PD-BAO-197

CLASSIFICATION: UNCLASSIFIED

AID 1120-1 (3-65)

DEPARTMENT OF STATE
AGENCY FOR
INTERNATIONAL DEVELOPMENT

PAAD

PROGRAM ASSISTANCE
APPROVAL DOCUMENT

1. PAAD NO.
PROJECT NO. 615-0213

2. COUNTRY
Kenya

3. CATEGORY
Program Grant Technical Assistance

4. DATE
June 14, 1983

5. TO:
M. Petter McPherson, A/AID

6. OYB CHANGE NO.
Not Applicable

7. FROM:
Alexander R. Love, Acting, AA/AFR

8. OYB INCREASE
None

TO BE TAKEN FROM:
None Applicable

9. APPROVAL REQUESTED FOR COMMITMENT OF:
$ 30,000,000

10. APPROPRIATION - ALLOTMENT
ESF - FY 1983

11. TYPE FUNDING: ☐ LOAN XX GRANT

12. LOCAL CURRENCY ARRANGEMENT: XX INFORMAL ☐ FORMAL ☐ NONE

13. ESTIMATED DELIVERY PERIOD

14. TRANSACTION ELIGIBILITY DATE

15. COMMODITIES FINANCED

$200,000 for microcomputers

16. PERMITTED SOURCE		17. ESTIMATED SOURCE	
U.S. only:	2,000,000	U.S.:	2,000,000
Limited F.W.:		Industrialized Countries:	
Free World:		Local:	
Cash:	28,000,000	Other:	28,000,000

18. SUMMARY DESCRIPTION

The purpose of the Structural Adjustment Program Grant is to provide critical balance of payments and budget support to the Government of Kenya while promoting the structural changes needed to redress the underlying problems of the economy. Local currency resulting from the program will be used for mutually agreed development projects.

(continued on next page)

19. CLEARANCES		DATE
AFR/PD:NCohen		6/21/83
AFR/EA:BChapnick		6/21/83
AFR/DP:HJohnson		6-21-83
GC/RDerham		6-24-83
GC/AFR/TBork		6/20/83
AA/PPC:JBolton		6/24/83
DAA/AFR:GPatterson		6/24/83
M/FM/PAD:IPeterson	for	6/24/83

20. ACTION
☒ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE

June 24, 1983
DATE

M. Peter McPherson, Administrator
TITLE

CLASSIFICATION: UNCLASSIFIED

The proposed grant will provide $28 million of balance of payments support on a program grant basis to enable Kenya to continue its structural adjustment program. $2 million of foreign exchange will be utilized for technical assistance and commodities to help implement announced structural adjustment policies. Local currency proceeds from the $28 million cash grant will be attributed to the GOK budget for mutually agreed development purposes in the areas of rural development, agriculture development, rural private enterprise, and family planning.

A program grant in the amount of $28 million and a technical assistance grant in the amount of $ 2 million to the Government of Kenya are hereby authorized subject to the following terms and conditions, to be included in substance in the Grant Agreement:

<u>Conditions Precedent to Disbursement</u>: Prior to disbursement of funds under the Program Grant, or to the issuance of documentation by A.I.D pursuant to which disbursement will be made, the Grantee will furnish to A.I.D., in form and substance satisfactory to A.I.D., except as A.I.D. may otherwise agree in writing, the following:

a. Evidence that the Government of Kenya has simplified the export documentation and licensing procedures since December 30, 1982.

b. Evidence that the Government of Kenya has taken or has initiated reasonable steps to meet the following targets:

(1) At June 30, 1983, net domestic bank credit does not exceed 14,794 million Kenya shillings.

(2) At June 30, 1983, net domestic bank credit to the Government, less the deposits of the Cereal 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.

(3) Government intends to limit the contracting of public and publicly guaranteed external borrowing 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 during the 18 months ending June, 1984.

c. 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.

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d. Evidence that there will be no restrictions on the importation of, or availability of foreign exchange for appropriate agricultural inputs, except that for insecticides and fertilizers, there will be established a list of acceptable types, and that for fertilizers there may 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 requirements for 1982/83.

e. Regarding fertilizer, evidence that:

(1) 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:

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

(b) The system for establishing prices of fertilizers.

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

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

(2) 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.

f. Evidence 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.

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

Covenants: The Government of Kenya agrees as follows:

a. To restructure the tariff system and phase out the system of import licensing so as to make more uniform and lower the general level of effective protection.

b. To continue to encourage exports by adjusting the exchange rate of the Kenya shilling periodically; pursuing improvements in bureaucratic procedures pertinent to exports and export incentives; and expediting the study of alternative means of export promotion, including the establishment of bonded warehouses or export zones.

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, impose sanctions for practice in restraint of fair trade and recommend reduction of price controls on specified items for which there is sufficient internal and external competition in the Kenya market and will give 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 undertake a program to reduce the Government's participation in public enterprises as recommended by the July 1982 "Report and Recommendations of the Working Party on Government Expenditures."

h. To make available within 90 days of this agreement the Kenyan shilling equivalent of twenty-eight million (U.S. $28,000,000) United States dollars. These shillings shall be utilized to fund developmental activities mutually agreed upon by AID and the Government in the areas of rural development, agricultural production, rural private enterprise, and family planning.

AID 1120-1 (8-66)

DEPARTMENT OF STATE
AGENCY FOR
INTERNATIONAL DEVELOPMENT

PAAD

PROGRAM ASSISTANCE
APPROVAL DOCUMENT

1. PAAD NO.: Project No. 615-0213

2. COUNTRY: Kenya

3. CATEGORY: Program Grant Technical Assistance

4. DATE:

5. TO: M. Peter McPherson

6. OYB CHANGE NO.: Not Applicable

7. FROM: Francis S. Ruddy

8. OYB INCREASE: None

TO BE TAKEN FROM: Not Applicable

9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 30,000,000

10. APPROPRIATION - ALLOTMENT: ESF: FY 1983

11. TYPE FUNDING: ☐ LOAN ☒ GRANT

12. LOCAL CURRENCY ARRANGEMENT: ☒ INFORMAL ☐ FORMAL ☐ NONE

13. ESTIMATED DELIVERY PERIOD:

14. TRANSACTION ELIGIBILITY DATE:

15. COMMODITIES FINANCED

$200,000 for microcomputers

16. PERMITTED SOURCE		17. ESTIMATED SOURCE	
U.S. only:	2,000,000	U.S.:	2,000,000
Limited F.W.:		Industrialized Countries:	
Free World:		Local:	
Cash:	28,000,000	Other:	28,000,000

18. SUMMARY DESCRIPTION

The purpose of the Structural Adjustment Program Grant is to provide critical balance of payments and budget support to the Government of Kenya while promoting the structural changes needed to redress the underlying problems of the economy. Local currency resulting from the program will cover the GOK budget costs of certain policy reforms.

19. CLEARANCES — DATE

20. ACTION ☐ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE — DATE

TITLE

CLASSIFICATION:

Authorization (cont.)

The proposed grant will provide $28 million of balance of payments support on a program grant basis to enable Kenya to continue its structural adjustment program. $2 million of foreign exchange will be utilized for technical assistance to help implement announced structural adjustment policies. All local currency proceeds will be attributed to the GOK budget to help Government meet current IMF domestic borrowing performance criteria.

A program grant in the amount of $28 million and a technical assistance grant in the amount of $2 million to the Government of Kenya are hereby authorized subject to the following terms and conditions to be included in the Grant Agreement:

Conditions Precedent to Disbursement: Prior to disbursement of funds under the Program Grant, or to the issuance of documentation by A.I.D pursuant to which disbursement will be made, the Grantee will furnish to A.I.D., in form and substance satisfactory to A.I.D., except as A.I.D. may otherwise agree in writing, the following:

a. evidence that the Government of Kenya has taken or has initiated all necessary steps to comply with the current IMF Stand-By Agreement and the World Bank Structural Adjustment Loan;

b. evidence that the Government of Kenya has simplified the export documentation and licensing procedures since December 30, 1982.

c. evidence that import schedule I has been subdivided to establish a list of goods for which unlimited foreign exchange is freely available;

d. evidence that there will be no restrictions on imports of major agricultural inputs, except that for insecticides and fertilizers there may be established a list of acceptable types and that in consultation with representatives of those countries which export fertilizers to Kenya there may be estblished a list of bona fide private enterprises permitted to import fertilizers; and that foreign exchange will be available automatically for imports of all major agricultural inputs.

Covenants:

The Government of Kenya agrees as follows:

a. to comply fully with the terms and conditions of the IMF Stand-By Agreement and the World Bank Structural Adjustment Loan;

b. to develop a plan to assure that scarce budget resources are utilized for high priority investments and that lower priority investments for which insufficient budget resources are available are either curtailed or terminated;

c. to establish a special mechanism to manage planning and implementation of externally-financed development programs;

d. to establish a Monopolies and Prices Commission which will review commercial practices, impose sanctions for practices in restraint of fair trade and recommend reduction of price controls on specified items for which there is sufficient internal and external competition;

e. to make and implement decisions on the grain marketing structure, including the role and financing of the National Cereals and Produce Board;

f. to undertake a program to reduce the Government's participation in public enterprises as recommended by the July 1982 "Report and Recommendations of the Working Party on Government Expenditures";

g. to continue to encourage export activities by adjusting the exchange rate of the Kenya shilling periodically in order to establish and maintain an equilibrium rate; to pursue simplification of export procedures; and to expedite the study of alternative methods for export promotion;

h. to utilize the shilling equivalent of Twenty-eight Million United States Dollars (U.S. $28,000,000) to meet the needs of the Fiscal Year 1982/83 budget, as revised.)

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PAAD
STRUCTURAL ADJUSTMENT PROGRAM GRANT
(615-0213)

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- E. Technical Assistance
- F. 1980-81 Fertilizer C.I.P. Review
- G. Disbursements of Foreign Grant Assistance
- H. GOK Brief on the IMF Stand-By

X. Supplementary Annexes (available from AFR/PD/EAP)

- A. Structural Adjustment in Kenya
- B. Fertilizer Marketing and Distribution in Kenya: A Case Study, Louis Berger International, Inc.

1. SUMMARY:

The purpose of the FY 1983 $30 million Structural Adjustment Program Grant (615-0213), and of the 3-year $117 million program of which this grant is the first increment, is to provide critical balance of payments and budget support to the Government of Kenya (GOK) while promoting the structural changes needed to redress the underlying problems of the economy.

The program is founded on the conclusion that the overall GOK structural adjustment effort is of fundamental importance to Kenya's future economic development and that it is essentially sound in its approach and objectives. This program's strategy is therefore to support and stimulate more rapid and effective implementation of structural adjustment. The foreign exchange component of the FY 1983 program will provide a program grant of $28 million. It will also finance $2 million for technical skills and consultancies to support implementation of structural adjustment policies. Local currency resulting from conversion of the FY 1983 Program Grant will be programmed to cover the costs of certain structural adjustment policy reforms. In addition to supporting policy reform costs, second and third year local currency proceeds will be utilized to support priority agricultural and rural development activities within the GOK budget, and to finance private enterprise development.

Since 1980 Kenya has undertaken self-help policy measures as part of a long range structural adjustment program designed to re-orient Kenya's economy from a protected domestic market toward the international market. Four devaluations of the Kenya shilling were carried out between February, 1981 and late December, 1982 and important reforms were begun in tariff, import and foreign exchange controls. GOK budget deficits have been reduced regularly over the past few years, and deposit and lending have been raised to promote savings and investment. Agricultural and energy prices have been increased, and various price controls have been eliminated. Program assistance has been provided by the IMF, the World Bank, the United States, and several other bilateral and multi-lateral donors in support of these structural adjustment efforts.

Despite the policy reform measures undertaken and foreign assistance provided, Kenya still faces serious balance of payments and budget problems this year. The GOK estimates the overall balance of payments deficit during CY 1983 to be $45 million. This gap is due in part to external factors (decreased purchasing power of Kenya's imports, sluggish world economy), in part to lagging implementation of announced reforms, and in part to rigidities in the Kenyan economy. On the budget side, despite deep and painful cuts in expenditures, the GOK faces a budget gap of $42 million by June 30, 1983, which, if unfilled, will result in suspension of the most recent IMF Stand-By Agreement. The current budget gap results from a shortfall in revenues due to reduced customs duty resulting from reduced imports, a depressed economy and from slower than promised disbursements by some donors. Longer term pressure on the budget results from a mismatch between the Government's available financial and managerial resources and its desire to provide expanded services to a rapidly growing population.

Structural adjustment in Kenya means changing the pattern of economic growth to increase efficiency and competition and to earn or save foreign exchange resources. It also means bringing the magnitude, scope and efficiency of Government activity more into line with the Government's human and financial resources and allowing market forces to play a greater role in the economy. Structural adjustment is a long-term and complex process requiring institutional as well as policy changes. It also requires sustained inputs of foreign exchange and local currency resources. Without these foreign exchange resources, liberalized import regimes would quickly lead to a depletion of reserves and force curtailment of programs to open domestic markets to competition. Without the local currency resources, it would not be possible to finance many of the priority public and private sector development activities which are needed to increase income and Government revenues in the future. This proposed U..S. program will provide a substantial portion of the foreign exchange and local currency resources needed to continue the structural adjustment program. Concurrently, policy dialogue, studies leading to policy reform, and assistance in implementation of policies already established will help direct the structural adjustment program. Innovative programming of local currency generations will help finance costs of structural adjustment implementation, support priority public sector development activities and promote private enterprise development.

II. STATEMENT OF THE PROBLEM

A. Background

1. Macro-economic Trends:

During the first ten years after Independence Kenya achieved rapid economic growth. From 1964 to 1973 real Gross Domestic Product (GDP) grew at an average rate of 6.6 percent per year, and per capita GDP rose at an average rate of nearly 3 percent. More recent developments are less promising, reflecting both internal problems and Kenya's vulnerability to external events: the collapse of the East African Community in 1977; the end of the coffee boom in 1978; international recessions; substantial increases in petroleum and other import prices; and periodic drought.

GDP growth during the period 1974-81 has averaged only 4.8 percent annually, and the rate for 1982 has been estimated to be approximately 4 percent. Per capita GDP at market prices stood at $393 in [illegible]. Estimated per capita GDP calculated in 1982 dollars will be closer to $325 given the current strength of the U.S. dollar and the 17.6 percent devaluation of the shilling in December 1982. Government and donor analysts agree that Kenya will be unable to meet the original economic targets of the 1979-83 Development Plan. According to recent Government estimates, growth rates (which were to have averaged 6.3 percent per year over the 1979-1983 Plan period) have been revised downward to an average 3.8 percent per year. Moreover, even if the country's terms of trade halt their recent decline, the growth rate of real resources over the period will average only 1.8 percent annually, well below the 4 percent rate of population increase. On average, people will be less well off in Kenya in 1983 than in 1978. (See Table 1.)

Table 1

Annual Rates of Growth of GDP (at Factor Cost) 1979-83

	1979	1980	1981	1982	1983	1979-83 Average
Development Plan	4.5	7.0	6.5	6.7	6.9	6.3
Sessional Paper No. 4 of 1981	3.5	5.8	5.9	5.9	6.0	5.4
Recent GOK Estimates	4.2	3.0	4.8	4.0	3.0	3.8
Per Capita GDP Growth	0.2	-1.0	0.8	0.0	-1.0	-0.2
(Adjusted for Terms of Trade)	(-2.5)	(-3.4)	(-4.0)	(-0.1)	(-1.0)	(-2.2)

Nearly every major sector of the economy has shared in the general slowdown of activity since the early 1970's. Some sectors have performed better than others, however, and the economy has undergone a slow but steady sectoral transformation.

2. Manufacturing:

In terms of increased production, the manufacturing sector in Kenya has performed consistently better than the economy as a whole, growing at an average rate of 8.4 percent per year in the first decade of independence and at a slower but still impressive annual rate of 6.2 percent since 1974. However, despite its rapid growth the manufacturing sector remains relatively small accounting for 14 percent of wage employment and 13.3 percent of GDP in 1981. Nearly 80 percent of GDP in manufacturing is accounted for by private sector activity and the remainder by majority-owned Government corporations or parastatal organizations.

Since Independence, Kenya has fostered the growth of its manufacturing sector primarily by means of a policy of import substitution based on quantitative trade controls and foreign exchange restrictions. Although these measures have resulted in impressive growth in the manufacturing sector, the limits to this kind of growth are rapidly being reached and the costs have been high. Most of the easy investments of the import-substitution variety have already been made. Industry operates with heavy dependence on imported inputs and is therefore vulnerable to limitations on availability of foreign exchange. High levels of protection, including an overvalued exchange rate, have in the past resulted in an anti-export bias reducing the availability of foreign exchange. At the same time, the net contribution to foreign exchange savings of many past investments is open to question. The capital-intensive nature of many import-substitution industries (encouraged by protectionist policies) has contributed to the relatively slow growth of industrial employment. The relatively poor quality and high prices of many manufactured goods represent an implicit tax on the agricultural sector.

3. Agriculture:

The growth of the agricultural sector has declined from an average annual rate of 4.7 percent during 1964-73 to 4.1 percent during 1974-82. Despite a rate of growth since Independence below that of the general economy, the agricultural sector still provides Kenya with 33 percent of total GDP, 34 percent of inputs into manufacturing, 67 percent of non-petroleum exports and approximately 65 percent of total employment. Agriculture remains overwhelmingly in private hands with 99 percent of total output accounted for by the private sector. Kenya's agriculture is characterized by a wide variety of production systems reflecting different ecological zones, population densities and land holding patterns. Farms of twenty hectares or more cover 3.7 million hectares or just over half of Kenya's recorded farmland. During most of the 1970's, these farms provided approximately 25 percent of the value-added in agriculture and 45 percent of recorded marketed production. When coffee and tea prices were at their highest in 1977, farms of 20 hectares or more increased their share of agricultural value-added to just over one-third of the total. Kenya's large ranches and open grazing lands in pastoral areas provided an additional 2 percent of agricultural value-added on average during the 1970's. The small farm, however, remains the dominant mode of agricultural production in Kenya accounting for 49 percent of recorded farmland, 55 percent of marketed production, 70 percent of value-added in agriculture, and more than 80 percent of agricultural employment.

Problems in Kenya's agricultural sector were outlined in Kenya's National Food Policy Paper published early in 1981. Producer prices in the past have been inadequate (maize, beef and milk prices in particular), credit services inefficient, and provision of input supplies inadequate and untimely. Marketing services have been poor with parastatal bodies and cooperatives taking an important share of sale proceeds at the expense of the producer.

4. Public Sector:

The contribution of the public sector to total output has grown only marginally since Independence from 24 percent of GDP (at factor cost) in 1964 to 27 percent in 1981. During the same period, however, the Government's share of wage employment rose from 31 percent to 47 percent of the total, and the Government expenditures rose from the equivalent of 20 percent of GDP to 35 percent. Moreover, Government services currently account for just over half of public sector output with Government enterprises accounting for the remainder -- proportions which have remained virtually static since the first year of independence. Although local government authorities provided more than a quarter of all government services in terms of value in 1964, this share was reduced to less than 7 percent by 1981 as revenues and responsibilities were concentrated in the central government. This concentration has now proceeded well beyond the point of economic efficiency. The implicit need for increased decentralization and revitalization of the rural areas has been widely recognized by donors and will be incorporated as one of the objectives of the new Five Year Plan for the period 1984-89.

