained in export trade policy analysis;
- A reduction of GOK controls ranging from licensing simplification to import and export liberalization;
- Increased export incentives provided by the GOK;
- A functional dialogue between the GOK and the private sector;
- An operating EPC providing timely advice to senior GOK policy makers on export development; and,
- Coordinated export-related technical assistance.

2. Firm Level Assistance Component

The KEDS Firm Level Assistance Component will increase non-traditional exports, foreign exchange earnings and employment generation through Kenya's private sector. The component will strengthen Kenya's private sector capacity to accelerate manufacturing, agro-processing and horticultural exports to foreign markets.

The Firm Level Assistance Component consists of two principal parts: direct firm level assistance to current and new exporters; and institutional support to trade associations to reinforce their capacity to deliver trade-related services and information to export firms. Firm level assistance will be used to provide Kenyan exporters with market assessments, quality and production assistance, planning for business expansion, and export promotion through short term consultancies. Institutional support will be provided to key Kenyan trade associations and will comprise export market information, seminars and trade association export promotion in overseas markets.

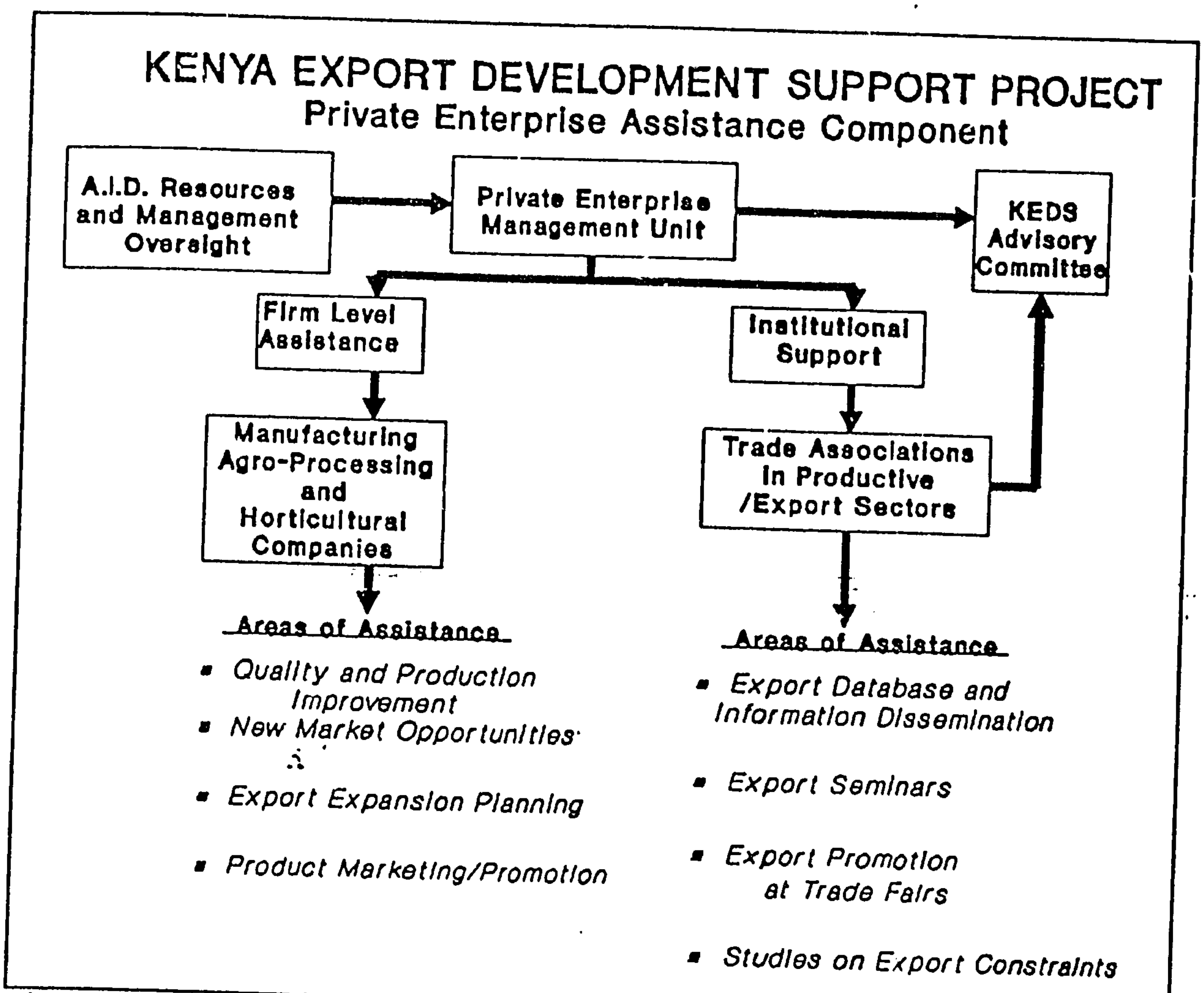

Figure 3: PEMU ORGANIZATIONAL FRAMEWORK

Both firm level assistance and institutional support activities will be delivered through a Private Enterprise Management Unit (PEMU) financed by KEDS. The Unit will have independent offices and administrative support staff in Nairobi, and will work closely with the leading export trade institutions in Kenya. Inputs will include a technical team of two expatriate export development advisors; PEMU office support, short term technical experts and commodities. USAID will also establish an Export Development Fund (EDF) to support cost-shared technical assistance activities for export-oriented enterprises.

The total level of effort for the Firm Level Assistance Component will be 288 person-months over seven years. This will consist of 108 person-months of long-term expatriate support, 147 person-months of PEMU office support and 33 person-months of short-term assignments. Commodities will include computer hardware, promotional materials and equipment, overseas travel and office equipment.

Export Development

The PEMU team, in collaboration with KEDS-assisted trade associations, will establish a strategic action plan for identifying enterprises with direct and indirect export potential. The action plan will define criteria for selecting eligible firms such as product development opportunities, financial performance, expansion capability, export experience and employment potential. Preliminary discussions with the firms, evaluations of export markets for available products, and examination of opportunities for similar product lines in overseas locations will be initiated by the PEMU team.

The PEMU will utilize short-term consultants to design market-oriented promotional strategies and identify specific product development opportunities for Kenyan export groups. The PEMU team will forge input linkages between intermediate producers and larger exporters, establish contacts with buyers, and develop systems to access information on entry-level trade requirements in foreign countries.

This methodology will be repeated on an enterprise-by-enterprise basis and will be used to design an introductory program for non-traditional exporters and established firms. The PEMU will use its preliminary findings to encourage firms to make more extensive assessments of their export potential. In this way the unit will help targeted firms to follow through with stronger commitments to export development. KEDS will provide guidance through the core contract to assist each firm with its preliminary export plans. These preliminary consulting assignments and each series of "first contact" interventions with firms will be funded with PEMU core funds.

Specialized Technical Assistance

Export-related expansion activities often occur in phases combined with promotional visits as new products are developed

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and tested in alternative markets. Specialized services will be marketed to companies to help them through each stage of their export development process. Under KEDS, a company interested in developing an international niche would go through various phases of pre-export development.

First, the firm would need detailed information on market trends, sampling, seasonality, promotion techniques, quality control, packaging requirements and other marketing and production standards. Second, a financing plan, product costing, skill training program and supplier links for new materials and equipment would have to be developed. Third, after financing is secured and production capability is established, the firm must conduct production and market trials. Finally, the feedback from distributors and retailers would then be used to fine tune the production process, adjust product content and/or change for a full scale export operations.