With regard to Government enterprises, the inefficiency, bad management, corruption and lack of dynamism demonstrated during the past decade and a half (despite the many advantages inherent in operating as a branch of the Government) also suggest the need for a change of direction and an opportunity for expansion of the role of the private sector. So too does the lack of growth of the Government's contribution to total output during a period when the Government has substantially increased its share of both domestic expenditure and wage employment.

Sessional Paper No. 4 of 1982 on Development Prospects and Policies adopts the position that Government expenditures must be reduced as a percentage of GDP. Government expenditures are expected to fall from their peak level of 35 percent of GDP in 1980/81, to 32 percent in 1981/82 and to 26 percent in 1982/83, according to recent government data. The projected figure of 26 percent of GDP is well below the 30 percent share of GDP established as a program target under the March 1983 IMF Stand-By Agreement. The Government's current efforts are a positive indication of strong determination to meet IMF program targets this year, and are a good start on reversing the pattern of excessive government demand on total resources evident until recently. (For detailed budget analysis refer to Section II.C. below).

5. External Trade:

The external sector has become increasingly important to Kenya since Independence. The value of imported goods and services rose from 29 percent of GDP in 1964 to as much as 40 percent in 1980. The level for 1981 is estimated at 35 percent despite substantial restrictions on import licensing. Imported inputs have become important to the growth of Kenyan industry and to a lesser extent of commercial agriculture. Kenya's Social Accounting Matrix for 1976 shows that in the overall economy 35 percent of primary and intermediate inputs were accounted for by imports. Imports accounted for 33 percent of gross output in the manufacturing sector. By comparison 3 percent of gross output in agriculture was directly accounted for by imports.

Exports of goods and services have not kept pace with the rapid growth of imports in Kenya. The value of exports has fallen from more than 33 percent of GDP in both 1964 and 1974, to 28 percent in 1980, and to an estimated 26 percent in 1981. The volume of Kenya's worldwide exports was only 12 percent higher in 1981 than in 1972, the year when Kenya's program of industrial protection and import substitution began in earnest. Given a decrease of 35 percent in the external terms of trade, the purchasing power of Kenya's exports was 27 percent lower in 1981 than in 1972. By 1981, the volume of Kenya's manufactured exports had fallen to 70 percent of its 1972 level.

Kenya has attempted to develop new export markets in the Middle East, but little tangible evidence of success can be noted and no major breakthroughs are expected. The 1977 closing of the Tanzanian border resulted in a major market loss for Kenya. Exports to Tanzania fell from 10 percent of total exports in 1976 to 1 percent in 1980 and 1981. The Ugandan export market similarly dropped from 10 percent of total exports in 1976 to 1 percent in 1979. The Ugandan market rebounded to 13 percent of the total in 1980, but fell again in 1981 to only 8 percent, indicating that prospects remain uncertain.

In contrast with the above trends, real GDP has grown by more than 4 percent annually since 1972. The failure of the export sector to expand or diversify has implied increasing relative shortages of imports as overall GDP continues to rise. Industry and agriculture have increasingly suffered from periodic shortages of imported inputs as the result of foreign exchange shortages, and Kenya's balance of payments on current account has been under considerable pressure.

B. The Balance of Payments Problem

Since the coffee boom of 1977, Kenya's balance of payments position has fluctuated widely in response to a number of factors including: extreme variations in the terms of trade; abrupt changes in fiscal and monetary policy; frequent changes in administration of the import licensing system and foreign exchange regime; and excessive bureacratic control of exports. Despite such fluctuations there has been a strong overall trend toward improvements in both the overall and current account balances since 1980. Such improvements, have been brought about to a significant degree through periodic application of stringent foreign exchange restrictions. Such restrictions have not been without their negative effects on capacity utilization in industry, and on the overall rate of economic growth.

1. Current Account:

Kenya's current account deficit rose from less than one percent of GDP in the coffee boom year of 1977 to a peak of nearly 13 percent of GDP in 1980. This deficit has been systematically reduced to 10 percent of GDP in 1981, to 7 percent in 1982, and to a projected level of just under 6 percent in 1983. In absolute terms Kenya's current account deficit (expressed in U.S. dollars) peaked in calendar year 1980 at a level of $893 million. (See Table 2.) Government data indicate a reduction in the current account deficit for 1981 to a level of $686 million, with further reductions in 1982 and 1983 to levels of $469 million and $381 million respectively. Such improvements, however, have been more than accounted for by reductions in imports from a level of $2.6 billion in 1980 to an estimated $1.8 billion in 1982 and 1983. Moreover, projected increases in donor assistance in the form of program grants will also contribute substantially to the reduction in the current account deficit between 1982 and 1983.

2. Capital Account:

Despite the strong improvement in Kenya's current account balance between 1980 and 1982, Kenya's overall balance of payments deficit has changed less dramatically, from $185 million in 1980, to $232 million in 1981, and to $161 million in 1982.

Table 2. Kenya: Balance of Payments, 1977-83
(Millions of U.S. Dollars)[a]

	1977	1978	1979	1980	1981	(Pro[illegible] 1982	[illegible] 1983
Exports	1,131	958	1,031	1,242	1,081	1,012	1,066
Imports	-1,280	-1,879	-1,832	-2,632	-2,174	-1,781	-1,759
Trade Balance	-148	-921	-801	-1,390	-1,093	-769	-693
Invisibles and Transfers (net)	175	259	302	497	407	301	311
Current Account Balance	27	-662	-498	-893	-686	-469	-381
Private Long Term Cap.(net)	117	153	207	191	163	124	126
Public Long Term Cap.(net)	88	297	302	394	205	143	174
Other Capital [b]	41	12	187	120	87	41	36
Capital Account Balance	245	462	696	707	455	307	336
Overall Balance	272	-202	199	-185	-232	-161	-45
Financing	-272	202	-199	185	232	161	45
Gross Off. Resources	-234	194	-275	135	206	4	-14
Use of Fund Credit	-43	6	72	57	27	146	60
Other Liabilities	5	1	4	-8	-1	11	-
Memorandum Item:							
Current Account/GDP	0.6	-12.4	-8.2	-12.6	-10.2	-7.1	-5.9

Source: IMF; February, March, 1983.

Notes: a/ Final digits may not add due to rounding and exchange conversions.

b/ Includes errors, omissions, valuation adjustments, and allocations of 7 million SDR's in each of the years 1979-81.

Continued reductions in the current account deficit have been partially offset each year since 1980 by a continued reduction in the surplus on capital account. Net private long-term capital inflows fell by more than $67 million between 1980 and 1982. More importantly, net public long-term capital flows decreased by nearly $251 million, and net short-term flows fell by almost $72 million (even when allocations of SDR 7.0 million ($9.1 million) are eliminated from the 1980 figure). For 1983, private long-term capital flows appear to be stabilizing at their 1982 level. Increases in loan assistance from external donors will permit improved performances in the capital account and a reduction in the overall deficit to a level of $45 million. This overall deficit figure assumes all currently projected donor flows, including a $28 million program grants from the United States.

3. Appraisal:

Although the Kenyan Government has once again demonstrated that it is willing to apply severe import controls to reestablish balance in the external accounts, the consistent application of such methods over the next few years would not permit the external trade liberalization and internal structural changes required to achieve either long-term improvements in the balance of payments, or desirable rates of long-term growth. Further, the $45 million deficit figure would permit no increase in the volume of imports in 1983. At the same time the GOK predicts that the economy will expand by 3 to 4 percent in real terms. To the extent that such a combination of events is in fact inconsistent, the GOK's current estimate of required financing may be unrealistically conservative. Despite the significant improvements in the current account since 1980, Kenya is likely to require continued significant assistance from bilateral donors if the growth of the overall economy through the mid-1980's is not to be sacrificed in order to achieve narrow balance of payments objectives.

C. The Budget Problem

The volatility exhibited by Kenya's balance of payments in recent years has been closely matched by a similar volatility in budgetary developments. Despite strong fluctuations in the overall budget deficit, a clear pattern emerges of generally worsening deficits during the period 1977/78 - 1980/81, with significant improvements demonstrated in 1981/82 and projected for 1982/83. During the period 1977/78 - 1980/81, the overall budget deficit more than tripled from 1.7 billion shillings to 5.4 billion (an increase from 4.3 percent of GDP to 9.6 percent). (See Table 3.) In 1981/82, however, the deficit was reduced by over a billion shillings to 4.3 billion shillings (6.5 percent of GDP).

Table 3. Kenya: Central Government Finances, 1977/78-1982/83
(In billions of Kenya shillings)

	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83 (Budget)	1982/83 (GOK Proj.)	1982/83 (IMF Proj.)
Total revenue and grants	9.6	10.3	12.3	14.8	16.6	19.2 c/	17.5 b/	19.5 c/
Recurrent revenue	9.4	10.0	12.0	14.3	15.7	18.2	16.0	18.0
Foreign grants	0.2	0.3	0.3	0.5	0.9	1.0 c/	1.6 b/	1.6 c/
Total expenditure	11.8	14.0	15.8	19.7	21.4	22.2	20.5	23.2
Recurrent expenditure	8.0	9.6	11.4	14.0	15.0	15.0	15.7	16.4
Development expenditure	3.8	4.4	4.4	5.7	6.4	7.2	4.8	6.8
Adjustment a/	0.5	0.5	0.7	- 0.5	0.5	0.0	- 0.2	0.0
Overall deficit	- 1.7	- 3.2	- 2.8	- 5.4	- 4.3	- 3.0 c/	- 3.2 b/	- 3.7 c/
Financing	1.7	3.2	2.8	5.4	4.3	3.0	3.2	3.7
Foreign financing (net)	1.0	1.5	2.0	2.8	1.1	2.5	1.1	1.9
Drawings (Gross)	1.4	1.8	2.4	3.5	2.2	4.1 d/	2.8 d/	3.5 d/
Repayments	- 0.4	- 0.3	- 0.4	- 0.7	- 1.1	- 1.6	- 1.7	- 1.6
Domestic financing (net)	0.7	1.7	0.8	2.6	3.2	0.5	2.0	1.8
Nonbank domestic	0.7	0.6	0.8	1.0	1.5	0.3	1.0	0.8
Bank and CSFC	-	1.1	-	1.6	1.7	0.2	1.0	1.0
Overall deficit excluding foreign grants	- 1.9	- 3.5	- 3.1	- 5.9	- 5.2	- 4.0	- 4.9	- 5.2
Total GDP at current market prices	39.2	43.4	49.0	56.5	66.4	77.9	77.9	77.9
Memorandum items:			(In per cent of GDP)					
Recurrent revenue	24.0	23.0	24.5	25.3	23.6	23.4	20.5	23.1
Total expenditure	30.1	32.3	32.2	35.0	32.2	28.5	26.3	29.8
Overall deficit	- 4.3	- 7.4	- 5.7	- 9.6	- 6.5	- 3.9	- 4.1	- 4.7

Source: GOK, Ministry of Finance, May 5, 1983.
IMF; February, March, 1983.

Notes: a/ Reflects the fact that revenue and expenditure data are not strictly on a cash basis. Negative adjustment item is treated as an expenditure.
b/ Includes $28 million of U.S. program assistance.
c/ Includes $10 million of U.S. program assistance.
d/ Includes only the first tranche of the IBRD SAL loan.

A further reduction in the deficit to 3.2 billion shillings, or 4.9 percent of GDP, is now projected by the Government for the current fiscal year ending June 30, 1983. Such a reduction has called for extraordinary budget cuts on the part of the Government and for special increases in external program assistance, in view of the drastic shortfall in revenue now projected for the current fiscal year.

1. Revenues:

Normally Kenya's broadly based and diversified tax base protects the country from violent fluctuations in total revenue. Tax revenues accounted for 83 percent of all revenue during the period 1977/78 - 1981/82 and no single tax provided a disproportionate share of the total. (Personal and corporate income taxes accounted for 27 percent of all revenue; sales and other direct taxes for 34 percent; and import and export taxes accounted for an additional 21 percent). In addition a large variety of sources, including investment income, contributed to the 14 percent of total revenue which was accounted for by domestic non-tax receipts during the last five years. Foreign cash grants, and grants in kind provided for the remaining 3 percent of revenues in recent years.

As indicated in Table 3, fluctuations in Kenya's budget deficit have been caused more by variations in expenditures than by variations in total revenues. Revenues rose from 24.0 percent of GDP in 1977/78 to a peak of 25.3 percent in 1980/81 (just when the budget deficit was at its highest).

Revenues subsequently declined to 23.6 percent of GDP in 1981/82. The total fluctuation in revenues during the period 1977/78 - 1981/82 has been relatively minor. The sudden drop in revenues to 20.5 percent of GDP projected for the current fiscal year is, therefore, all the more unusual and disturbing. Such a reduction reflects severe limitations on the availability of required imports, and a general slowdown of the overall economy, rather than any failure in revenue collection (which, in fact, has been substantially improved during the current fiscal year).

2. Expenditures:

Total expenditures rose from 30.1 percent of GDP in 1977/78 to a peak of 35 percent in 1980/81, but will decline to 26.3 percent of GDP in 1982/83. Such fluctuations have been responsible for the similar pattern of change in the budget deficit during the period as a whole.

During the period 1977/78 - 1981/82, the recurrent budget accounted for an average of 70 percent of total expenditures. In overall terms, fluctuations in the recurrent budget share were mild until the current fiscal year. Recurrent expenditures rose from 68 percent of the total budget in 1977/78 to a peak of 72 percent in 1979/80, and subsequently declined to 70 percent of total expenditures in 1981/82. The slight upward trend in the share attributable to recurrent expenditure through 1981/82 reflected mainly above average increases in outlays on education, defence, interest payments, agriculture, and general administration. A detailed breakdown of the recurrent budget on a ministry by ministry basis is provided in Annex C, both in terms of actual budget outlays, and in terms of individual ministry shares. (It should be noted that individual ministry budgets do not fully reflect trends based on a functional classification of expenditures such as has been utilized in the discussion above).

Development expenditures accounted for an average of 30 percent of the total budget during 1977/78 - 1981/82. Following the coffee and tea boom, the Government attempted to increase the development effort, and the development budget claimed 32.2 percent of total expenditures in 1977/78. Ambitious efforts were begun to increase Government investment particularly in livestock development, irrigation, crop-storage, water supply, roads, schools, and health facilities. As administrative, technical and financial constraints became more apparent, progress slowed. The share of development expenditures in the total budget fell to 31.4 percent in 1978/79 and to 27.8 percent in 1979/80. As recurrent expenditures were brought under control, the development share slowly began to rise to 28.9 percent of total expenditures in 1980/81 and to 29.9 percent in 1981/82 (although overall project implementation showed no particular improvement during the latter two years). A complete breakdown of development ministry budgets during the period 1977/78 - 1981/82 is provided in Annex C.

3. <u>The Current Situation:</u>

The detailed budget data submitted to USAID early in May and summarized in Table 3 demonstrate that the GOK requirement for immediate assistance is based on a serious shortfall in expected revenues (including shortfalls in Treasury receipts from program assistance being supplied by external donors). Total revenues and grants will fall from the 19.5 billion shillings estimated under the IMF program to 17.5 billion shillings by June 30 (even assuming U.S. program assistance of 28 million dollars). This shortfall in tax revenues stems principally from the current depressed state of the Kenyan economy, rather than from any reduction in efforts to collect tax revenue. A further shortfall is created by the fact that some other donor commitments (mainly those from U.K.) will not, in fact, reach Treasury until well after June 30.

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The Government projections made available in May have budgeted for some 1.56 billion shillings in foreign grants during the current fiscal year, just under the 1.57 billion programmed by the IMF in December. By March 31, 1983, just over 1 billion of this amount had been received or identified in terms of program grants, project grants, or grants in kind. An additional 0.20 billion shillings was expected before June 30 directly from European donors, and indirectly from a variety of donors through the Kenya Farmers Association and the National Cereals and Produce Board (as the result of previous commodity sales). This leaves a gap of .36 billion shillings if additional harmful budget cuts are to be avoided.

D. The Structural Adjustment Problem

The pattern of economic growth and development in Kenya over the past decade described in Section II.A above has generated mounting structural imbalances between resource availability and resources required to sustain further growth.

The most immediate and tangible imbalance is the gap between foreign exchange requirements for economic growth along past patterns, and the limited foreign exchange made available by the existing structure of production and demand. Further growth along these patterns would be achievable only if foreign resource transfers expanded in pace with the widening foreign exchange gap. In the absence of such a trend, the structural adjustment problem facing Kenya is in part the conventional one of establishing a different pattern of growth in production and demand, one that conserves on scarce foreign exchange.

A second fundamental imbalance in Kenya's development pattern up to now is the wide gap between the myriad economic tasks which the public sector has assumed and the capacity of the public sector to carry out these tasks effectively. In addition to provision of conventional social and economic services, and normal regulatory functions, the Government has assumed an active role in production and distribution in a wide variety of activities and sectors: in the rationing of scarce resources including foreign exchange and credit; in controlling and setting prices; and in extraordinary regulatory functions that govern private economic activity. These functions place enormous demands on GOK human and institutional resources . The gap between the intended role of the public sector and its capacity to perform that role adequately must be significantly narrowed if sustainable economic development is to proceed. Insofar as "capacity" constraints in public sector performance are fairly rigid, a critical element of the adjustment problem in Kenya is that of diminishing the role of the public sector to one more in keeping with its capacity, while taking greater advantage of the efficiency of competitive private markets.

A third fundamental imbalance that jeopardizes the sustainability of development progress in Kenya stems from the effects of rapid growth in population on the current and prospective gap between resource availability and the resources required for productive employment and satisfaction of basic needs. Here the adjustment problem facing Kenya is to lower fertility rates and reorient the pattern of economic growth along lines that provide for more rapid growth in productive employment, more effective conservation of natural resources, and increases in the capacity to provide efficiently for basic needs.

Conventionally, structural adjustment is discussed in terms of adjusting to increased scarcity of foreign exchange resulting from changes -- such as the oil price increases of the past decade -- that are expected to be permanent. One method of adjusting is to compress overall economic activity, and thereby reduce the excess demand for foreign exchange. This has the obvious disadvantage of reducing employment and living standards and stalling development progress. A preferable alternative is to maintain economic growth by changing the <u>pattern</u> of production and demand along lines that reduce the requirements for imports and increase the level of exports associated with given <u>levels</u> of production and demand. More specifically, this calls for:

1) Changes in the structure of production in favor of goods that can be exported, particularly those which have a high local-resource (as opposed to import) content.

2) Changes in the structure of production in favor of goods that efficiently substitute for imports, particularly goods with a high local-resource content.

3) Changes in the structure of production away from goods and services with a high import content, particularly those which do not effectively save or earn foreign exchange.

4) Changes in techniques of production in the direction of greater use of domestic resources (including labor, land, and intermediate inputs with a high local-resource content) as opposed to imported resources (including many forms of capital, and imported intermediate inputs).

5) Reductions in the level of domestic demand (consumption plus investment) relative to production (GDP), which improves the trade balance.

6) Changes in the composition of domestic demand in favor of investment that facilitate and reinforce changes in the pattern of production described above.

In the Kenya context such a change in pattern entails a greater emphasis on agriculture (without clear implications for the balance between food and export crops); greater emphasis on manufacturing that is local-resource intensive (in terms both of labor and intermediate inputs with a high local-resource context); and less emphasis on industry that intensively uses imports (both imported capital and intermediate inputs) without effectively earning or saving foreign exchange.

The conventional policies for promoting structural adjustment include:

1) Devaluation, which is intended to raise the prices (in domestic currency) of exports, imports and efficient import substitutes relative to goods and services that cannot be traded (including services of labor and inefficient "import substitutes"). This encourages a switching of production patterns and techniques in the desired direction, and a switching of demand patterns in the opposite direction, towards goods and services that have a high local-resource content and cannot be traded.

2) Other policies that increase the prices of goods that save or earn foreign exchange e.g., agricultural prices where these are controlled.

3) Reform of the trade regime, to increase incentives for export and reduce protection that fosters inefficient import substitution.

4) Restrictive monetary policy, to hold down domestic demand, to dampen inflationary pressures, and preserve the relative price changes described above.

5) Restrictive fiscal policy, to reinforce monetary policy, increase public saving, lower consumption, and free up resources for investment.

6) Raising of interest rates (where these are controlled at artifically low levels) to promote savings relative to consumption, free up resources for investment, narrow excess demand for investment funds by making investments with low returns unprofitable and encourage employment of labor and land relative to capital.

If such policies are successful in changing the array of incentives to producers and consumers, and if the allocation of productive resources (including capital, land, labor, and intermediate inputs, both imported and domestic) can shift in response to these incentives, then structural adjustment that promotes more economical use of foreign exchange takes place.

A serious impediment to the potential success of these kinds of policies in Kenya is the imbalance between the extensive role of the public sector in production, distribution, and allocation of resources and the capacity of the public sector to perform that role efficiently. Direct price controls, which are extremely diffficult to administer effectively because of both technical and political constraints, result in inappropriate signals to producers and consumers. Ineffective and over-extended public marketing boards raise costs and lessen incentives to producers and pose a drain on fiscal resources. Public industrial enterprises, in the absence of effective monitoring, remain insulated from market forces and will maintain or expand production along inefficient lines by recourse to direct subsidies, privileged access to resources rationed by the public sector and other forms of protection. Private monopolies (frequently with public financial participation) are insulated from competition from imports, are ineffectively regulated, and enjoy generous concessions. Rationing of scarce foreign exchange and investment funds in an efficient way is both technically and politically difficult. Ineffective or counter-productive regulations impede the establishment of new economic activity, and prevent the more effective utilization of land in particular.

Further, the excessive demands on the limited capacity of Government contributes to the inability of the Government to implement conventional fiscal, monetary, and development policies including control of expenditures and borrowing, collection of revenues, and planning and implementation of development projects.

Accordingly, structural adjustment in Kenya calls not only for the conventional policies described above, but also for reforms of a more institutional nature that lessen public interference with market forces and allow the Government to carry out more effectively activities that clearly belong in the public domain.

Implementing policy and institutional reforms of this type would do much in the medium term towards narrowing the imbalance posed by rapid growth of population and the labor force. In the longer run, continued development progress is heavily dependent on achieving lower fertility rates at the earliest possible time.

III. RESPONSE TO THE PROBLEM

A. Balance of Payments

In response to the balance of payments problems discussed in section II.B. above, significant balance of payments support is being provided by both multilateral and bilateral donors. The IMF entered into a new Stand-By Agreement ($165 million) with Kenya in March 1983 and the World Bank is implementing a $130 million Structural Adjustment Loan. As a result of donor meetings in November and January, additional balance of payments support from major bilateral donors is being supplied to supplement that being provided by the World Bank and the IMF. The Government now estimates a minimum level of increased or accelerated assistance from bilateral donors during CY 83 of some $73 million. Major bilateral donors responding include the U.S., the U.K., the Netherlands, France, Canada, Italy, Norway and the European Economic Commission. Government and the IMF are confident that sufficient assistance has been identified to reduce the overall balance of payments deficit to an acceptable level this year ($45 million).

The Government has included in its calculations, U.S. program assistance of $28 million under the currently proposed program. Such a level of assistance would permit the United States to cover approximately two-fifths of the estimated $73 million of exceptional financing.

B. Budget

USAID Director Herrick and staff met with Financial Secretary James Karuga and key Government staff early in May to review in detail the budget projections for the Kenyan fiscal year ending June 30, 1983, based on performance through March 31. Discussions of budget developments was extraordinarily frank. Karuga made it clear that GOK is absolutely determined to meet the IMF program targets and performance criteria established for fiscal year 1982/83. Karuga demonstrated that if disbursement of the full $28 million of U.S. program assistance (363 million Kenya shillings) is made by June 30, it will be possible, by continuing extreme measures to curtail expenditures, to stay within the IMF ceilings both for the budget deficit (3.660 billion shillings), and for domestic bank lending to Government (1.025 billion shillings). Government will also be under the ceiling for external borrowing. Given the depressed state of the economy, GOK will also meet the target on total domestic bank credit.

As is indicated by the summary below, the major burden or reducing the budget deficit has been borne by the Kenyans themselves through a series of extraordinary revenue and expenditure measures taken since December 1982..

Revenue Measures:

a) New Tax measures to yield KSh 0.4 billion during December 1982 - June 1983, including: a 10 percent increase in all import duties; increased sales tax on petroleum products; increased sales tax on beer; increased exercise tax on cigarettes.
Status: Implemented. Finance Act No.4 of December 17, 1982.

b) A crash program to collect tax arrears has been put into place.
Status: Implemented. Effective March 13, 1983.

c) Instructions to parastatals to use existing cash balances to repay debts to Treasury, dividends and interest, and to purchase Government securities. Status: Implemented. Effective March 13, 1983.

d) Improved monitoring of fiscal developments including creation of a task force to speed up utilization of available foreign aid.
Status: Initial phase under implementation.

e) Supplementary appropriations to cover unbudgeted expenditures have been ruled out for the remainder of FY 1982/83.
Status: Implemented. Effective March 13, 1983.

Expenditure Measures:

a) Economies totalling KSh 0.23 billion in the recurrent budget chiefly in purchases of equipment, travel and transportation expenses. Principal Ministries affected include: Higher Education; Basic Education; and Health.
Status: Implemented. Treasury Circular No 10 of December 8, 1982.

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b) Development budget cutbacks totalling KSh .545 billion, mainly in transfers and loans to public enterprises, roads, and building construction. Principal Ministries affected include: Ministry of Transport and Communications; Ministry of Culture and Local Services; Ministry of Agriculture; Ministry of Finance; Ministry of Water Development; and Ministry of Regional Development, Science and Technology.
Status: Implemented. Treasury Circular No.10 of December 8, 1982.

c) Recurrent budget expenditures further cut back to including only essentials: staff salaries; Consolidated Fund Services; electricity; water; raw materials for production; food rations for hospitals, penal institutions, etc; rents and leases. Accounting Officers instructed to withdraw A.I.E's (Authority to Incur Expenditures) issued before March 4, 1983. No more A.I.E's to be issued during remainder of the fiscal year without prior concurrence of the Treasury. No goods and services to be received during remainder of FY 1982/83 on L.P.O's (Local Purchase Orders) issued after March 4, 1983.
Status: Implemented. Treasury Circular No.1, March 4, 1983.

d) Development budget expenditures further cut back to high priority activities only. Ranking considerations include projects which are:

i) 70 percent or more donor financed on concessional terms;

ii) subject to prepayment, direct payment, or payment under credit purchase;

iii) 50 percent or more completed; and

iv) locally funded projects which are 90 percent completed or for which the cost of stopping is clearly agreed to exceed savings relized.

Status: Implemented, Treasury Circular No.1, March 4, 1983.

e) Most vehicles which are allocated to "non-essential" Ministries and activities grounded to conserve operating and maintenance funds; lights extinguished in Government offices during daylight hours.
Status: Implemented. Treasury Circular No.1, March 4, 1983.

Largely as a result of the measures described above, expenditures will be cut from the 23.2 billion shillings estimated under the IMF program to 20.5 billion shillings by June 30, (in dollar terms, from $1,786 million to $1,579 million). These cuts of some 207 million dollars represent a major effort by the Kenyans in the short period of time since the IMF projections were made in December. An injection of 28 million dollars of U.S. program aid by June 30 would be equivalent to approximately 12% percent of the 230 million dollar adjustment being borne by the Kenyan's themselves.

Expenditures for development in Kenya's fiscal year 1982/83 will be 29 percent below the IMF program level and 33 percent below the original Government budget. Recurrent expenditures have been more difficult to cut, but even these will be 4 percent below the IMF program. As Table 3 shows, expenditure cuts in 1982/83 will exceed revenue shortfalls by a substantial amount. As a result, the total deficit will fall from a level of $281 million estimated by the IMF in December to $244 million by June 30. This large reduction in the deficit is required in order to offset reduced donor project loan financing which has indirectly resulted from drastic cuts in development expenditures by the Government. With the other available financing indicated in the Government's recent budget projections, the overall deficit can just be covered without exceeding the IMF ceiling on domestic bank credit to Government if $28 million (.36 billion shillings) of U.S. program assistance arrives in time. If the full $28 million of U.S. program assistance is not disbursed by June 30, the IMF target for domestic bank lending could be exceeded by a substantial amount.

Twenty-eight million dollars of U.S. program assistance (0.36 billion shillings) disbursed by June 30th, would represent 65 percent of the overall assistance gap of 0.56 billion shillings remaining as of March 31, 1983; 62 percent of the 0.58 billion shillings of "special assistance" arranged at the donors meetings in November and January; and 44 percent of total program grant assistance to be received by Kenya this fiscal year. Other major donors of program assistance include the Dutch (48 million Kenya shillings), the EEC (35 million Kenya shillings), the French (28 million Kenya shillings), Canada (15 million Kenya shillings), Italy (12 million Kenya shillings), the UNDP (12 million Kenya shillings), and the EEC Stabex program (more than 150 million Kenya shillings). A comparison of the GOK/IMF projections which were made in December, and currently projected levels of assistance, is provided in Annex G.

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C. The Structural Adjustment Program

1. Description

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 and budgetary constraints acted interdependently to lower the growth rate of the Kenyan economy. Periodic application of strict measures to control balance of payments deficits also resulted in reduced use of industrial capacity and shortfalls in tax revenues. The Government's ability to implement its long-range policies in both the industrial and agricultural sectors was therefore limited. Basic structural changes in both sectors became (and remain) essential to achievement of long-range improvements in the foreign exchange and budgetary situations and for creation of the basis for sound long-term growth. In 1980, in response to this critical and unacceptable situation, the Government undertook, with donor encouragement and support, a major program to re-orient growth along patterns that make better use of local resources and conserve on foreign resources, including commercial imported energy, imported capital goods and imported intermediate inputs.

The Government identified the following as required to achieve structural adjustment:

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

-- reforms in pricing, marketing, research and extension, and land utilizatation 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 rates 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 improved analysis of such investments; more effective monitoring of debt.

- a diminished role (at least relatively) 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 the formulation and publication of the 1979-83 Development Plan (1978 and early 1979) and June 1981, progress in both articulation and implementation of these policies was slow, uneven, and at times negative:

- There was some movement on the trade regime (abolition of letters of objection; increased use of tariffs in lieu of quantitative restrictions; analysis on how to go about reforming the trade regime; reform of export incentives), but these had only minimal effects on the structure of production.

- Low prices to maize producers contributed (with drought) to declines in production, requirements for emergency food imports, tighter controls on marketing, and weaker performance by marketing institutions. There was no progress on the land issue.

- Following the collapse of the coffee boom there were increases in the ratio of Government expenditures to GDP; increases in the deficits; excessive credit expansion; and a squeeze on credit to the private sector.

- There were only marginal adjustments in the exchange rate and interest rates, and a large increase in public sector wages.

- There was weak performance in planning and implementing development projects; no visible improvement in terms of the level and quality of Government financial participation in commercial investments; some steps toward improved debt management.

- The role of the public sector in production and distribution was not visibly reduced.
- There was reasonable performance on energy pricing; with less certain progress in the areas of natural resources and population.

Since June 1981, progress has been more rapid and more uniformly positive:

-- A new import regime was introduced in October 1981; actual movement on adjustments in June 1982 (subsequently curtailed due to scarcities of foreign exchange).

-- There was significant upward movement in producer prices for agriculture; less significant but still positive movement in consumer prices for food; continued weak marketing performance with some relaxation of restrictions on private sector marketing; no progress on land.

-- Fiscal and monetary performance has improved. There has been better success in controlling expenditures and raising revenues and better performance in limiting credit expansion.

-- Government has undertaken large positive adjustments in the exchange rate and interest rates. There has been continued restraint on wage levels to promote employment.

-- An apparent slowdown in Government financial participation in commercial investments has occurred. The cabinet has accepted a detailed report calling for important reforms in the role and conduct of the public sector.

-- There has been good performance in raising energy prices. There has been uncertain (probably limited) progress on natural resources, but increased action to limit population growth.

-- A more comprehensive far-reaching set of measures to promote structural adjustment was negotiated with the World Bank in 1982, and supported by a major loan.

The current situation is summarized below:

-- The GOK has recently concluded a new agreement with the IMF; (approved in March 1983) and has taken exceptional measures since the agreement was negotiated to ensure performance. A review of fiscal, monetary, exchange rate, and import policy is scheduled for July and September.

The second tranche of the World Bank Structural Adjustment Loan (SAL) was scheduled to be disbursed in March or April of this year. A mission to review progress has just been completed and a second review is scheduled for June. Expectations are that the disbursement will be delayed until the fall. The World Bank is to particiapte in the September IMF/GOK review of import policy. Progress in implementing the measures identified in the SAL has been uneven, with little movement in some areas (land and grain marketing), but good performance in some other area (agricultural pricing). The disbursement of the second tranche of the World Bank loan will probably be tied to a number of measures yet to be taken, including possible revision of the import regime to make it conform with realistic projections of fereign exchange availability.

Foreign exchange availability is extremely limited with extensive participation by the Government in rationing. Under these circumstances the impact of reforms in the trade and exchange regimes is somewhat limited, particularly given the protected and privileged position of many inefficient import-substituting enterprises, both public and private. The credit situation is less clear with dejure controls on interest rates, but with a defacto pattern of negotiated deposit and lending rates well above official ceilings.

2.Appraisalof the GOK Adjustment Process:

The strategy for structural adjustment enunciated by the GOK in its major policy statements is on the whole sound. First the strategy contains a good analysis of the problem -- the need to re-orient growth along patterns that make better use of local resources and conserve on foreign resources, including reduced reliance on commercial imported energy, imported capital goods, and imported intermediate inputs. Second, the analysis of sources of the problem is accurate. Govenment recognizes that the existing structure of industrial incentives has created an undue bias in favor of inefficient import substitution and production for the local market at the expense of export production and agriculture. In recent policy statements Government acknowledges that its participation in industrial and commercial activities has been excessive and detrimental to the economy. There has been substantial recognition of the problems entailed by rapid population growth.

As outlined above, performance of the GOK has significantly improved since June 1981. Progress has been substantial and arguably at the political and technical limits of what is feasible. At the same time progress is still far short of what is economically necessary for structural adjustment to occur. Much more needs to be done, particularly on the institutional side (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. Structural adjustment requires at least a relative contraction of some production activities and expansion of others. This calls for diverting scarce resources (credit and foreign exchange) from one group to another. As long as Government rations foreign exchange and as long as inefficient enterprises are insulated from market forces that would impel them to adjust or contract, structural adjustment will take place at best slowly.

Both the 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 <u>necessary</u> condition for structural adjustment to take place. The programs are not yet <u>sufficient</u> to ensure that structural adjustment takes place. Further major reforms, particularly on the institutional side, need to be taken. Both the IMF and the World Bank foresee that this will take several years, during which substantial external assistance (in program form) will be needed to sustain the economy; ease the political and economic strains generated by the structural adjustment process; and augment the technical and institutional capacity to formulate and implement policies.

A more detailed description and appraisal of the structural adjustment effort can be found in "Structural Adjustment in Kenya", prepared in April, 1983 by M. Crosswell, PPC/EA. The report is available from AFR/PD/EAP.

D. <u>Previous U.S. Program Assistance:</u>

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

Commodities imported under the CIPs were exclusively manufactured fertilizer. Fertilizer was chosen for this purpose because: 1) it is susceptible to bulk ordering, thus permitting relatively fast disbursement, and 2) it is a key input in increased production of food grains, particularly maize.

The local currency resulting from U.S. program assistance from 1980-82 was deposited in a special account and used for mutually agreed upon development purposes in the GOK budget. Lists of activities supported by the 1980 and 1981 programs are included in Annex D. In addition to supporting specific GOK development activities, the 1982 program is currently providing $5.1 million in Kenya shillings for a special discount facility at the Central Bank to assist in the rehabilitation of private sector businesses looted on August 1, 1982. Local currency generations from U.S. program assistance have protected to some degree, priority rural development activities in a period of relatively tight budgets. Support for activities already in GOK budgets has avoided the start-up of new projects with attendant requirements for future increases in recurrent expenditures. Use of local currency to assist businesses looted on August 1 enables them to continue buying from local suppliers.

USAID conducted a review of the FY 1980-81 fertilizer CIPs in April, 1983 (See Annex F). The principal conclusions of this review were as follows:

1. The programs were clearly successful in meeting two of the stated objectives: providing rapidly disbursing balance of payments support and assuring supplies of fertilizer during a period of foreign exchange stringency. Program funds were disbursed in a timely manner and most fertilizer imported under the programs was sold within a few months of arrival in the country. The total level of fertilizer imports underwent a substantial expansion.

2. A third objective, that of providing budgetary support, was also met but at a date much later than anticipated. Repayments from farmers to the Agricultural Finance Corporation (AFC), from the AFC to the Kenya Farmers Association (KFA), and from KFA to Government all lagged substantially, with the result that effective budget support was much delayed.

3. Accomplishment of a fourth, implicit, objective, that of contributing to a revival of Kenyan food grain production during the period 1980-82 is supported by the available evidence. Increased grain production contributed to achievement of the balance of payments objective by reducing potential food imports.

In light of the experience of the FY 1980-81 programs, USAID attempted with the FY 1982 CIP, to move financing and distribution of U.S. - provided fertilizer to the private sector. (The basis for estimates of the amount and timing fertilizer needs had previously been changed from the Ministry of Agriculture to private sources). This approach, which was intended to accelerate the generation of local currency for the budget, failed in that purpose because of rigidities in the institutions responsible for importation of donor-financed fertilizers.

The conclusion of the review was, therefore, that a more effective way to provide balance of payments and budget support, while assuring the importation of fertilizer needed for agricultural production, would be for Government to lift the import licensing requirements and make foreign exchange freely availabile for private sector fertilizer imports. An independent study of fertilizer marketing and distribution in Kenya also concluded that fertilizer imports should be freed of import and foreign exchange licensing requirements. 1/

IV. PROPOSED PROGRAM

A. Strategy

1. Program Strategy:

The definition of a 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. Each provision of program assistance must therefore be based on a careful weighing of actual and projected progress towards structural adjustment against the likelihood of progress without the proposed assistance.