An Export Development Fund (EDF) will be established to provide cost shared co-financing for specialized technical assistance. The fund will be allocated in two ways:

0 Direct cost-shared services to obtain specific market and product information, finance technical assistance for firm expansion, test marketing and follow up advice through PEMU; and,

0 Indirect IESC production and quality improvement assistance to KEDS-targeted firms.

Selection of participants in the EDF cost sharing scheme will be the overall responsibility of the core contractor. As such, the core contractor will decide whether TA should be provided by the core contractor or the IESC. In making this decision, the core contractor will work in consultation with the client to match the type of TA required with expertise available from the contractor or the IESC. Upon expiry of the institutional contract, the EDF will be implemented through a local trade/business association, such as the Kenya Institute of Management (KIM), Kenya Association of Manufacturers (KAM) or Federation of Kenya Employers (FKE).

In order to make fees charged by the core contractor and the IESC comparable, the core contractor will charge out for services at its actual direct labor cost. That is, overhead, direct costs, G&A and fee for the core contractor will not be charged out to the client. This will result in a charge out rate of approximately $40/hr. The IESC charge out rates, assuming the client pays one-half the cost, should approximate $35/hr, a slightly lower rate, but appropriate for the longer term IESC projects.

The PEMU will access the Fund directly to deliver technical services to new exporters to help each firm enter new markets, obtain specific market knowledge and develop detailed financing and expansion plans. The Project will offer firms EDF co-financing to cover eligible consultancy and exploratory market visits and for promoting and test marketing new products. For established exporters, EDF funds would finance follow-up services to refine products or re-examine markets and production limitations and identify solutions to serious firm level constraints which would limit export expansion.

EDF eligibility requirements will include quality of business development and management plans, type of enterprise, financial capacity of the beneficiary firm, and preliminary evaluations of firm level export capacity and opportunities. Assistance will only be provided to privately owned firms. Acceptable activities would include product upgrade, packaging re-design, quality improvements, travel to export markets, acquiring design and processing knowledge, and in-house training.

While the PEMU will focus on a broad range of direct export development services, it will also buy into a limited number of specialized business assistance programs to address specific firm level production and quality constraints. Typically, KEDS will obtain these services after the PEMU's preliminary assistance has been completed, as part of its first series of pre-export development interventions.

The PEMU will provide direct firm level assistance in identifying new market opportunities, export expansion planning and in export marketing and promotion. IESC activities will focus on production and quality improvement assignments. The PEMU will be responsible for identifying KEDS-targeted client firms and for brokering IESC assistance for firms under the cost shared Export Development Fund. Through the PEMU, KEDS will reimburse IESC up to 50% of project costs. To ensure uniformity within the EDF cost shared program, IESC will be required to adhere to the KEDS co-financing structure and criteria for firm level assistance.

Both PEMU direct assistance and indirect IESC assignments will be funded under the EDF. Disbursements will allow for a maximum of three co-financing grants per company up to a ceiling of $15,000 per grant on a 50% cost-sharing scheme. That is, KEDS will pay for 50 percent of project costs. Each client firm will be permitted to access up to a maximum of $45,000 of EDF funds.

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Institutional Support

Institutional support to export service institutions will consist of four key activities including development of export market databases and dissemination of market, industry and product information; seminars and workshops for exporters; targeted export promotion in overseas markets; and studies on regulatory and fiscal constraints to rapid export growth.

KEDS institutional support will be provided to export support institutions which, in the first instance, already have an institutional framework to immediately utilize KEDS support to deliver improved export-related services. The current organizations which supply services in manufacturing, agro-processing and horticulture, and meet this criteria are: the Kenya Association of Manufacturers (KAM), the Fresh Produce Exporters Association of Kenya (FPEAK), and the Horticultural Crops Development Authority (HCDA). Provision will be made for similar support, on a case-by-case basis, to smaller associations as they evolve into viable exporter bodies. The core contractor will recommend to USAID the amount of funding to be provided to each association.

Through USAID support under the PED Project, KAM has emerged as a clearinghouse for enquiries from export markets. It has expanded its services through technical seminars for its various industry groups and has become an effective proponent of policy reform for its members. KAM has over 600 members and is now well-positioned to develop and offer similar export services to its membership.