"1/ Fertilizer Marketing and Distribftion in Kenya: A Case Study" Louis Berger International, Inc., April, 1983

Given the conclusion that the GOK/IMF/World Bank structural adjustment effort is basically sound in its strategy and goals, the primary long-term U.S. objective is to reinforce and accelerate implementation efforts. The proposed approach is:

- to make it clear to the GOK that continued cooperation with the IMF and World Bank is a critical factor in U.S. decisions concerning the type and level of future U.S. program assistance;

- to urge the IMF and World Bank to set the most rapid pace for reform that is consistent with the technical and institutional capabilities of the Government (and with short-term political stability);

- to provide assistance in a fungible, rapidly disbursing form to the extent that progress in carrying out structural adjustment is satisfactory;

- to make available technical assistance and local currency resources to facilitate the adjustment process; and

- to press for specific policy reform implementation steps which are in harmony with the overall program.

To the extent that overall progress on structural adjustment is less than satisfactory, USAID will propose to provide assistance in a less fungible form (for example commodity imports), to channel a greater proportion of local currency resources to the private sector, or to provide assistance conditioned on more substantive policy reforms which would not be rendered ineffective by unsatisfactory progress in the IMF/World Bank programs.

The implications for the FY 1983 program of the strategy described above are clear: to the extent that GOK progress in structural adjustment is judged to be "satisfactory", fungible, rapid-disbursing assistance (program grant) should be provided based on policy steps which are well integrated into the overall program. To the extent progress is not "satisfactory", assistance should be less fungible (CIP) and tied to more independent policy actions.

The judgement of whether or not progress has been "satisfactory" is complicated by timing. The logical time for appraising progress would be in September when the IMF will review its program and the World Bank will make a judgement on disbursement of the second tranche of its program. However, based on analysis by GOK, USAID and the IMF (see section II.C above), the GOK will not meet the June IMF targets without disbursement of $28 million of U.S. program assistance on a program grant basis by mid-June. Since the primary objective is to reinforce the GOK/IMF/World Bank structural adjustment program, the conclusion must be that the United States should disburse the $28 million on a program grant basis by mid-June if GOK progress is judged to be satisfactory to warrant continued support for the overall program. Based on consultations with the IMF and World Bank during recent missions, and on a report from GOK concerning actions undertaken to meet IMF/World Bank conditions, it is USAID's conclusion that progress has been satisfactory. The principal considerations are summerized below:

IMF: With multi-lateral donor (including U.S) encouragement the Government of Kenya devalued the shilling and raised interest rates in December, 1982. It has also expressed its intention to maintain a realistic exchange rate and to keep interest rates on bank time depostis positive in real terms. The GOK has also been resolute in its determination to keep Government domestic borrowing within IMF limits and it met the March 31 targets by a sizeable margin. The key problem area in the most recent IMF Stand-By Agreement is the size of the June 30 budget deficit and its financing. On the expenditure side, through a variety of extraordinary expense-cutting measures (including slowing drastically or stopping many development projects) Government has so far managed to meet the targets. Many of the cost-saving actions have had substantial political and economic costs, and it is a measure of Government's commitment to the program that it has been willing to incur those costs. The cause of the deficit problem lies, therefore, not so much with Government expenditures, but rather with revenues (both internal and foreign) which have fallen substantially short of projections. Internal revenues have suffered from reduced economic activity and lower import duty revenues. Projected donor receipts prior to June 30, 1983 will be lower than anticipated largely because cutbacks in development budget expenditures by Government slow donor disbursements and because local currency generations from commodity programs will not be deposited into Government accounts until too late to support the FY 1982/83 budget. In sum, Government's problems meeting IMF targets, at least in the near term, stem from factors largely beyond its control and, in fact, Government has taken extraordinary and difficult steps to try to reduce the deficit where it does exercise control (expenditures). A GOK brief on the studies of the IMF Stand-By Agreement is provided in Annex H.

World Bank: Concerning the World Bank Structural Adjustment Loan, a more nebulous picture emerges. Satisfactory progress has been made in the important areas of agricultural and energy pricing, fiscal and monetary control and population. The disbursement of the second ($50 million) tranche of this loan did not take place in April as scheduled, however. The decision not to disburse was apparently based primarily on unsatisfactory progress in four areas: grain marketing, import administration, external debt management, and government investments. There is now some evidence that measures taken before September will enable disbursement by that time. Progress since March includes the following:

Grain Marketing: GOK is carrying out an internal study of the stated and actual functions of the National Cereals and Produce Board (NCPB) in grain markets (study carried out by the AID-assisted Technical Assistance Pool) and has contracted for an outside study of grain marketing (which is now underway), as required under the World Bank Structural Adjustment Loan.

Import Administration: GOK is in the process of assessing the tariff system. The plan is gradually to lower the level of nominal tariffs, which were raised when quantitative restrictions on over 1500 items were lifted. It is also modifying the Import Schedule system to ensure a match between available foreign exchange and amounts needed for items eligible for importation without restriction. The modified system will divide schedule I into IA and IB, the former receiving foreign exchange allocation automatically, the latter based on availability of resources. Schedule IA will include high priority imports such as imports for export-oriented industries. The implementation of Schedule IA is due June 15. The proposed revised system should largely remove the Central Bank from its current role in foreign exchange rationing.

Government Investments: A recently published standard handbook for project evaluation will be officially adopted for project appraisal. Thirty-four parastatals that account for approximately eighty percent of parastatal investment have been incorporated in the 1983/84-1987/88 Forward Budget. No new direct Government investment proposals can be approved unless they survived the challenge of review for the forward budget and annual estimates. A comprehensive investment plan is to be developed before the 1983 Consultative Group meeting.

External debt management: A draft external borrowing plan satisfactory to the World Bank has now been completed and should be finalized by June.

In light of the above actions and plans, USAID believes it is appropriate to support fully the structural adjustment effort at this critical moment. Given this conclusion, the question of whether a Program Grant or CIP is the most appropriate assistance mechanism is moot. By the very nature of CIPs, the necessary local currency support could not be provided to Government in time to support the Kenya FY 1982/83 budget. Further, as will be discussed further in the policy reform Section (IV.B.) below, a continuation of past years' fertilizer CIPs would run counter to the current policy reform thrusts of deregulation and privatization of imports and distribution of agricultural inputs. The question of a CIP component in the proposed second and third years of the proposed three-year program remains open depending on: progress on structural adjustment in general, implementation of steps to improve management of development programs (especially donor-supported programs), success of the policy measures affecting importation and distribution of agricultural inputs and divestiture of parastatals, subsequent potential policy reforms and future budget needs.

2. Relation to AID Development Objectives:

AID's primary development objective is to promote alleviation of poverty and increased satisfaction of basic needs through sustainable, broadly based economic growth. Instruments for achieving this objective include emphasis on sound economic policies; greater reliance on the private sector and competitive market mechanisms; a stronger focus on institution building; and improved transfer, adaptation, and dissemination of technology. Each of these promotes better use of existing resources and thus contributes to increased efficiency and growth.

The specific priority objectives identified by USAID in Kenya are, in priority order: increased rural production, employment and income; reduced population growth; and more efficient delivery of basic social services. The relation of these specific priorities to AID's primary development objective is clear-cut, and is more fully documented in the CDSS.

The GOK analysis of the problem of structural adjustment, and its program for addressing this problem, are strongly supportive of these specific objectives, and AID's more general primary objective. Further, the GOK structural adjustment program places considerable emphasis on improved economic policies; greater reliance on the private sector; an increased role for market forces and market mechanisms; improvements in institutional capacity and performance; and development of improved agricultural technologies and techniques more suited to Kenya's natural resource endowment.

More specifically, the program places primary emphasis on improvements in agricultural production, employment, and incomes, through increased incentives to producers, improved research and extension, and better utilization of land. Policy measures designed to support this include:

-- higher prices to producers consistent with world market levels;

-- improved marketing and distribution of agricultural inputs and outputs, including an enhanced role for the private sector;

-- continued reforms in the trade regime and price controls leading to improvement in the rural/urban terms of trade;

-- strengthening of research and extension to make better use of semi-arid land;

-- reforms in land tenure to promote better utilization of land.

More broadly, the structural adjustment program--once fully implemented --is one which will effectively promote broadly based economic growth. In particular, reform of the trade regime along the lines identified by the program; continued adjustments in exchange rates and interest rates; continued wage restraint; and institutional reforms that permit these policies to work will lead to more rapid economic growth in output that entails widespread, significant increases in productive work opportunities.

The GOK explicitly acknowledges the problems for Kenya's development posed by rapid growth in population (in both qualitative and quantitative terms), and the need to reduce birth rates through family planning. The structural adjustment agreement with the World Bank explicitly included establishment of a National Council on Population and Development, and provided that "Work of the Council and actions taken by Government in this area will be closely monitored as an essential element of structural adjustment." Other measures taken include the strengthening of the National Family Welfare Center, the expansion of family planning service delivery points, and the initiation of officially sanctioned community-based family planning services.

The 1979-83 Development Plan, which is the basic point of reference for the structural adjustment program and for the major policy statements since then that have embodied the implementation of the program, called for rapid expansion in provision of social services that directly meet basic needs. Subsequent policy statements have recognized both the resource and the institutional constraints to this objective, and have focused on measures that would directly address these constraints. These include the general measures of the structural adjustment program that aim to improve the pattern of economic growth and accelerate the pace of economic growth--the basic determinant of resources available to the Government. They also include more specific measures aimed at better planning, budgeting, and implementation of development projects; and an improved balance between recurrent and development expenditures that would lead to better utilization of existing capacity, including capacity for delivery of essential services.

B. Description of the U.S. Program:

The proposed three year program for FY 1983-1985 is projected to total $117 million. The proposed FY 1983 program consists of a $30 million grant. In order to provide the basis for realistic and continuing planning and implementation of reforms emerging from US-Kenya policy dialogue, approval for the entire program concept is sought in 1983 with specific authorization of $30 million for the first year. Amendments to this document will request subsequent authorizations in FY 1984 and FY 1985 based on:-

- analysis of this current economic, balance of payments and budget situations;
- GOK progress on the overall structural adjustment and on AID-specific policy reform implementation steps.

These amendments will also include the specific conditions and covenants for the FY 1984 and FY 1985 agreements.

During the three-year period, balance of payments support of $111 million will be provided through program grants and $6 million will fund consultancies to advise on policy reform and help implement reforms undertaken. Local currency resulting from the program will help finance the costs of policy reforms, fund GOK priority agricultural and rural development activities in the GOK budget, and support private enterprise development. Planned obligations will be made in annual increments as follows:

	FY1983	FY1984	FY1985	Total
Program Grant	28.0	38.0	45.0	111.0
Consultancies	2.0	4.0	-0-	6.0
	30.0	42.0	45.0	117.0

The program is designed to respond to both short-and medium-term structural adjustment assistance needs.

1. Immediate Needs

In the very short-term, GOK has pressing balance of payments and budget needs which must be met for structural adjustment to continue. Without the balance of payments support to be provided by the program, GOK would not be able to implement fully its policies of import liberalization, tariff reform, and re-orientation of industry towards exports. Current projections indicate that in the absence of the level of support envisaged in this program, implementation of these policies would lead to rapid depletion of foreign exchange reserves, thus forcing deviation from the program and restriction of economic growth. In fiscal management, the painful steps taken by Government to reduce expenditure and limit the deficit are already having a detrimental impact on development programs necessary for long-term growth. Of more immediate and pressing concern is the fact that the IMF performance crition limiting FY 1982/83 domestic bank borrowing by Government could be missed without the U.S. budget support proposed here. A GOK failure to meet the June ceiling would throw into jeopardy the entire structural adjustment effort. Failure of structural adjustment would be a significant setback to Kenya's hopes for long-term self-sustaining economic growth and political stability. Rapid disbursement of the proposed program grant will respond efficiently to both the balance of payment and budget requirements.

2. Policy Reform Implementation:

In the medium term, the structural adjustment policy reforms announced by the GOK and supported by the IMF/World Bank and USAID must be fully implemented in order to establish a sound basis for long-term economic growth. The GOK has made some progress in implementing announced reforms, but much remains to be done, particularly with regard to the institutional changes necessary to implement new policies. This program will use three instruments to effect policy implementation in priority areas: conditionality in annual agreements; consultancies; and innovative programming of local currency. The framework within which each of these instruments will be utilized is described briefly below.

Within the overall structural adjustment effort, the following areas, by virtue of their relevance to the USAID development strategy, are emphasized in the ongoing U.S. policy dialogue with the GOK:

(1) improved planning and management of the Government investment program, including rank ordering of development projects, improved budgeting and improved co-ordination with external donors

(2) continued movement toward equilibrium interest rates;

(3) a more flexible exchange rate mechanism;

(4) reduced Government participation in parastatals;

(5) more flexible import, pricing and marketing policies for agricultural inputs;

(6) more flexible agricultural output pricing and marketing policies;

(7) re-orientation of agricultural research and extension policy toward small-holders;

(8) implementation of family planning policy and programs;

(9) expanded user-financing of services;

(10) rationalization of GOK regulations and procedures to promote investment and exports;

(11) increased reliance on the private sector to achieve development objectives.

Within the context of ongoing policy dialogue in the areas defined above, USAID will use the resources provided by this program to stimulate discrete, practical, and possible policy reform implementation steps.

(a) Conditionality:

The specific conditions against which disbursement of FY1983 funds will be made are as follows:

(1) Exchange and Interest Rate Adjutsments:

During the November 1982 donor meeting on Kenya, the United States and other donors let it be known that additional donor support could not be expected as a substitute for IMF lending if Kenya failed to come to a new agreement with the Fund. The GOK was consequently under significant pressure to take the difficult steps suggested by the donors and the IMF, including the December 1982 devaluations and interest rate increases. Given the importance of continued movement towards equilibrium interest rates and a more flexible exchange rate, the FY 1983 Agreement will explicitly recognize Government's December 1982 actions in this area as conditions (already complied with) for the Program Grant.

(2) Sufficient Progress in Adherence to the conditions of the IMF Stand-by Agreement andWorld Bank Structural Adjustment Loan (SAL):

Since the principal objective of the Program is to encourage further GOK progress in the overall structural adjustment effort, it is essential that GOK take the necessary steps to comply with the conditions of these two programs. Disbursement of FY 1983 funds will therefore depend on presentation to AID of evidence that GOK has initiated the necessary actions to comply with these agreeements. The Agreement will require a letter from GOK outlining the steps planned and taken. Particularly important will be deficit management (IMF Stand-By) public investment and grain marketing policy, import liberalization, external debt management and land policy (SAL).

(3) Completion of export incentive actions agreed under the FY 1982 Program Grant:

Given the institutional nature of some of the changes required to improve the climate for exports, certain simplifications in export control measures were scheduled to take place subsequent to disbursement of FY 1982 U.S. program grant funds. The Agreement will require a report, satisfactory to AID, of the administrative steps taken by GOK to facilitate exports and of the status of other potential export incentive measures.

(4) Deregulation of the importation of agricultural inputs:

Compliance with this condition will be a concrete step in the import liberalization process, and one which is of fundamental importance to the agricultural sector. USAID's review of its fertilizer import program and that recently completed by Louis Berger International Inc. 1/ for fertilizer distribution in general both strongly support a move toward private sector importation and distribution of fertilizer. The first step in this process, and the one which will be required under the Agreement, will be to remove the principal import and foreign exchange licensing requirements for fertilizer and other major agricultural inputs.

(5) Improved Import Administration:

Underlying the problems of export promotion and imports of agricultural inputs is the poor functioning of the current import administration. The system must be modified to ensure that sufficient foreign exchange is available to service items scheduled to receive foreign exchange automatically. The Agreement will therefore require evidence that Schedule I has been sub-divided so that a category (Schedule I.A) list exists for which foreign exchange is freely available.

1/ Private Sector Fertilizer Distribution Kenya, Lous Berger International, March, 1983

(6) <u>Improved planning and management of investment programs</u>:

The present difficulty the Government has in accurately forecasting revenues from donors for Government development projects and programs demonstrates that successful implementation of structural adjustment requires better planning and management of both GOK and donor-provided resources. This improved planning and management is required, not only for Government to predict its anticipated receipts from donor sources, but also to plan and budget correctly for Government contributions to development activities. Success in this area will require determination of which projects and programs should receive priority funding. Those projects not deemed to be priority activities will need to be curtailed or terminated. This process is one which will clearly extend beyond this first year agreement. The Agreement will include a Government commitment to develop a plan to achieve these objectives and to create of a special mechanism in the Ministry of Finance supported by a number of multilateral and bilateral donors and charged with tracking and assuring budgeting and reimbursement requests for donor projects and programs and will include funds for technical assistance to help get such a mechanism started.

The principal policy objectives of the second and third years of the program will be; 1) completion of further concrete steps to improve Government planning and management of the investment program; 2) financial reform or divestiture of Government interest in one or more major agricultural support institutions; 3) significantly reduced Government intervention in pricing decisions; 4) an improved agricultural output marketing structure; and 5) changes in other areas relevant to USAID development objectives in Kenya which emerge from the ongoing policy dialogue. Government has been notified that USAID's major policy focus in FY 1984 and FY 1985 will be in these areas and covenants in these areas will be included in the Agreement to lay the groundwork for future year negotiations. Each of the items mentioned still requires considerable analytical and feasibility work before USAID or the Kenyans will have a firm idea of the most appropriate strategies in these complex areas. The specific changes needed in each category will be developed through the technical assistance to be provided under the consultancies element of the program (see below) and through negotiations to be conducted when funds for additional tranches are assured.

(b) Consultancies:

A key constraint in the implementation of a number of the structural adjustment policy reforms is the GOK institutional capacity to devise and carry out the needed steps. To strengthen Government capacity, $2 million will be used from the FY 1983 program to finance consultancies which will assist the Government implement its structural adjustment program. An additional $4 million is programmed from FY 1984 funds for this same purpose. The principal uses of the consultancy funds will be as follows:

(1) Improved management and analysis of policies related to agricultural inputs and outputs:

An important element of the overall structural adjustment effort, and one which is of particular interest to USAID, is management of policies related to agricultural inputs and outputs. The Technical Assistance Pool (TAP), which operates in the Ministries of Agriculture, Livestock and Planning, has played an important role in the significant producer price increases which have occurred during the last two years, in the internal GOK grain marketing study, and in development of the "Report and Recommendations of the Working Party on Government Expenditures" which focuses on public investments. The TAP provided critical technical staff work in these and other areas, allowing informed agricultural policy decisions to be made. USAID has supported the TAP in the past, through the Rural Planning II Project (615-0189). Given the relevance of the TAP work to issues of immediate concern to the proposed program (particularly in the areas of agricultural inputs and parastatals) $2 million ($0.9 million in FY 1983) is proposed to support and expand the activities of the TAP through an ongoing contract with the Harvard Institute of International Development.

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(2) Improved Planning and Management of the Investment Program:

A key constraint to any effort by GOK to get a firmer grip on the investment program is the lack of consistent and reliable data on what Government and donor resources are available, during what time frame and under what conditions. Any efforts to assure funding of high priority programs and curtail or discontinue low priority programs depends on a clear picture of those factors. At present there is no central point in Government which collects, analyzes, and budgets for the investment program. As noted above, one of the conditions for the FY 1983 grant will be a commitment to create a mechanism in the Ministry of Finance to carry out these tasks. Long-term technical assistance will be needed to launch the mechanism and $0.55 million ($0.25 million in FY 1983) is reserved for this purpose.

(3) Special Studies:

Successful implementation of structural adjustment requires an array of technical inputs, not all of which can be identified in detail. To respond in a flexible fashion to the diverse requirements for special structural adjustment implemenation studies, $2.4 million ($0.65 million in FY 1983) is reserved for consultancies to be identified as needs are identified. In FY 1983 those funds will be used primarily for laying the groundwork for future policy reforms, especially parastatals.

(4) Microcomputers:

At present special policy and budget analysis units such as the TAP and the proposed special mechanism in Treasury for the investment program, must rely on GOK central computing facilities to carry out their analyses. To improve the capacities of such units to carry out analysis rapidly and on-the-spot, $300,000 is reserved for procurement of computer hardware and for short-term consultancies to establish efficient user systems.

(5) Evaluation:

Approximately $50,000 of FY 1983 consultancy funds will be used to evaluate the program in October/November, 1983. This timing was selected because major IMF/World Bank benchmarks will be passed in September, because all conditions of the USAID grant will be filled by then and to allow the evaluation to have an impact on the design of the FY 1984 PAAD amendment. The evaluation will examine overall progress on structural adjustment, GOK success in meeting IMF/World Bank requirments, and GOK responsiveness to AID-specific conditions included in the Grant Agreement. The evaluation will then review the effectiveness of the technical assistance provided by the project. Finally it will propose specific policy objectives for the FY 1984 program. An additional $50,000 is programmed for evaluation of the FY 1984 program.

The estimated budget for consultancies is as follows:

	1983	1984
TAP Support	900	1,100
Ministry of Finance Special Mechanism	250	300
Studies	650	2,400
Computers	150	150
Evaluation	50	50
Totals	2,000	4,000

A more detailed description of the required technical and consultancy assistance is included as Annex E.

c) Local Currency:

The local currency made available under the program will be applied to three purposes: financing of costs of policy reforms; support for jointly agreed upon high priority agricultural and rural development projects; and funding through the commercial banking system of major foreign exchange saving or foreign exchange earning private enterprise investments.

(1) Policy Reform

Local currency resulting from the program will provide financing to facilitate policy reforms agreed upon by the GOK and USAID. For FY 1983 USAID proposes to utilize the entire local currency equivalent of $28 million resulting from the program grant to underwrite the higher shilling costs to Treasury of the December 1982 devaluations and interest rate increases. The GOK estimates that such costs (which were not included in the original 1982/83 budget) will exceed $31 million. During the final seven months of the fiscal year these costs will at a minimum include the higher shilling cost of Government imports ($17 million), the higher shilling cost of external debt service ($10 million), and the higher interest payments on domestic debt ($4 million). Receipt of first year local currency resources by the GOK prior to June 30, 1983 is particularly important since without these funds GOK may not meet the performance criterion for domestic bank lending to Govenment under the most recent IMF Stand-By. By making local currency available to finance these unexpected increases in budget costs, the program will help maintain the structural adjustment program and facilitate similar needed policy and structural changes in the future. Further, given Government's clear commitment to do everything possible to try to meet the IMF performance criteria, a failure on the part of USAID to provide the $28 million Program Grant proposed here would result in even more severe cuts in the development and recurrent budgets. Thus another impact of the proposed assistance will be to make the expenditure cuts less deep and less painful. As the first target of expenditure cuts, development programs will benefit most from any moderation in needed cuts.

Specific policy reform implementation steps which could require local currency support in FY 1984 and FY 1985 have yet to be identified, but could include costs of restructuring existing parastatals, costs of export promotion activities, or the local currency costs of the technical assistance efforts described above.

(2) Development Projects:

In previous years local currency generations from commodity imports and the FY 1982 program grant have been used to support jointly agreed upon development activities in the GOK budget. (See Annex D). USAID believes such activities are worthy of continued support and proposes to program $10-15 million annually for them. During Kenya's 1983/84 fiscal year approximately $10 million is already available for such purposes from the FY1982 fertilizer CIP and Program Grant. Thus local currency resources from the FY 1983 program will not be required to maintain recent levels of budget support for priority projects. It is planned that from $10-15 million each year from the FY 1984 and FY 1985 programs will be used

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to support development projects. In the past, priority has been given to activities which promote rural production, employment and income. Two additional criteria will apply in the future. Supported activities will be designed to minimize the recurrent cost burden on the GOK and will be among the projects designated as high priority activities by the GOK.

(3) Private Enterprise Development:

The final use of the local currency (in years two and three only) will be to provide liquidity to the commercial banking system for loans to private sector enterprises with substantial capability to earn or save foreign exchange. Investments of the import-substitution variety will be funded only if analysis demonstrates economic viability without artificial support provided by protective measures. A precedent for private sector use of local currency in Kenya was established under the $10 million program grant signed in FY 1982. Under the grant up to $5.1 million in local currency is available to assist businesses which lost their inventories during the coup attempt of August 1, 1982.

A study completed for USAID by management consultants Deloitte, Haskins and Sells has assessed the unmet credit needs of agribusiness and rural private enterprises in Kenya. The study also appraised the management capacity of potential financial intermediaries. Substantial business capacity to absorb additional medium term credit was identified, and commercial banks were found to be capable intermediaries for disbursing and managing such credit. Assisting businesses with strong backward and forward linkages to agriculture directly contributes to attainment of the top priority U.S. assistance objective of increased rural production, employment and income. Moreover, by using a significant portion of the local currency to support private investment, the program will contribute to the structural adjustment policy objective of relying more on the private sector to achieve development goals, while expanding overall foreign exchange availability.

Local currency resources provided under this program will supplement the resources provided under the PRE project with the Kenya Commercial Bank and USAID's Rural Private Enterprises Project (615-0220). The emphasis of these two projects is on rural production and employment whereas the local currency resulting from the proposed program grants will be targeted at foreign exchange earning or saving enterprises in direct support of structural adjustment.

V. PROGRAM IMPLEMENTATION:

The FY 1983 Program obligation will be made in a single increment in June 1983. Subsequent annual obligations will be contingent upon annual 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. Although obligations will be handled jointly for the program grant and consultancies in a single agreement, disbursement and implementation mechanisms will differ.

A. Program Grant:

The Program Grant will be completely disbursed in June, 1983, in response to current pressing budgetary requirements for local currency proceeds. Disbursements in years two and three will be made in equal semi-annual installments each year. This latter disbursement system is proposed in recognition of the facts that: 1) meaningful reforms rarely come about overnight; 2) implementation of reform decisions often lags; and 3) U.S. leverage is largely dissipated once disbursement is made. By phasing disbursements, USAID will have an opportunity to monitor agreed-upon reforms closely and will be better able to enforce policy conditionality.

The mechanism for disbursing Program Grant funds in FY 1983 is as follows:

1) Upon compliance with all conditions precedent to first disbursement, the Ministry of Finance will request disbursement of the grant into the Government account at the Federal Reserve Bank of New York,

2) USAID will telegraphically transmit the request to AID/FM along with its certification that all CPs have been satisfactorily complied with.

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

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

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

No special account facility will be utilized in FY 1983 since all funds will be directly and immediately used for budget purposes. Local Currency from the FY 1984 and FY 1985 program grants will be deposited into a special account and disbursed after agreement with AID, as has been the case with previous balance of payments assistance programs.

B. Consultancies:

Obligations of funds for consultancies will be made in each of the first two years of the program. The principal commitments in the first year will be achieved through host country contracts. In the case of the Technical Assistance Pool a contract already exists to which AID will provide supplementary funding. For assistance to Treasury to improve planning and management of donor-financed projects, it is anticipated that Government will execute a similar institutional contract to which USAID will provide a portion of the funding. Concerning special studies, including evaluation, USAID will contract directly, with prior Government approval, for the necessary services.

VI. INTERNAL FINANCIAL ANALYSIS

Import flows financed under the proposed Program Grant can be expected to have limited direct effects on Kenya's overall domestic money supply and rate of inflation during the period of program implementation. The program disbursement schedule is outlined in Table 4 below. Flows of imports temporarily increase the overall supply of goods, and the collection of payments from importers by the Central Bank decreases the actual or potential supply of money. Kenya's overall money supply (money and quasi-money) as of September 30, 1982, however, stood at some $2.4 billion U.S. dollars. Overall disbursements under the proposed project over three years will total $117 million, and the largest semi-annual disbursement ($28.0 million in 1983) will amount to just over one percent of outstanding money supply. Moreover, given projected foreign exchange shortages, and the need for additional budget resources, it is likely that foreign exchange and local currency balances will be minimized by Government, thus further diluting any net effect, positive or negative resulting from acccumulation and subsequent expenditures of local currency balances. It should be noted that the Kenyan economy during most of the project disbursement period is likely to be under significant inflationary pressure as the result of the devaluations of December 1982 and possible future depreciation of the Kenyan shilling. In consideration of this factor it is proposed that at least $10-15 million annually in local currency expenditures which are not directly connected with underwriting new policy reform measures or private sector initiatives will be utilized for items already planned for inclusion in GOK budgets, thus further reducing any possible medium term inflationary effects of the proposed project.

Table 4

Proposed Disbursement Schedule:

Date	6/83	12/83	6/84	12/84	6/85	Total
Program Grant	28.0	19.0	19.0	22.5	22.5	111.0
Consultancies	1.0	1.5	1.5	1.0	1.0	6.0
Total	29.0	20.5	20.5	23.5	23.5	117.0

VII. SPECIAL U.S. INTERESTS:

The United States has important political and strategic interests in Kenya. Kenya is one of the few countries in Africa with relatively democratic political institutions and a freely elected civilian government. The economy is based on free market principles with a strong private sector. The economic and political well being of Kenya is important to the United States as a demonstration that progress and stability are possible under a government with basically democratic institutions and a market oriented economy.

In international affairs, Kenya pursues a moderate course and has been a good friend of the United States on numerous issues of importance to us. On international and regional security matters, Kenya provides important support to the U.S. strategic position in this part of the world through access for U.S. forces to its airfields and the Indian Ocean port of Mombasa. This security cooperation is formalized by a facilities access agreement between the United States and Kenya signed in 1980.

The United States firmly supports democratic institutions and the private enterprise system in Kenya, both currently under a great deal of stress. In order to provide such support, the Kenya economy will need to be strengthened, the trade balance improved and the quality of life enhanced. In the short run the timely provision of foreign exchange for balance of payments support will help as the Kenya Government continues adjustment of economic policies.

VIII. Negotiations Status and Covenants

The principal policy issues outlined in Section IV.B.2(b) above have been discussed at the Permanent Secretary level in the Ministry of Finance and in the Office of the President. Draft Agreement language has also been discussed with Government. Proposed conditions precedent to disbursement are as follows:

a. evidence that the Government of Kenya has taken or has initiated all necessary steps to comply with the current IMF Stand-By Agreement and the World Bank Structural Adjustment Loan;

b. evidence that the Government of Kenya has simplified the export documentation and licensing procedures since December 30, 1982.

c. evidence that import schedule I has been subdivided to establish a list of goods for which unlimited foreign exchange is freely available;

d. evidence that there will be no restrictions on imports of major agricultural inputs, except that for insecticides and fertilizers there may be established a list of acceptable types and that in consultation with representatives of those countries which export fertilizers to Kenya there may be estblished a list of bona fide private enterprises permitted to import fertilizers; and that foreign exchange will be available automatically for imports of all major agricultural inputs.

Covenants:

The Government of Kenya agrees as follows:

a. to comply fully with the terms and conditions of the IMF Stand-By Agreement and the World Bank Structural Adjustment Loan;

b. to develop a plan to assure that scarce budget resources are utilized for high priority investments and that lower priority investments for which insufficient budget resources are available are either curtailed or terminated;

c. to establish a special mechanism to manage planning and implementation of externally-financed development programs;

d. to establish a Monopolies and Prices Commission which will review commercial practices, impose sanctions for practices in restraint of fair trade and recommend reduction of price oontrols on specified items for which there is sufficient internal and external competition;

e. to make and implement decisions on the grain marketing structure, including the role and financing of the National Cereals and Produce Board;

f. to undertake a program to reduce the Government's participation in public enterprises as recommended by the July 1982 "Report and Recommendations of the Working Party on Government Expenditures";

g. to continue to encourage export activities by adjusting the exchange rate of the Kenya shilling periodically in order to establish and maintain an equilibrium rate; to pursue simplification of export procedures; and to expedite the study of alternative methods for export promotion;

h. to utilize the shilling equivalent of Twenty-eight Million United States Dollars (U.S. $28,000,000) to meet the needs of the Fiscal Year 1982/83 budget, as revised.

REPUBLIC OF KENYA
MINISTRY OF FINANCE

ANNEX A

Telegraphic Address
FINANCE-NAIROBI
Telephone: 338111
When replying please quote
Ref. No. EA/FA.9/03
and date

THE TREASURY
P.O. Box 30007
NAIROBI
KENYA

16th May 1983

Mrs. Allison B. Herrick,
Director,
U. S. A. I. D.,
NAIROBI.

Dear Mrs. Herrick,

PROGRAMME GRANT ASSISTANCE

As you know, the Government of Kenya has taken extraordinary measures to cut expenditures during the past several months in order to meet the requirements of the IMF. These expenditure cuts have had serious consequences for the development programme, but Government is determined to meet the IMF targets and pursue the structural adjustment efforts vigorously.

In spite of Government's efforts, it is now clear that without external assistance the targets will be missed, with serious consequences for the overall structural adjustment programme. This situation has arisen not because of a failure on Government's part to limit expenditures, but rather because revenues, both domestic and foreign, have dropped sharply.

The Government of Kenya therefore requests that the United States provide $28 million of programme grant assistance and $2 million for consultancies prior to June 30, 1983. Such assistance will give us both the financial and human resources needed to continue the structural adjustment effort to which we are committed. Furthermore, as the balance of payments and budgetary constraints are likely to persist until 1985 at the earliest, Kenya Government will be grateful if this request is considered as part of continuing programme support until 1985.

Yours sincerely,

(H. M. Mule)
PERMANENT SECRETARY

ANNEX B

Non-Project Statutory Checklists

3A(1) -COUNTRY CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In Part B a distinction is made between the criteria applicable to Economic Support Funds and the criteria applicable to Development Assistance. Selection of the appropriate criteria will depend on the funding source for the program.

A. GENERAL CRITERIA FOR COUNTRY

1. FAA Sec. 481 Second CR FY 83 Sec, 133. Has it been determined that the government of recipient country has failed to take adequate steps to prevent narcotics drugs and other controlled substances (as defined by the Comprehensive Drug Abuse Prevention and Control Act of 1970) produced or processed, in whole or in part, in such country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully? — No

2. FAA Sec. 620(c). If assistance is to a government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) debt is not denied or contested by such government? — No

3. FAA Sec. 602(e)(1). If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control or property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligation toward such citizens or entities? — No

4. FAA Sec. 620(f); FY 82 App. Act Secs. 512 and 513. Is recipient country a Communist country? Will assistance be provided to the Democratic Republic of Vietnam (North Vietnam), South Vietnam, Cambodia, or Laos?	No
5. FAA Sec. 602(j). Has the country ermitted, or failed to take adequate measures to prevent, the damage or estruction, by mob action or U.S. property?	No
6. FAA Sec. 620(k). Does the program furnish assistance in excess of $10,000,000 for the construction of a productive enterprise, except for productive enterprises in Egypt that were described in the Congressional Presentation materials for FY 1977, FY 1980 or FY 1981?	No
7. FAA Sec. 620(l). If the country has failed to institute the investment guaranty program for the specific risks of expropriation, inconvertibility or confiscation, has the AID Administrator within the past year considered denying assistance to such government for this reason?	Kenya has instituted the program.
8. FAA Sec. 620(o): Fishermen's Protective Act, Sec. 5 If country has seized, or imposed any penalty or sanction against, any U.S. fishing activities in international waters, a. has any deduction required by Fishermen's Protective Act been made? b. has complete denial of assistance been considered by AID Administrator?	Kenya has not seized, or imposed sanctions against any U.S. fishing activity

9. FAA Sec. 620(q): FY 82 App. Act Sec. 517. (a) Is the recipient country in default for more than six months on interest or principal or any AID loan to that country? (b) Is country more than one year in default on interest or principal on any U.S. loan made pursuant to program for which the appropriation bill appropriates funds?

(a) No

(b) No

10. FAA Sec. 620(s). What percentage of country budget is for military expenditures? How much of foreign exchange resources spent on military equipment? How much spent for the purchase of sophisticated weapons systems? Has the Administrator taken into consideration the amount of foreign exchange or other resources which the country has spent on military equipment?

Yes. Taken into account by the Administrator at the time of approval of the Agency OYB.

11. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?

No

12. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the AID Administrator in determining the current AID Operational Year Budget?

Kenya is not in arrears.

13. FAA Sec. 620A FY 82 App. Act Sec. 520. Has the country granted sanctuary from prosecution to any individual or group which has committed an act of international terrorism? Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed a war crime?

No

14. FAA Sec. 669, 670. Has the country, after August 3, 1977, delivered or received nuclear enrichment or reprocessifng equipment, materials or techology, without sdpecified arrangements or safeguards? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device, after August 3, 1977?

No

15. ISDCA of 1981, Sec. 720. Was the country represented at the meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned countries to the 36th General Session of the General Assembly of the U.N. of Sept. 25 and 28, 1981, and failed to disassociate itself from the communique issued? If so, has the President taken it into account?

The position of the GOK on this matter has been taken into account by the Administrator. Taking into Consieration Memo of 1/28/83.

B. FUNDING CRITERIA FOR COUNTRY

1. Economic Support Fund Country Criteria.

a. FAA Sec. 502B. Has the Department of State made findings which indicate that the country has engaged in a consistent pattern of gross violations of international recognized human rights? If so, is program in accordance with policy of this Section?

No

b. FAA Sec. 531. Is the Assistance to be furnished to a friendly country, organization, or body eligible to receive assistance?

Yes

c. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

N/A

2. Development Assistance Country Criteria

a. FAA Sec. 102(c), (d). Have criteria been established, and taken into account, to assess commitment and progress of country in effectively involving the poor in development, on such indexes as: (1) small-farm labor intensive agriculture, (2) reduced infant mortality, (3) population growth, (4) equality of income distribution, and (5) unemployment. — N/A

b. FAA Sec. 116. Can it be demonstrated that contemplated assistance will directly benefit the needy? If not, has the Department of State made findings which indicate that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? — N/A

3A(2) - NONPROJECT ASSISTANCE CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In Part B a distinction is made between the criteria applicable to Economic Support Funds and the criteria applicable to Development Assistance. Selection of the appropriate criteria will depend on the funding source for the program.

CROSS-REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? IDENTIFY. HAS STANDARD ITEM CHECKLIST BEEN REVIEWED?