The HCDA, a government parastatal, is responsible for facilitating and regulating the development of Kenya's horticultural sector. HCDA concentrates on small farmer development, and has worked successfully to increase the share of total horticultural exports by small scale exporters from 45 percent in 1985 to 60 percent in 1989. The HCDA provides small farmer groups with extension services and information on international market prices. The HCDA also issues Export Certificates which certify export prices and product quality on a fee basis. The Authority is financially autonomous of GOK subsidies as its activities are funded through a direct tax on all export produce. The HCDA is constrained by its revenue mechanism. Unless export volumes increase, it cannot broaden its service base without raising taxes. This impedes the development of the horticultural sector because marginal tax revenues are inadequate to support further expansion of HCDA services, particularly to small farmers. The HCDA, like KAM, is well-respected for its professional approach to institutional services for its members. Most of the growth in horticultural exports has come from increased small farmer production, and the HCDA has proven to be the most effective vehicle for channelling export assistance to this subsector.

The FPEAK is at an early stage of development but is beginning to surface as a legitimate representative of Kenya's larger horticultural exporters. FPEAK has approximately 100 members, including a significant number of large producers and exporters. Its first priority is to lobby the GOK for investment and export incentives, and for improved export facilities for its members through periodic meetings with various GOK ministries.

FPEAK needs institutional support, particularly in organizational development, to expand its membership base and to offer basic information, seminars and other support services to exporters. FPEAK is a prime target for KEDS institutional support given the employment generation and foreign exchange implications of improvements in the horticulture sector. USAID's previous success with support to KAM lends further credence to the utility of providing institutional support to FPEAK under the KEDS Project.

Institutional support inputs under the KEDS Firm Level Assistance Component will be delivered through the PEMU, and will consist of limited technical assistance, commodities to develop trade information libraries, computers, and on line access to foreign databases. The PEMU will help FPEAK prepare a development plan on the association's behalf. Critical areas for institutional support are summarized below:

<u>Development of Export Market Databases and Dissemination of Market, Industry and Product Information</u>

The PEMU will supply expertise to the associations and the HCDA to improve their delivery of publicly-available information on export markets. This will occur through short-term technical assistance in database development to KAM and HCDA, and through institutional development assistance to FPEAK.

<u>Seminars and Workshops for Exporters</u>

The PEMU will use market feedback such as import market requirements, buyer priorities and product specifications to identify training needs and access professional resources to help KAM, HCDA and FPEAK develop the capability to upgrade exporters' business skills.

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Targeted Export Promotion in Overseas Markets

The PEMU will help KAM, FPEAK, and other organizations which meet KEDS institutional support criteria prepare and participate in overseas trade fairs. The PEMU team will access sector specific trade and market information and will help associations and emerging exporters develop the capability to pre-screen exhibitions and organize attendance programs. The associations will draw on short term specialists for advice on promotional methods, effective follow-up techniques and logistical arrangements to ensure that maximum results are achieved through business involvement at overseas fairs.

Studies on Regulatory and Fiscal Constraints

Obstacles to rapid private sector export growth, such as the impact of fiscal measures on Kenya's competitiveness in export markets, will be identified by KAM, HCDA, and FPEAK through interaction with, and feedback from, members and through KEDS assistance under the Studies and Public Sector components. On the firm level side, the PEMU and the KEDS-supported institutions will raise key issues for analysis and evaluation and will establish agendas for conducting related studies and for following up on implementing solutions through the KEDS Advisory Committee.

Firm Level Assistance Inputs

KEDS Private Enterprise Assistance inputs will consist of the following:

- Long-term technical assistance (108 person-months of expatriate long-term);
- Short-term technical assistance (33 person-months);
- 147 person-months of administrative support for the PEMU;
- Commodities for KAM, HCDA and FPEAK (approx. $125,000);
- Commodities for PEMU office (approx. $90,000);
- An Export Development Fund (EDF) over 7 years for special cost-sharing technical assistance programs to export enterprises ($3.5 million in a Cost Sharing Fund for TA and $250,000 for IESC TA (The KEDS contractor will disburse the IESC funds through a sub-contract with the IESC); and,
- 15 2-day Export Seminars in Kenya over a six year period.