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 82 Approp. Act Sec. 523, FAA Sec. 634A, Sec. 653(b) Second CR FY 83, Sec. 101(b)(1).

a. Describe how Committee on Appropriations of Senate and House have been or will be notified concerning the non-project assistance; — This program was included in the FY 83 CP at page 158. A Congressional Notification was sent to Congress on ______ The 15-day waiting period expired on ______ without Congressional objection.

b. Is assistance within (Operational Year Budget) country or international organization allocation reported to the Congress (or not more than $1 million over that amount)? — Yes

63

c. If the proposed assistance is a new country program or will exceed or cause the total assistance level for the country to exceed amounts provided to such country in FY 82, has notification been provided to Congress? — N/A

d. If proposed assistance is from the $85 million in ESF funds transferred to A.I.D. under the second CR for FY 83, for "economic development assistance projects" has the notification required by Sec. 101(b)(1) of the Second CR for FY 83 been made? — N/A

2. FAA Sec. 611(a)(2). If further legislative action is required within recipient counry, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

   No further legislation is required

3. FAA Sec. 209, 619. Is assistance more efficiently and effectively given through regional or multilateral organizations? If so why is assistance not so given? Information and conclusion whether assistance will encourage regional development programs. If assistance is for newly independent country, is it furnished through multilateral plans to the maximum extent appropriate?

   No. It is country-specific balance of payments support

4. FAA Sec. 601(a); (and Sec. 201(f) for development loans). Information and conclusions whether assistance will encourage efforts of the country to:. (a) increase the flow of international trade;(b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce, and (f) strengthen free labor unions.

   Program will: increase the flow of international trade; foster private initiative and competition, discourage monopolistic practices, and improve technical efficiency of industry, agriculture and commerce. Impact on development and use of cooperatives, credit unions and savings and loan associations and and labor unions is not clear, but no adverse impacts are anticipated.

5. FAA Sec. 601(b). Information and conclusion on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

Program cash grant of FX will improve economy and permit increased importation of U.S. goods and investment in private sector-oriented economy. A portion of the FX will be allocated to U.S.-owned private enterprises in Kenya which will import key industrial inputs, in some cases from private U.S. suppliers.

6. FAA Sec. 612(b), Sec. 636(h); FY 82 Approp. Act Sec. 507 Described steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the United States are utilized to meet the cost of contractual and other services in lieu of dollars.

Provisions in the grant agreement will require Kenya to utilize, counterpart local currencies for general budget support prior to June 30, 1983.

7. FAA Sec. 612(d). Does the United States own excess foreign currency and, if so, what arrangements have been made for its release?

No

8. FAA Sec. 601(e): Will the project utilize competitive Selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

Yes

9. FY 82 Approp. Act Sec. 521: If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same or similar compering commodity?

This assistance is not specifically for production of any commodity for export.

10. FAA 118(c) and (d)
Does the program comply with the environmental procedures set forth in AID Regulations 16? Does the program take into consideration the problem of the distruction of tropical rain forests?

Pursuant to AID Reg.16, the program was categorically excluded from detailed environmental analysis. This determination was approved by the Bureau Environmental Officer.

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Funds.

a. FAA Sec. 531(a). Will this assistance support promote economic or political stability? To the extent possible, does it reflect the policy directions of FAA Section 102?

Yes, through provision of budget and balance of payments support during a period of economic slowdown.

b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities?

No

c. FAA Sec. 534. Will ESF funds be used to finance the construction or the operation or maintanance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such use of funds is indispensable to nonproliferation objectives?

No

d. Second CR FY 83, Sec. 101(b)(1). If ESF funds to be utilized are part of the $85 million transferred to A.I.D. under the Second CR for FY 83 for "economic development assistance projects", will such funds be used for such projects and not for non-development activities including balance of payments support, commodity imports, sector loans, and program loans?

N/A

e. FAA, Sec.609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

N/A

2. Nonproject Criteria for Development Assistance.

a. FAA Sec. 102(c); 111; 113, 281(a). Extent to which activity will (1) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production, spreading investment out from cities to small towns and rural areas; and (2) help develop cooperatives, assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local government institutions? N/A

b. FAA Sec. 103, 103A, 104, 105, 106, 107. Is assistance being made available: (include only applicable paragraph -- e.g, a, b, etc. -- which corresponds to sources of funds used. If more than one fund source is used for assistance, include relevant paragraph for each fund source). N/A

(1) [103] for agriculture, rural development or nutrition; if so, extent to which activity is specifically designed to increase productivity and income of rural poor; [103A] if for agricultural research, is full account taken of needs of small farmers; N/A

(2) [104] for population planning or health; if so, extent to which activity extends low-cost, integrated delivery systems to provide health and family planning services, especially to rural areas and poor; extent to which assistance gives attention to interrelationship between (A) population growth and (B) development and overall improvement N/A

in living standards in developing countries. Is activity designed to build motivation for small families in programs such as education in and out of school, agriculture production, rural development, and assistance to urban poor?

(3) [105] for education, public administration, or human resources development; if so, extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, or strengthens management capability of institutions enabling the poor to participate in development; N/A

(4) [106] for technical assistance, energy, research, reconstruction, and selected development problems; if so, extent activity is: N/A

(a) to help alleviate energy problem;

(b) reconstruction after natural or manmade disaster;

(c) for special development problem, and to enable proper utilization of earlier U.S. infrastructure, etc., assistance;

(d) for programs of urban development, especially small labor-intensive enterprises, marketing systems, and financial or other institutions to help urban poor participate in economic and social development.

(5) [107] by grants for coordinated private effort to develop and disseminate intermediate technologies appropriate for developing countries. N/A

c. FAA Sec. 113. Extent to which assistance reflects appropriate emphasis on integrating women into the recipient country's national economy. — N/A

d. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self sustaining economic growth? — N/A

e. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government.

3. Non-project Criteria for Development Assistance (Loans only)

a. FAA Sec. 122(b). Information and conclusion on capacity of the country to repay the loan, at a reasonable rate of interest. — N/A

b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20% of te enterprise's annual production during the life of the loan? — N/A

c. Second CR FY 83, Sec. 134. If the recipient country has an annual per capita gross natural product greater than $795 but less than $1285, will the loan be repayable within 25 years following the date on which funds are initially made available? If it has an annual per capita GNP greater than or equal to $1285 within 20 years?

N/A

3A(3) - STANDARD ITEM CHECKLIST

Listed below are statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by exclusion (as where certain users of funds are permitted, but other uses not).

These items are arranged under the general headings of (A) Procurement and (B) Other Restrictions.

A. PROCUREMENT

1. FAA Sec. 602. Are there arrangements to permit U.S. small business to participate equitably in the furnishing of goods and services financed?

   This Program Grant does not provide financing specifically for procurement of goods. Procurement of services will be from the United States. It is likely that some of these services will be furnished by U.S. small businesses.

2. FAA Sec. 604(a). Will all commodity procurement financed be from the United States except as otherwise determined by the President or under delegation from him?

   N/A

3. FAA Sec. 604(b). Will all commodities in bulk be purchased at prices no higher than the market price prevailing in the United States at time of purchase?

   N/A

4. FAA Sec. 604(c). Will all agricultural commodities available for disposition under the Agricultural Trade Development & Assistance Act of 1954, as amended, be procured in the United States unless they are not available in the United States in sufficient quantities to supply emergency requirements of recipients? — N/A

5. FAA Sec. 604(d). If the cooperating country discriminates against U.S marine insurance companies, will agreement require that marine insurance be placed in the United States on commodities financed? — Yes

6. FAA Sec. 604(e) ISDCA of 1980 Sec. 705(a). If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? — N/A

7. FAA Sec. 604(f). Are there arrangements whereby a supplier will not receive payment under the commodity import program unless he/she has certified to such information as the Agency by regulation has prescribed? — N/A

8. FAA Sec.604(g). Will construction or engineering services be procured from firms otherwise ineligible under code 941, but which have attained competitive capability in international markets in one of these areas. — No engineering or construction services are contemplated.

9. FAA Sec. 608(a). Will U.S. Government excess personal property be utilized wherever practicable in lieu of the procurement of new items? — N/A

10. MMA Sec. 901(b). Sec. 603, FAA
(a) Compliance with requirement that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S.-flag commercial vessels to the extent that such vessels are available at fair and reasonable rates. — Yes

11. International Air Transport and Fair Competitive Practices Act, 1974.

If air transportation of persons or property is financed on grant basis, will provision be made that U.S.-flag carriers will be utilized to the extent such service is available? — Yes

12. FY 82 Approp. Act, Sec. 504
If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States: — Yes

13. FAA Sec.621. If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? If the facilities of other federal agencies will be utilized, are they particularly suitable, not competitive with private enterprise and made available without undue interference with domestic programs? — Yes

B. OTHER RESTRICTIONS

1. FAA Sec. 620(h). Do arrangements preclude promoting or assisting the foreign aid projects or activities, of communist-bloc countries contrary to the best interests of the United States? — Yes

2. FAA Sec. 636(i). Is financing prohibited from use, without waiver, for purchase, long-term lease, exchange, or guaranty of sale of motor vehicle manufactured outside the United States? — Yes

3. FAA Sec. 122(b). If development loan funds, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter? — N/A

4. FAA Sec.301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have auditrights? — N/A

5. Will arrangement preclude use of financing:

   a. FAA Sec. 114, 104(f), FY 82 Approp Act Sec. 525. to pay for performance of abortions or involuntary sterilization or to motivate or coerce persons to practice abortions? to pay for performance of involuntary sterilizations as method of family planning or to coerce or provide any financial incentive to any person to practice sterilizations? or to lobby for abortions? — Yes

   b. FAA Sec. 620(g). to compensate owners for expropriated nationalized property? — Yes

c. FAA Sec. 660. to finance police training or other law enfocement assistance, except for narcotics programs? Yes

d. FAA Sec. 662. for CIA activities? Yes

e. FY 82 Approp. Act. Sec. 503. to pay pensions, etc., for military personnel? Yes

f. FY 82 Approp. Act. Sec. 506. to pay U.N. assessments? Yes

g. App. Sec. 107. to carry out povisions of FAA Sections 209(d) and 251(h)? (transfer to multi-lateral organization for lending). Yes

h. FY 82 Approp. Act, Sec. 510. To finance the export of nuclear equipment, fuel, or technology or to train foreign nationals in nuclear fields? Yes

i. FY 82 Approp. ACt Sec. 511. To aid the efforts of the government to express the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights?

k. FY 82 Approp. Act. Sec. 515. To be used for publicity or propaganda purposes within U.S. not authorized by Congress? Yes

ANNEX C

GOK: Gross Recurrent and Development Expenditures By Ministry 1977/78-1982/83

Table 1

GOK Gross* Expenditures
Budget Estimates, Approved Estimates, Audit Accounts
(K£)

Expenditures	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82
Total Expenditures							
- Budget Estimates	366,251	398,945	555,312	709,546	745,049	838,716	984,176
- Approved Estimates	383,861	445,443	674,639	754,105	781,717	954,707	1,122,486
- Audited Accounts	372,933	411,254	590,710	699,419	783,566	974,043	-
Development Expenditures							
- Budget Estimates	136,047	127,643	197,025	258,002	242,956	258,123	281,843
- Approved Estimates	134,789	146,927	234,836	268,206	250,226	305,726	324,480
- Audited Accounts	124,616	122,759	186,681	220,093	232,046	282,893	-
Total Recurrent Estimates							
Budget Estimates	230,204	271,302	358,287	451,546	502,093	580,593	702,333
Approved Estimates	249,072	298,516	439,803	485,899	531,491	648,981	798,006
Audited Accounts	248,317	288,495	404,029	479,326	551,520	691,150	-
Recurrent Expenditures							
- Budget Estimates	195,142	224,035	268,241	376,397	415,759	470,234	545,787
- Approved Estimates	210,589	249,777	345,309	410,750	440,480	538,622	628,164
- Audited Accounts	211,287	245,868	336,209	405,603	463,658	559,491	-
Consolidated Fund							
- Budget Estimates	35,062	47,267	90,046	75,149	86,334	110,359	156,546
- Approved Estimates	38,483	48,739	94,494	75,149	91,011	110,359	169,842
- Audited Accounts	37,030	42,627	67,820	73,723	87,862	131,659	-

*Includes Appropriation-in-Aid

Table 2

GOK Gross Expenditures
Approved Estimates and Audited Accounts
As a % of Budget Estimates

	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1982/83
Total Expenditures							
- Budget Estimates	100.0	100.0	100.0	100.0	100.0	100.0	100.0
- Approved Estimates	104.8	111.7	121.5	106.3	104.9	113.8	114.1
- Audited Accounts	101.8	103.1	106.4	98.6	105.2	116.1	...
Development Expenditures							
- Budget Estimates	100.0	100.0	100.0	100.0	100.0	100.0	100.0
- Approved Estimates	99.1	115.1	119.2	104.0	103.0	118.4	115.1
- Audited Accounts	91.6	96.2	94.8	85.3	95.5	119.0	...
Total Recurent Expenditures							
- Budget Estimates	100.0	100.0	100.0	100.0	100.0	100.0	100.0
- Approved Estimates	108.2	110.0	122.8	107.6	105.9	111.4	113.6
- Audited Accounts	107.9	106.3	112.8	106.2	109.8	...	...
Reccurent Expenditures							
- Budget Estimates	100.0	100.0	100 0	100.0	100.0	100.0	100.0
- Approved Estimates	107.9	111.5	128.7	109.1	106.0	114.5	115.1
- Audited Accounts	108.3	109.8	125.3	107.8	111.5	119.0	...
Consolidated Fund							
- Budget Estimates	100.0	100.0	100.0	100.0	100.0	100.0	100.0
- Approved Estimates	109.8	103.1	104.9	100.0	105.4	100.0	108.6
- Audited Accounts	105.6	90.2	75.3	98.1	101.8	119.3	...

*Includes Appropriation-in-Aid

Table 3

Gross Development Expenditures, 1977/78 - 1982/83
(K£ million)

Vote	Actual Gross Expend. 1977/78	Actual Gross Expend. 1978/79	Actual Gross Expend. 1979/80	Actual Gross Expend. 1980/81	Gross Approved Estimates 1981/82	Gross Estimates 1982/83
	(	Current Prices				)
1. Office of the President	2.71	2.33	(12.15)	(10.37)	12.39	10.44
2. Ministry of Lands, Settlement			( )	( )		
and Physical Planning	5.42	6.21	(-)	(-)	5.63	5.72
3. The State House	0.10	0.18	0.21	0.80	0.39	0.43
4. Directorate of Personnel Management	0.05	0.14	0.04	0.24	0.77	1.35
5. Ministry of Foreign Affairs	0.69	0.63	0.83	0.12	0.47	0.28
6. Ministry of Constitutional Affairs	-	-	(1.58)	(2.25)	0.64	0.49
7. Home Affairs	(0.29)	0.73	(-)	(-)	(2.93)	(3.53)
8. Office of the Vice-President	(-)	(-)	(-)	(-)	(-)	(-)
9. Ministry of Finance	(20.50)	(15.71)	(25.02)	(12.22)	18.50	13.53
10. Ministry of Economic Planning	( )	( )				
and Development	(-)	(-)	0.61	1.17	2.46	2.83
11. Department of Defence	5.55	8.85	7.22	7.82	10.23	9.78
12. Ministry of Agriculture	21.18	30.06	22.16	32.42	33.30	40.65
13. Ministry of Livestock Dev.	-		6.54	10.03	11.62	11.71
14. Ministry of Health	7.68	7.73	10.71	12.83	11.92	14.47
15. Ministry of Local Government	3.78	6.12	11.22	9.69	12.60	8.12
16. Ministry of Information and Broadcasting	1.10	0.69	3.28	2.98	3.95	2.84
17. Ministry of Transport & Communications	26.68	36.83	51.65	60.62	82.00	102.03
18. Ministry of Labor	0.64	1.87	1.49	0.55	1.62	1.05
19. Ministry of Tourism & Wildlife	4.20	6.45	2.34	3.70	8.10	8.05
20. Ministry of Works	28.50	37.67	5.19	5.88	(13.35)	(15.13)
21. Housing	(-)	(-)	(-)	-	(-)	(-)
22. Ministry of Culture & Social	( )	( )	( )			
Services	(8.90)	(7.76)	(8.70)	3.68	5.86	10.65
23. Ministry of Urban Development	-	-	-	7.33**	-	-

Table 3 (Continued)

Vote	Actual Gross Expend. 1977/78	Actual Gross Expend. 1978/79	Actual Gross Expend. 1979/80	Actual Gross Expend. 1980/81	Gross Approved Estimates 1981/82	Gross Estimates 1982/83
	(		Current Prices			)
24. Ministry of Water Development	30.21	30.43	24.56	27.91	32.93	36.60
25. Ministry of Environment and Natural Resources	5.98	6.04	10.84	15.53	9.96	12.90
26. Ministry of Cooperative Dev.	1.47	1.20	1.68	4.79	4.93	5.07
27. Ministry of Commerce			1.56	0.49	1.01	0.58
28. Ministry of Industry	6.58	7.24	3.85	5.88	4.97	4.25
29. Ministry of Higher Education	-	-	10.25	8.49	9.48	9.74
30. Ministry of Basic Education	4.38	5.10	0.79	2.13	4.42	4.59
31. Judicial Department	0.11	0.10	0.10	0.67	0.92	0.99
32. Office of the Attorney General	-	-	1.00	-	-	0.10
33. Ministry of Energy	-	-	0.50	3.84	3.22	5.43
34. Cabinet Affairs & Development Coordination	-	-	5.97	28.46	1.24	-
35. Ministry of Regional Dev., Science and Technology	-	-	-	-	12.69	13.38
Total Development Expenditures	186.68	220.09	232.05	282.89	324.50	356.71

Source: The Appropriation Accounts, Other Public Accounts and The Accounts of the Funds, 1977/78; 1978/79; 1979/80; 1980/81
Development Estimates, 1982/83.

Note: * Includes Appropriations in Aid.
** Includes Housing.