Firm Level Assistance Outputs

KEDS Private Enterprise Assistance outputs will consist of the following:

- 0 A fully staffed Private Enterprise Management Unit (PEMU);
- 0 Direct technical assistance delivered by PEMU (and supported by the cost sharing EDF) to 15-40 exporting firms over seven years;
- 0 Indirect technical assistance delivered by IESC to 10-20 firms over the first five years of project implementation;
- 0 Attendance by trade associations at 15 international trade fairs over the first six years of project implementation;
- 0 Increased employment in KEDS-targeted firms by at least 5 percent per year over life of Project; and,
- 0 Increased exports to international markets by KEDS targeted firms by at least 10 percent per year over life of Project.

3. <u>Trade Finance Component</u>

Non-traditional export development requires expansion of trade financing opportunities for exporters. Pre-shipment credit is necessary to enable exporters to pay for inputs required to fill export orders and post-shipment credit is needed to finance exporters until they are paid by the importers for their goods. Given the option exporters have for negotiating immediate payment terms, post-shipment finance is considered less critical than pre-shipment finance.

There are several serious institutional and policy issues that currently hinder the private sector's ability to provide adequate collateralized lending. Most banks require substantial collateral before approving loans. Trade documents are not normally acceptable security: the most conventionally accepted collateral is a land title deed. The second issue is that GOK does not provide political risk insurance coverage for exporters. Another barrier to export finance relates to the structure for rediscounting of trade finance "paper" at the Central Bank. The CBK imposes a heavy penalty on these transactions (only buying back trade documents at 80% of their value). Also, the Banking Act does not specifically provide for discount houses which would normally provide a secondary market by discounting trade papers. A conditionality under the World Bank Export Development Program will address this disincentive to trade finance by removing the penalty for rediscounting of trade finance documents.

USAID will provide a grant of $2.0 million to the GOK for an Export Credit Guarantee (ECG) Facility which will be implemented as a pilot project through a commercial bank to demonstrate the effectiveness of utilizing Letters of Credit and other trade papers for short-term pre-shipment financing instead of asset-based collateral. To be eligible to implement the ECG facility, a commercial bank, must be privately owned and operated under the Kenyan Banking Act and must have a reputable management team with a track record for small business development.

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The eligible commercial bank will provide all the pre-shipment financing required and bear 50 percent of credit risks associated with each credit. These export credits will therefore be collateralized 50 percent by a confirmed Letter of Credit and 50 percent by the USAID ECG facility to be established with the commercial bank. The commercial bank is expected to use standard procedures and due diligence in the disbursement of funds and little, if any, of the credit proceeds will be directly handled by the borrowers. Therefore, to the extent possible, the bank will disburse funds through suppliers of raw materials and other working capital needs. The tenor of all Letters of Credit will be 90 days. The commercial bank will charge market interest rates on the credit.

The KEDS Project will seek to assist small and new exporters in financing their exports through the export credit guarantee (ECG) facility to be implemented by the local commercial bank. The project plans to assume 50% credit risk while the commercial bank assumes the other 50% for these short-term, transaction-based trade credits. The ECG facility is currently budgeted for $2 million over the life of the project. Access to the ECG facility will be available to any privately-owned and managed business enterprise operating in Kenya and exporting non-traditional goods. The specific type of assistance targeted for small and new exporters is pre-shipment finance, that is, credit which enables the exporter to pay for inputs required to fill export orders. This may require foreign currency as well as local currency credit.

As for local currency pre-export financing, the KEDS project will assist exporters in utilizing the ECG Facility with the commercial bank to purchase inputs locally and meet other short-term working capital needs. Preliminary discussions with Barclays Bank of Kenya indicate an interest in capitalizing on the relatively higher interest rates and turnover associated with pre-export financing. The 50 percent USAID guarantee (up to $150,000 per transaction) should address the "perceived risk" of extending export financing to small and new exporters and permit lower collateral requirements than would otherwise be the case. If the pre-shipment trade credits extended average three months (90 days), the total credits placed under the proposed $2 million ECG Facility could total $8 million per year.