Table 4

Gross Development Expenditures, 1977/78 - 1982/83*
(Percentage of the Total Budget)

	Vote	Actual Gross Expend. 1977/78	Actual Gross Expend. 1978/79	Actual Gross Expend. 1979/80	Actual Gross Expend. 1980/81	Gross Approved Estimates 1981/82	Gross Estimates 1982/83
		(Current Prices)					
1.	Office of the President	1.45	1.06	(5.24)	3.67)	3.82	2.93
2.	Ministry of Lands, Settlement and Physical Planning	2.90	2.82	( ) (-)	( ) (-)	1.73	1.60
3.	The State House	0.05	0.08	0.09	0.28	0.12	0.12
4.	Directorate of Personnel Management	0.03	0.06	0.02	0.08	0.24	0.38
5.	Ministry of Foreign Affairs	0.37	0.29	0.36	0.04	0.14	0.08
6.	Ministry of Constitutional Affairs	-	-	(0.68)	(0.80)	0.20	0.14
7.	Home Affairs	(0.16)	0.33	(-)	(-)	(0.90)	(0.99)
8.	Office of the Vice-President	(-)	(-)	(-)	(-)	(-)	(-)
9.	Ministry of Finance	(10.98)	(7.14)	(10.78)	(4.32)	5.70	3.79
10.	Ministry of Economic Planning and Development	( ) (-)	( ) (-)	0.26	0.41	0.76	0.79
11.	Department of Defence	2.97	4.02	3.11	2.76	3.15	2.74
12.	Ministry of Agriculture	11.35	13.66	9.55	11.46	10.26	11.40
13.	Ministry of Livestock Dev.	-		2.82	3.55	3.58	3.28
14.	Ministry of Health	4.11	3.51	4.62	4.54	3.67	4.06
15.	Ministry of Local Government	2.02	2.78	4.84	3.43	3.88	2.28
16.	Ministry of Information and Broadcasting	0.59	0.31	1.41	1.05	1.22	0.80
17.	Ministry of Transport & Communications	14.29	16.73	22.26	21.43	25.27	28.60
18.	Ministry of Labor	0.34	0.85	0.64	0.19	0.50	0.29
19.	Ministry of Tourism & Wildlife	2.25	2.93	1.01	1.31	2.50	2.25
20.	Ministry of Works	15.27	17.12	2.24	2.08	(4.11)	(4.24)
21.	Housing	(-)	(-)	(-)	-	(-)	(-)
22.	Ministry of Culture & Social Services	( ) (4.77)	( ) (3.53)	( ) (3.75)	1.30	1.81	2.99
23.	Ministry of Urban Development	-	-	-	2.59**	-	-

Table 4 (Continued)

Vote	Actual Gross Expend. 1977/78	Actual Gross Expend. 1978/79	Actual Gross Expend. 1979/80	Actual Gross Expend. 1980/81	Gross Approved Estimates 1981/82	Gross Estimates 1982/83
	(Current Prices)					
24. Ministry of Water Development	16.18	13.83	10.58	9.87	10.15	10.26
25. Ministry of Environment and Natural Resources	3.20	2.74	4.67	5.49	3.07	3.62
26. Ministry of Cooperative Dev.	0.78	0.55	0.72	1.69	1.52	1.42
27. Ministry of Commerce			0.67	0.17	0.31	0.16
28. Ministry of Industry	3.52	3.29	1.66	2.08	1.53	1.19
29. Ministry of Higher Education	-	-	4.42	3.00	2.92	2.73
30. Ministry of Basic Education	2.35	2.32	0.34	0.75	1.36	1.29
31. Judicial Department	0.06	0.05	0.04	0.24	0.28	0.28
32. Office of the Attorney General	-	-	0.43	-	-	0.03
33. Ministry of Energy	-	-	0.22	1.36	0.99	1.52
34. Cabinet Affairs & Development Coordination	-	-	2.57	10.06	0.38	-
35. Ministry of Regional Dev., Science and Technology	-	-	-	-	3.91	3.75
Total Development Expenditures	99.99	100.00	100.00	100.00	99.98	100.00

Source: The Appropriation Accounts, Other Public Accounts and The Accounts of the Funds, 1977/78; 1978/79; 1979/80; 1980/81
Development Estimates, 1982/83.

Note: * Includes Appropriations in Aid.
** Includes Housing.

Table 5

Gross Recurrent Expenditures, 1977/78 - 1982/83*
(K£ million)

Vote	Actual Gross Expend. 1977/78	Actual Gross Expend. 1978/79	Actual Gross Expend. 1979/80	Actual Gross Expend. 1980/81	Gross Approved Estimates 1981/82	Gross Estimates 1982/83
	(		Current Prices			)
1. Office of the President	33.76	36.13	(48.09)	(61.34)	53.32	55.36
2. Ministry of Lands, Settlement and Physical Planning	3.84	4.47	(-)	(-)	9.99	10.89
3. The State House	0.34	0.55	0.76	1.29	1.07	0.99
4. Directorate of Personnel Management	2.19	3.18	3.42	3.72	4.00	4.20
5. Ministry of Foreign Affairs	4.04	6.00	6.85	8.75	11.29	12.36
6. Ministry of Constitutional Affairs	-	-	(14.40)	(17.21)	3.86	4.29
7. Home Affairs	(10.07)	14.87	(-)	(-)	(12.74)	(14.02)
8. Office of the Vice President	(-)	(-)	(-)	(-)	(-)	(-)
9. Ministry of Finance	(7.60)	(9.31)	(7.96)	(8.65)	9.92	12.73
10. Ministry of Economic Planning & Development	(-)	(-)	3.15	2.22	2.34	2.55
11. Department of Defence	73.74	96.81	104.61	81.93	124.35	131.25
12. Ministry of Agriculture	17.88	22.21	14.48	34.96	24.69	25.46
13. Ministry of Livestock Development	-	-	8.57	12.57	13.31	16.94
14. Ministry of Health	29.20	35.38	42.94	52.87	55.76	55.24
15. Ministry of Local Government	8.51	10.41	11.34	12.88	14.48	14.54
16. Ministry of Information and Broadcasting	3.08	3.69	4.35	5.49	5.50	5.96
17. Ministry of Transport and Communications	6.36	6.80	26.94	34.84	38.60	38.08
18. Ministry of Labor	3.91	5.14	2.93	3.57	3.92	4.64
19. Ministry of Tourism & Wildlife	4.52	5.86	1.75	2.04	9.62	10.32
20. Ministry of Works	25.13	28.49	12.61	14.10	15.48	17.24
21. Housing	( )	( )	( )			
22. Ministry of Culture & Social Services	(2.26)	(3.44)	(4.77)	6.70	7.33	7.90
23. Ministry of Urban Development	-	-		0.94**	-	-

Table 5 (Continued)

Vote	Actual Gross Expend. 1977/78	Actual Gross Expend. 1978/79	Actual Gross Expend 1979/80	Actual Gross Expend. 1980/81	Gross Approved Estimates 1981/82	Gross Estimates 1982/83
24. Ministry of Water Development	5.50	7.15	8.97	13.19	12.89	13.42
25. Ministry Environment and Natural Resources	1.28	1.63	8.01	10.41	2.21	2.38
26. Ministry of Co-operative Dev.	1.38	1.40	2.07	2.72	2.70	3.10
27. Ministry of Commerce	-	-	1.58	1.72	2.00	2.23
28. Ministry of Industry	1.34	1.66	0.45	1.20	1.33	1.55
29. Ministry of Higher Education	86.08	96.37	34.95	45.44	51.26	57.62
30. Ministry of Basic Education			80.04	104.09	114.47	122.29
31. Judicial Department	1.34	1.64	1.64	2.11	2.04	2.51
32. Office of the Attorney General	0.93	0.99	2.49	0.94	1.09	1.24
33. Ministry of Energy	-		0.16	0.66	1.92	0.88
34. Development Coordination and Cabinet Affairs	-	-	1.19	8.13	1.95	-
35. Ministry of Regional Development, Science and Technology	-	-	-	-	9.24	12.51
36. National Assembly	1.29	1.39	1.37	1.82	2.29	2.17
37. Public Service Commission	0.11	0.13	0.15	0.18	0.24	0.25
38. Office of the Controller and Auditor General	0.51	0.52	0.66	0.81	0.96	1.08
39. Provision for National Service	-	-	-	-	-	-
40. Consolidated Funds	67.82	73.72	87.86	131.66	169.84	285.25
Total Recurrent Expenditures	404.03	479.33	551.52	691.15	798.00	953.44

Source: The Appropriation Accounts, Other Public Accounts and the Accounts of the Funds, 1977/78; 1978/79; 1979/80; 1980/81. Estimates - Recurrent Expenditures, 1982/83.

Note: * Includes Appropriations-in-Aid.
** Includes Housing.

Table 6

Gross Recurrent Expenditures, 1977/78 - 1982/83*
(Percentage of Total Budget)

Vote	Actual Gross Expend. 1977/78	Actual Gross Expend. 1978/79	Actual Gross Expend. 1979/80	Actual Gross Expend. 1980/81	Gross Approved Estimates 1981/82	Gross Estimates 1982/83
	(		Current Prices			)
1. Office of the President	8.35	7.53	(8.71)	(8.87)	6.68	5.80
2. Ministry of Lands, Settlement			( )	( )		
and Physical Planning	0.95	0.93	(-)	(-)	1.25	1.14
3. The State House	0.08	0.11	0.31	0.18	0.13	0.10
4. Directorate of Personnel Management	0.54	0.65	0.62	0.53	0.50	0.44
5. Ministry of Foreign Affairs	0.99	1.25	1.24	1.26	1.41	1.29
6. Ministry of Constitutional Affairs	-	-	(2.61)	(2.49)	0.48	0.44
7. Home Affairs	(2.49)	3.10	(-)	(-)	(1.59)	(1.47)
8. Office of the Vice President	(-)	(-)	(-)	(-)	(-)	(-)
9. Ministry of Finance	(1.88)	(1.94)	(1.44)	(1.25)	1.24	1.33
10. Ministry of Economic Planning	( )	( )				
& Development	(-)	(-)	0.57	0.32	0.29	0.26
11. Department of Defence	18.25	20.19	18.96	11.85	15.58	13.76
12. Ministry of Agriculture	4.42	4.63	2.62	5.05	3.09	2.67
13. Ministry of Livestock Development	(-)	(-)	1.55	1.81	1.66	1.77
14. Ministry of Health	7.22	7.38	7.78	7.64	6.98	5.79
15. Ministry of Local Government	2.10	2.17	2.05	1.86	1.81	1.52
16. Ministry of Information and Broadcasting	0.76	0.76	0.78	0.79	0.68	0.62
17. Ministry of Transport and Communications	1.57	1.41	4.88	5.04	4.83	3.99
18. Ministry of Labor	0.96	1.07	0.53	0.51	0.49	0.48
19. Ministry of Tourism & Wildlife	1.11	1.22	0.31	0.29	1.20	1.08
20. Ministry of Works	6.21	5.94	2.28	2.04	(1.93)	(1.80)
21. Housing	( )	( )	( )		( )	( )
22. Ministry of Culture & Social	( )	( )	( )			
Services	(0.55)	(0.71)	(0.86)	0.96	0.91	0.82
23. Ministry of Urban Development	-	-		0.13**	-	-

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Table 6 (Continued)

Vote	Actual Gross Expend. 1977/78	Actual Gross Expend. 1978/79	Actual Gross Expend. 1979/80	Actual Gross Expend. 1980/81	Gross Approved Estimates 1981/82	Gross Estimates 1982/83
	(		Current Prices			)
24. Ministry of Water Development	1.36	1.49	1.62	1.90	1.61	1.40
25. Ministry Environment and Natural Resources	0.31	0.34	1.45	1.50	0.27	0.24
26. Ministry of Co-operative Dev.	0.34	0.29	0.37	0.39	0.33	0.32
27. Ministry of Commerce	-	-	0.28	0.24	0.25	0.23
28. Ministry of Industry	0.33	0.34	0.08	0.17	0.16	0.16
29. Ministry of Higher Education	(21.30)	(20.10)	6.33	6.57	6.42	6.04
30. Ministry of Basic Education	( )	( )	14.51	15.06	14.34	12.82
31. Judicial Department	0.33	0.34	0.29	0.30	0.25	0.26
32. Office of the Attorney General	0.23	0.20	0.45	0.13	0.13	0.13
33. Ministry of Energy	-	-	0.02	0.09	0.24	0.09
34. Development Coordination and Cabinet Affairs	-	-	0.21	1.17	0.24	-
35. Ministry of Regional Development, Science and Technology	-	-	-	-	1.15	1.31
36. National Assembly	0.31	0.28	0.24	0.26	0.28	0.22
37. Public Service Commission	0.02	0.02	0.02	0.02	0.03	0.02
38. Office of the Controller and Auditor General	0.12	0.10	0.11	0.11	0.12	0.11
39. Provision for National Service	-	-	-	-	-	-
40. Consolidated Funds	16.78	15.37	15.93	19.04	21.28	29.91
Total Recurrent Expenditures	99.86	99.86	100.01	99.82	99.83	99.83

Source: The Appropriation Accounts, Other Public Accounts and the Accounts of the Funds, 1977/78; 1978/79; 1979/80; 1980/81. Estimates - Recurrent Expenditures, 1982/83.

Note: * Includes Appropriations-in-Aid. Excludes Consolidated Fund.
** Includes Housing.

Table 7

Gross Recurrent and Development Expenditures, 1977/78 - 1982/83*
(K£ million)

	Vote	Actual Gross Expend. 1977/78	Actual Gross Expend. 1978/79	Actual Gross Expend. 1979/80	Actual Gross Expend. 1980/81	Gross Approved Estimates 1981/82	Gross Estimates 1982/83
		(Current Prices)					
1.	Office of the President	36.46	38.47	(60.24)	(71.7[illegible])	65.72	65.79
2.	Ministry of Lands, Settlement			( )	( )		
	and Physical Planning	9.26	10.68	(-)	(-)	15.62	16.61
3.	The State House	0.43	0.73	0.97	2.09	1.46	1.42
4.	Directorate of Personnel						
	Management	2.23	3.32	3.47	3.96	4.77	5.55
5.	Ministry of Foreign Affairs	4.73	6.63	7.68	8.87	11.76	12.64
6.	Ministry of Constitutional						
	Affairs	-	-	(15.98)	(19.46)	4.50	4.78
7.	Home Affairs	(10.35)	15.60	(-)	(-)	(15.68)	(17.55)
8.	Office of the Vice President	( )	( )	( )	( )	( )	( )
9.	Ministry of Finance	(28.10)	(25.01)	(32.98)	(20.87)	28.42	26.26
10.	Ministry of Economic Planning	( )	( )				
	and Development	( )	(-)	3.76	3.40	4.80	5.37
11.	Department of Defence	79.29	105.67	111.84	89.74	134.58	141.03
12.	Ministry of Agriculture	39.05	52.28	36.64	67.38	58.00	66.11
13.	Ministry of Livestock						
	Development	-	-	15.11	22.60	24.93	28.65
14.	Ministry of Health	36.89	43.11	53.65	65.70	67.67	69.71
15.	Ministry of Local Government	12.29	16.52	22.56	22.57	27.08	22.67
16.	Ministry of Information and						
	Broadcasting	4.18	4.38	7.62	8.47	9.46	8.81
17.	Ministry of Transport and						
	Communications	33.04	43.63	78.59	95.46	120.59	140.12
18.	Ministry of Labor	4.55	7.01	4.42	4.12	5.54	5.69
19.	Ministry of Tourism & Wildlife	8.72	12.31	4.09	5.74	17.71	18.36
20.	Ministry of Works	53.63	66.16	17.80	19.97	28.83	32.38
21.	Housing	(-)	(-)	(-)	(-)	(-)	(-)
22.	Ministry of Culture	( )	( )	( )	( )		
	and Social Dev.	(11.16)	(11.21)	(13.47)	(10.38)	13.19	18.55
23.	Ministry of Urban Development	-	-	-	8.27**	-	-

Table 7 (Continued)

Vote	Actual Gross Expend. 1977/78	Actual Gross Expend. 1978/79	Actual Gross Expend. 1979/80	Actual Gross Expend. 1980/81	Gross Approved Estimates 1981/82	Gross Estimates 1982/83
	(		Current Prices			)
24. Ministry of Water Development	35.71	37.58	33.52	41.10	45.82	50.02
25. Ministry of Environmental and Natural Resources	7.26	7.66	18.86	25.94	12.17	15.29
26. Ministry Cooperative Development	2.85	2.60	3.75	7.51	7.63	8.16
27. Ministry of Commerce	-	-	3.14	2.21	3.01	2.82
28. Ministry of Industry	7.93	8.91	4.29	7.08	6.30	5.80
29. Ministry of Higher Education	90.46	101.47	45.19	53.93	60.74	67.36
30. Ministry of Basic Education	-	-	80.83	106.22	118.88	126.88
31. Judicial Department	1.45	1.73	1.73	2.78	2.96	3.50
32. Office of the Attorney General	0.93	0.99	3.49	0.94	1.09	1.34
33. Ministry of Energy	-	-	0.66	4.50	5.14	6.31
34. Development Coordination and Cabinet Affairs	-	-	7.16	36.59	3.19	-
35. Ministry of Regional Development, Science and Technology	-	-	-	-	21.93	25.88
36. National Assembly	1.29	1.39	1.37	1.82	2.29	2.17
37. Public Service Commission	0.11	0.13	0.15	0.18	0.24	0.25
38. Office of the Controller and Auditor General	0.51	0.52	0.66	0.81	0.96	1.08
39. Provision for National Service	-	-	-	-	-	-
40. Consolidated Funds	67.82	73.72	87.86	131.66	169.84	285.25
Total Recurrent and Development Expenditures	590.71	699.42	783.56	974.04	1,122.50	1,310.16

Source: The Appropriation Accounts, Other Public Accounts and the Accounts of the Funds 1977/78; 1978/79; 1980/81.
Estimates of Recurrent and Development Expenditures, 1981/82 and 1982/83.

Notes: *Includes Appropriations-in-Aid. Excludes Consolidated Fund.
**Includes Housing.