As regards foreign currency pre-export financing, the KEDS Project will assist small and new exporters in utilizing the ECG facility to cover foreign exchange payments for imported inputs. The actual mechanisms envisioned uses the USAID guarantee and the export order as security for the foreign exchange payment. The local commercial bank would also be designated the beneficiary of a Letter of Credit opened by the ultimate purchaser of the finished product.

Trade Finance Inputs:

* A grant of $2.0 million to establish an Export Credit Guarantee Facility for small and new exporters of non-traditional goods within a local commercial bank;

* Promotion of transaction-based as opposed to asset-based trade financing in order to address collateral constraints of small and new exporters; and

* Promotion and publicity campaigns for the Export Credit Guarantee Facility to encourage participation by exporters of non-traditional goods.

Trade Finance Outputs:

* $32 million equivalent of pre-shipment credit placed under export credit guarantee (ECG) facility with a local commercial bank.

* 50 new and small exporters receive pre-shipment financing under the ECG facility.

4. Studies Component

The objective of the KEDS Studies Component will be to provide up to date information, analyses and recommendations to key policy officials on relevant export development issues. Studies will be administered through the KEDS Public Sector Component technical unit. The KEDS Public Sector Technical Advisory Committee (TAC) will review all studies funded under KEDS.

Most studies funded under the Project will be undertaken through the EPPO of the Ministry of Finance under the guidance of the Export Promotion Advisor. However, specific studies will be carried out by trade associations under the Firm Level Assistance Component and at the initiative of USAID. Findings from studies will be distributed extensively to reach as wide a range of decision makers in the GOK and the private sector as possible. Key study areas will include export bottlenecks and trade policy improvements, trade finance, and annual program and environmental impact assessments.

Study Areas

Baseline data will need to be collected in several areas of the KEDS Project to measure progress and outputs achieved. For example, baseline data will be assembled on GOK agencies working with the Project (see Public Sector Assistance Component). Data will also need to be assembled on current levels of exports, tax revenues from exporters, customs receipts on imported inputs for exports, and local taxes applicable to exporters. These data will be essential for monitoring exports, changes in GOK policies and the effects of KEDS.

Baseline data will also need to be assembled on current non-traditional export sectors. Information on trade associations and firms which will be assisted directly under the Project will need to be assembled. This information will be important not only to determine the areas of Project focus but to determine level of exports, value-added in targeted sectors, general import requirements and expenditures, level of employment, direction of trade, and other information over the life of the Project. This will help both the GOK and USAID to determine the impact of Project interventions, and should prove valuable in supporting policy initiatives on the GOK's part.

These data will enable the Project to focus on areas which have the highest export potential. These will include both producers who are poised to increase exports as well as those which show good potential for exports in the medium- to longterm. Studies will help identify the latter, and to set out the conditions under which they can be encouraged to diversify and improve Kenya's export base.

One of the key elements to improve Kenya's export climate is improving the foreign exchange regime. This includes reducing the anti-export bias inherent in an overvalued exchange rate. Additionally, the allocation of foreign exchange is a critical area to examine in order to encourage more exports, particularly non-traditional exports. It is anticipated that this will be one of the major areas of study during the KEDS Project.

KEDS will also conduct at least one study on the effects of Kenya's regulatory environment on non-traditional exports. The regulatory environment should be examined in order to determine how both export and import policy can be improved. Licensing criteria, marketing requirements and other areas of regulation need to be examined within this context to suggest sound policy recommendations to improve Kenya's export climate.

The Project will also examine labor costs within this context. While Kenyan labor is reputed to be inexpensive relative to other countries, the legislation regulating the use of labor is extensive. Competitive labor is one of the most important elements of a successful export regime. It may be necessary to examine how labor can be made more competitive.

Fiscal policy plays a major role in determining the competitiveness of Kenya's exports. The Project will build upon work being undertaken within the Ministry of Finance through the UNDP Tax Modernization Programme (which USAID is co-sponsoring). The effects of various taxes, including local cesses, customs and excise taxes, and indirect taxation need to be analyzed, particularly to determine how these taxes affect Kenya's exports vis-a-vis her competitors. This will be of particular importance to Kenya's horticulture sector.

KEDS might also examine the overall Kenyan investment climate, especially with regard to investments in non-traditional export sectors. Mobilization of both local and foreign capital requires a thorough understanding of the incentives and disincentives to investment in target areas.

The total costs of delays from point of production to actual international shipment need to be examined with an eye to recommend where the GOK can remove critical bottlenecks. Delays are experienced at the ports, on the railways, on roads, through Customs, and through other GOK enforcement agencies. Rents are often collected at these points which increase the cost of inputs to the export sector and reduce Kenya's advantages vis-a-vis her competitors. These delays will have to be drastically reduced if Kenya's competitive advantage is to be realized. Studies will be undertaken in these areas to determine how Kenya can best reduce these bottlenecks and improve its export environment.

The Project will examine the prospects for pre-export finance and subsidized credit (ex ante) to exporters. Virtually all industrialized countries, and most newly industrialized countries (NICS) have developed extensive credit schemes to finance their exports. These include pre-export guarantees, easy credit on concessional terms (or interest free), and export insurance for targeted sectors. The Project will examine the potential for utilizing one or several of these mechanisms to stimulate exports.

The KEDS Studies Component will also fund other studies during the life of the Project. Topics for such studies will generally focus on direct implementation issues relevant to the Project. These could include direct market analysis for specific sub-sectors; targeted surveys to gauge the impact of the KEDS Project; and studies of the impact of particular policy interventions which occur during the Project.

<u>Studies Component Inputs</u>

KEDS Studies Component inputs will consist of the following:

0 15 person-months of technical assistance to complete eight to twelve studies.

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Studies Component Outputs.

The KEDS Studies Component outputs will consist of:

0 Between eight and twelve studies in export policy related areas; and,

0 Ten 2.5-day workshops to discuss studies and policy issues raised from studies.

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Attachment 1 - Annex 1

A.I.D. Project No. 615-0249
Kenya Export Development Support (KEDS)

Fourth Amendment - Revision 1

Illustrative Budget

SUMMARY OF PROJECT COSTS BY EXPENSE CATEGORY AND SOURCE OF FUNDING 1/
(In $000's)

EXPENSE CATEGORY	Prior Obligations A.I.D. $	Prior Obligations GOK (equiv.)	This Revision A.I.D. $	This Revision GOK (equiv.)	Cumulative Obligations A.I.D. $	Cumulative Obligations GOK (equiv.)	Planned Life of Project Obligations A.I.D.2/ $	Planned Life of Project Obligations GOK3/ (equiv.)
Public Sector	1,502	180	0	0	1,502	180	1,550	500
Firm -Level Assistance	3,388	580*	0	0*	3,388	580*	9,280	4,476*
EPZ Swap Facility	859	0	0	0	859	0	0	0
Special Studies	301	20	0	0	301	20	780	63
Evaluation/Audit	0	0	78	0	78	0	410	0
Mission Support	678	0	(78)	0	600	0	980	0
Trade Finance	0	0	0	0	0	0	2,000	0
Total	6,728	780	0	0	6,728	780	15,000	5,039

1/ Either party may unilaterally, with written notice to the other, adjust line items in this budget to a maximum of 15% per line item, provided, however, that the total obligated amount as shown in the budget is not exceeded and provided further that the amounts budgeted for evaluation and audit are not reduced.

2/ Subject to the availability of funds to A.I.D. for this purpose, and to the mutual agreement of the parties to proceed at the time of each subsequent increment.

3/ Subject, on a proportional basis, to the provision by A.I.D. of the LOP grant amount set forth herein.

* Private Sector Contribution

od:\attachme