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Table 8

Gross Recurrent and Development Expenditures, 1977/78 - 1982/83*
(Percentage of the Total Budget)

Vote	Actual Gross Expend. 1977/78	Actual Gross Expend. 1978/79	Actual Gross Expend. 1979/80	Actual Gross Expend. 1980/81	Gross Approved Estimates 1981/82	Gross Estimates 1982/83
	(Current Prices)					
1. Office of the President	6.17	5.50	(7.68)	(7.36)	5.85	5.02
2. Ministry of Lands, Settlement and Physical Planning	1.56	1.52	( ) (-)	( ) (-)	1.39	1.26
3. The State House	0.07	0.10	0.12	0.21	0.13	0.10
4. Directorate of Personnel Management	0.37	0.47	0.44	0.40	0.42	0.42
5. Ministry of Foreign Affairs	0.80	0.94	0.98	0.91	1.04	0.96
6. Ministry of Constitutional Affairs	-	-	(2.03)	(1.99)	0.40	0.36
7. Home Affairs	(1.75)	2.23	(-)	(-)	(1.39)	(1.33)
8. Office of the Vice President	(-)	( )	( )	( )	( )	( )
9. Ministry of Finance	(4.75)	(3.57)	(4.20)	(2.14)	2.53	2.00
10. Ministry of Economic Planning and Development	( ) ( )	( ) (-)	0.47	0.34	0.42	0.40
11. Department of Defence	13.42	15.10	14.27	9.21	11.98	10.76
12. Ministry of Agriculture	6.61	7.47	4.67	6.91	5.16	5.04
13. Ministry of Livestock Development	-	-	1.92	2.32	2.22	2.18
14. Ministry of Health	6.24	6.16	6.84	6.74	6.02	5.32
15. Ministry of Local Government	2.08	2.36	2.87	2.31	2.41	1.73
16. Ministry of Information and Broadcasting	0.70	0.62	0.97	0.86	0.84	0.67
17. Ministry of Transport and Communications	5.59	6.23	10.02	9.80	10.74	10.69
18. Ministry of Labor	0.77	1.00	0.56	0.42	0.49	0.43
19. Ministry of Tourism & Wildlife	1.47	1.76	0.52	0.58	1.57	1.40
20. Ministry of Works	9.07	9.45	2.27	2.05	(2.56)	(2.47)
21. Housing	(-)	(-)	(-)	(-)	(-)	(-)
22. Ministry of Culture and Social Dev.	( ) (1.88)	( ) (1.60)	( ) (1.71)	( ) (1.06)	1.17	1.41
23. Ministry of Urban Development	-	-	-	0.84**	-	-

Table 8 (Continued)

Vote	Actual Gross Expend. 1977/78	Actual Gross Expend. 1978/79	Actual Gross Expend. 1979/80	Actual Gross Expend. 1980/81	Gross Approved Estimates 1981/82	Gross Estimates 1982/83
	(		Current Prices			)
24. Ministry of Water Development	6.04	5.37	4.27	4.21	4.08	3.81
25. Ministry of Environmental and Natural Resources	1.22	1.09	2.40	2.66	1.08	1.16
26. Ministry Cooperative Development	0.48	0.37	0.47	0.77	0.67	0.62
27. Ministry of Commerce	-	-	0.40	0.22	0.26	0.21
28. Ministry of Industry	1.34	1.27	0.54	0.72	0.56	0.44
29. Ministry of Higher Education	(15.31)	(14.50)	5.76	5.53	5.41	5.41
30. Ministry of Basic Education	(-)	(-)	10.31	10.90	10.59	9.68
31. Judicial Department	0.24	0.24	0.22	0.28	0.26	0.26
32. Office of the Attorney General	0.15	0.14	0.44	0.09	0.09	0.10
33. Ministry of Energy	-	-	0.08	0.46	0.45	0.48
34. Development Coordination and Cabinet Affairs	-	-	0.91	3.75	0.28	-
35. Ministry of Regional Development, Science and Technology	-	-	-	-	1.95	1.97
36. National Assembly	0.21	0.19	0.17	0.18	0.20	0.16
37. Public Service Commission	0.01	0.01	0.01	0.01	0.02	0.01
38. Office of the Controller and Auditor General	0.08	0.07	0.08	0.08	0.08	0.08
39. Provision for National Service	-	-	-	-	-	-
40. Consolidated Funds	11.48	10.54	11.21	13.51	15.13	21.77
Total Recurrent and Development Expenditures	99.86	99.87	99.81	99.32	99.84	100.11

Source: The Appropriation Accounts, Other Public Accounts and the Accounts of the Funds 1977/78; 1978/79; 1980/81.
Estimates of Recurrent and Development Expenditures, 1981/82 and 1982/83.

Notes: *Includes Appropriations-in-Aid. Excludes Consolidated Fund
**Includes Housing.

ANNEX D

OFFICE OF THE VICE-PRESIDENT AND MINISTRY OF FINANCE

Telegraphic Address:
FINANCE-NAIROBI
Telephone: 338111
When replying please quote
Ref. No. ....EA/FA 9/03
and date

THE TREASURY
P.O. Box 30007
NAIROBI
KENYA

.....March.31,.., 19..81.

Mrs. Allison B. Herrick,
Director,
USAID/Kenya,
P.O. Box 30261,
NAIROBI.

ACTION COPY
Action taken: #4
No action necessary:
(Initials) 3/31/81 (Date)

Dear Mrs. Herrick,

Grant Agreement No. 615-K-601
1980 Commodity Import Programme.

In accordance with the Grant Agreement for the 1980 Commodity Import Programme, I would like to inform you that the Government of Kenya has taken action to establish an account with Cereals and Sugar Finance Corporation as a repository for Kenya shillings generated under this programme.

I would also like to submit to you formally the list of activities agreed on by the Government and USAID for funding under this programme. The attached list indicates priority projects for which Kenya shillings are currently required. The amounts listed against each project are indicative of the requirements and do not necessarily represent the actual level of funding.

I trust that this meets the conditions precedent to the utilization of the Grant under Section 5.6 of the Grant Agreement.

Yours sincerely,

H.M. MULE
PERMANENT SECRETARY/TREASURY.

LIST OF PRIORITY PROJECTS FOR USE OF REFLOW FUNDS GENERATED BY SALE OF U.S.-FINANCED FERTILIZER IMPORTS

NAME OF PROJECT	ESTIMATED COST KSH.
1. Egerton College: Costs to complete part of the physical construction of the College not covered by - USAID project 615-0169	40,000,000
2. Kiboko Range Research Station: Improvement and expansion of social facilities at the Research Station	4,500,000
3. Rural Development Fund: Supplemental resources to fund District Development Committee initiatives	17,500,000
4. Seed multiplication: Production of seed for crops known to do well in arid and semi-arid lands	1,000,000
5. Private volunteer organisations: Developmental projects in rural areas proposed by such organisations as partnership for productivity, NCCK, Maendeleo ya Wanawake, other women's organisations	8,200,000
6. Micro-irrigation schemes managed by the small scale irrigation section of Ministry of Agriculture aimed at increasing and stabilising the production of food rear market and town centres	12,600,000
7. Programme seeking to increase the effectiveness and efficiency of extension activities through decentralised strategies	9,000,000
8. Soil and water conservation activities	10,000,000
9. National Fodder Bulking and Multiplication Project	22,500,000
	125,300,000

Funds available $14.5 (KSh. 116,000,000)

REPUBLIC OF KENYA

MINISTRY OF FINANCE

Telegraphic Address:
FINANCE-NAIROBI
Telephone: 338111
When replying please quote
Ref. No. EA/FA 9/03
and date

THE TREASURY
P.O. Box 30007
NAIROBI
KENYA

19th April, 1982.

Ms. Allison B. Herrick,
Director,
U.S.A.I.D.,
NAIROBI.

USAID DISTR(4-21-82)JK
ACTION:AGR -W/atch.
(DUE:4-29)
INFO:O/DIR;PROG;PRJ;RFMC;CHRON;RF.

Dear Allison,

KENYA SHILLING GENERATIONS FROM PL 480 TITLE I (1981) AND CIP FERTILIZER SALES (1980)

Thank you for your letter of 15th January, 1982 regarding the Generation and Plans for Utilization of Kenya Shilling from PL 480 Title I (1981) and CIP Fertilizer Sales (1980). Based on your discussions with Mr. Roy of the Treasury, I confirm the following:

PL 480 Title I (1981)

We will, as agreed with you, utilize the funds to support our Agricultural Credit Scheme during 1981/82 and 1982/83. The Self-Help Measures Report due as per the PL 480 Title I Agreement has been despatched to you by Mr. Mayaka on 8th April, 1982.

CIP Fertilizer 1980

As per our agreement of 30th September, 1980, these funds are to be placed in a Special Account to support programs agreed between us. The current position is shown in the attached Schedule from which you will notice that we expect a realization of approximately KShs. 110.6m. of which KShs. 83m. have already been received in the Special Account.

We intend to utilize the entire amount and to support the following programmes in 1981/82 which are already included in the budget and are being funded.

..../2

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MINISTRY OF FINANCE

Telegraphic Address: FINANCE-NAIROBI
Telephone: 338111
When replying please quote
Ref. No. ....
and date

THE TREASURY
P.O. Box 30007
NAIROBI
KENYA

..........................., 19.....

Program	Government of Kenya Contribution
	KShs.
1. Vote 14-Sub-vote 141-Head 465 Rural Roads	63
2. Vote 10-Sub-vote 104-Heads 241 and 244 Agriculture Extension	17
3. Vote 10-Sub-vote 104-Head 243 Soil Conservation	3
4. Vote 10-Sub-vote 105 Rural Development Fund	29
5. Vote 10-Sub-vote 108 Agriculture Research	6
Total	118

I believe the above is in conformity with our recent discussions and understanding in which case, it will be appreciated if you would confirm your agreement to the transfer of the present and future funds from the Special Account for application as above.

Yours sincerely,

(H. M. Mule)
PERMANENT SECRETARY

ANNEX E

TECHNICAL ASSISTANCE

A. Introduction:

The process of structural adjustement of a nation's economy is complex and fraught with uncertainty. The variables are many, the controls limited and the opportunities for economically and politically painful mistakes are manifold. It is small wonder that most nations--developed or developing--undertake major changes in the way they carry out production and commerce hesitantly and cautiously. Such is the case in Kenya. Since the promulgation of the 1979-83 Development Plan, and even since the signing of the Structural Adjustment Loan with the World Bank in 1981, the issuance of Sessional Paper No. 4 of 1982, and the Report and Recommendations of the Working Party on Government Expenditures in 1982, progress on implementing structural adjustment has been slow.

An important element of the problem is the need for expanded and improved staff work in the operating and financing ministries. In Agriculture and in Livestock, with the advisory work of the multi-donor financed Technical Assistance Pool (TAP), significant progress is being made. More needs to be done however, in the way of personnel development, special studies, improved data collection and analysis, and improved integration of decision-making and budgeting, both in these ministries and in those of Finance and Planning, to chart the impact of proposed alternative reforms and to continue to develop improved management.

Technical assistance in the form of advisors and consultants and the financing for special studies and evaluations is provided in this program assistance activity to spur the Kenyan Government to speedier and more appropriately targeted structural adjustment implementation through improved analysis of options and their likely economic impact on structural reform. From this FY 1983 program $2 million will be made available to finance these activities. In FY 1984 an additional $4 million will be required.

B. The Technical Assistance Pool:

(Note: the following draws from the Dec. 1982 consultant's report on the TAP prepared for the USAID by Wayne Schutjer of Pennyslvania State University.)

The TAP was established in 1981 with three objectives:

1. Build a Kenyan institutional capability, through training and the design of management systems, for the planning and management systems, for the planning and management of agricultural development;

2. Advise on substantive management and policy matters essential to the formulation and implementation of a coherent strategy for agricultural development during the institution-building period; and

3. Strengthen the capacities for the identification, analysis and implementation of projects and programs which translate strategy into practical development.

The TAP which is presently scheduled to run through June, 1986 is staffed by approximately 12 expatriate advisors contracted from the Harvard Institute for International Development (HIID) by the Government of Kenya with funding provided by a consortium of donors. They have been working to: (1) formulate development strategies for both crops and livestock, (2) conduct commodity analyses and price policy formulation, (3) identify, prepare and appraise development projects, (4) evaluate and monitor crop and livestock programs, and (5) help improve the management, budget and financial systems of the two ministries.

In addition to the analytical contributions, the advisors have been responsible for improving the policy analysis capacity of the relevant ministries through collaborative analysis and training activities.

The advisors in the TAP have been working to prepare realistic forward budgets and using micro-computers to develop a system of fast and accurate monthly expenditure data. In order for this to be uniformly applied a Budget and Finance Manual is being prepared and training programs down to the district level organized. A Management Calendar designed to identify key management and finance dates and evolve a recognized system matched to the Ministries of Finance and Planning regulations and procedures is being prepared. The advisors have also been engaged in preliminary work to establish a Project Registry using a micro-computer with standardized data requirements covering development and recurrent inputs and outputs and indicators of progress or problems. It is expected that general criteria will be issued to all ministries on factors to consider in ranking projects (percent-donor financed, recurrent funding requirements, economic or social returns, etc.). The ranking should be followed by the setting of individual priorities by ministries. Since a large number of projects are under the control of parastatals or other agencies these must be included in the analysis. In addition, the TAP has been active in developing a more flexible and responsive price control system and has just completed an important study of the role of the public grain marketing board.

As presently envisioned the TAP will provide a total of 60 person-years of technical assistance through mid- 1986 and 50 person-years of training. The present configuration of the staff is provided in Attachment 1 to this Annex.

A major purpose of the funding to be provided to the TAP under the Structural Adjustment Grant will be to expand activities more intimately related to the structural adjustment process. While the TAP has increasingly been used to deal with structural adjustment topics, it is clear that more of the skills of the advisors should be utilized in the analysis of such issues as individual commodity price controls, reducing the Govenment's role in the marketing and distribution of agricultural production and studying the processes by which the Government would divest itself of at least some of the agricultural parastatals. To date TAP has contributed to the study of grain marketing required by the World Bank to satisfy a major condition precedent to disbursement of the second tranche of the SAL. Additional funding is required to ensure continuity in such involvement.

The TAP advisors in management and fiscal policy have played a key role in the development of a management system that will create greater congruence between sectoral development strategy and project activities in the Livestock and Agriculture Ministries. This sytem is permitting the ministries to take more complete control of the approval and monitoring the projects and is leading to improvements in the approach to forward budgeting. The effort is to develope a system whereby a central authority within each of the agricultural ministries will be assigned specific responsibilities for guiding, coordinating and monitoring the identification, appraisal, approval, implementation and evaluation of all projects within the relevant ministry and related parastatals. This is a necessary first step toward government-wide setting of priorities for all projects and elimination of projects with the lowest priorities in order to reduce the development project portfolio to a more manageable size.

In working in the policy area, the advisors in the TAP are faced with a number of constraints which hamper effectiveness. First, the analytical basis necessary for both short term and longer term policy is thin. For example, analyses of markets for major commodities and production inputs are generally lacking. Farm management analysis that will permit research-based judgments on the supply response of individual crops to relative prices changes is not available. Studies that would permit examination of the welfare and employment implications of alternative policy actions are likewise not available. Because of the limited analytical base, much of the policy analysis is limited to general discussion of the issues involved in a decision with resultant recommendations for action based upon economic judgments supported by only limited analysis.

Second, the data required to improve and expand policy analysis and the longer term background are weak and inaccurate. Data, such as that related to farm management, are simply not available. Other data, while available, lack the consistency necessary to make them credible.

Third, the TAP advisors have been dominated by the need to deal with short term policy issues at the expense of longer term policy analysis.

The policy environment has changed considerably, however, since the TAP was first established. There is manifestly more appreciation among senior Kenyan policy makers of the need for serious and intensive analytical work to underpin the decisions that the World Bank, the IMF and the bilateral donors are requiring be made in order to assure continued assistance flows. Even in absence of pressure from the donors Kenyans at all levels of government have indicated the need to undertake reforms to get the economy moving again. The political, economic and fiscal crises of the past many months has frightened many who were complacent before.

The required funding for the remaining TAP lifetime is estimated in Table 1:

Table 1: Technical Assistance Pool Donor Funds and Expenditures (FY 1983/85)
(thousands of U.S. $)

Donor:	FY 1983	FY 1984	FY 1985	Total	
IBRD	295	-	-	295	
UNDP	200	200	200	600	
CIDA	324	99	99	522	
SIDA	400	400	400	1,200	(tentative)
USAID	900	1,100	-	2,000	(tentative)
Total	2,119	1,799	699	4,617	
TAP Expenditures	1,860	1,510	1,150	4,520	

Of the $1.5 million originally expected from AID, the proposed Structural Assistance Grant will provide $900,000 from FY 1983 funds. The remainder of $600,000 will be provided from the FY 1984 program assistance activity. Further, it is anticipated that an additional $500,000 will be provided from FY 1984 funds (a total of $1.1 million) for additional support of the TAP advisory assistance, training and limited local costs to bolster its capabilities to deal with longer term policy issues directly related to structural reform.

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C. <u>Support to the Ministry of Finance for Analysis and Budgeting of Donor-Financed Projects:</u>

AID as well as other bilateral and multilateral donors have become concerned the number of donor-supported projects in Kenya is too large. It is apparent that the GOK finds it difficult to provide the human and financial resources necessary adequately to support these projects. In agreeing to this program the Kenyans will commit themselves to take the first steps necessary to establish priorities and to rank projects against these priorities in order to more effectively allocate resources against those higher priorities and suspend or terminate the flow of resources going to those projects lower on the list. It is being proposed by the donors that the Kenya Government agree to designate, presumably within the Ministry of Finance, an "aid management unit" (or sub-unit) with the responsibility for analysis and budgeting of donor programs. The unit would have the additional responsibility of insuring that no donor-financed project would escape full scrutiny by the Ministry of Finance in terms of the need for financing within the budget, both in any current Financial Year and in future budget projections. The unit would ensure that sufficient financing is and will be available, or that the project is reduced in scope or terminated. This unit, working in close association with the planning and budgeting staff of the operational ministries would recommend those projects for high priority funding as well as those to be curtailed.

1. Specifically, the unit would be responsible for budget coordination insuring that all external aid as agreed with the donors is accurately reflected in forward and current budgets. (This will require access to all agreements signed as well as be aware of matters under discussion with the donors). The unit would liaise with the Budgetary Supply Officers, the Estimates Working Groups and Budgetary Procedures Group and would have access to all agreements signed and all pending negotiations with donors.

2. In cases where program assistance is conditioned upon imports from the donor country the unit would be responsible for liaison with the Central Bank, Ministry of Commerce and the donor (as well as the operating Ministry where necessary). It will concur on items to be imported, identify potential importers in Kenya and monitor the operation until such time as the counterpart funds from the importers are received by the Central Bank.

3. When the program assistance is in the form of agricultural inputs food aid, the function would be:

(i) to prepare an annual commodity aid plan as part of a total national plan. This would require liaison on the one hand, with the external aid desk officers to establish aid availability, and, on the other hand,

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with the Ministry of Agriculture to establish the national requirements. This would require the unit to be represented in the consultative meetings with the donors as well as in the interministerial importation committees;

(ii) to plan the arrivals of the commodities in Mombasa and monitor the handling operations and distribution arrangements until such time as the local funds are deposited in the Treasury and used for the purposes agreed to by the Treasury; also to assist in negotiating the use of the counterpart funds and be responsible for providing regular reports on the use of these funds to the Government and to the donors.

4. Regarding project assistance, the function would be:

(i) to liaise with the Ministry of Planning and Economic Development, which is responsible for monitoring the progress of all development projects, to set up a regular reporting system on the progress and problems of the externally aided projects. This is necessary in order to comply with any reporting arrangements that are agreed with the donors and also to advise the Ministry of Finance when it is considered desirable to seek any amendments to existing agreements in the light of changed circumstances.

(ii) to ensure that all reimbursement claims are made to the donors at the earliest possible time and follow up systematically until all reimbursement are received in the Treasury.

(iii) to produce monthly reports showing the status of the reimbursement and projections for the subsequent months of the fiscal year. The present Reimbursement Section of the External Aid Department will form part of this unit, and be strenghthened as necessary.

(iv) to the extent that the GOK budgets assistance as "Appropriations-in-Aid" in the form of goods and services for direct use by the recipients, to plan, monitor and control this operation. This is particularly necessary in view of the progressively greater use of direct payments to local contractors by the donors which by-pass serious Treasury scrutiny and the Government accounting system. The unit would keep track of all external Appropriations-in-Aid, monitor the performance of the ministries in this respect, and provide monthly reports for budget management.

(v) to follow up on any donor requirement such as audit requirements for receipt and use of funds, cases for exemption from duties and taxes which often cause considerable delays, and such other matters as appropriate.

(vi) to monitor the budget process in all development ministries to ensure that projected donor flows and required GOK counterpart contributions are accurately and fully represented in the annual and forward budgets.

Donors to Kenya envisage the need for several expatriate experts, economist, accounting/financial experts with systems experience and a person with strong computer experience. A donor group would participate with Kenyan professionals in setting up a system and procedures and help to get the work of the unit underway. Kenyans should replace the expatriates as soon as there were qualified and experienced officers to do so.

AID financing will be made available from the FY 1983 grant to fund two person-years of services. In FY 1984 an additional $300,000 would be committed to this activity. As the actual mix of skills and the numbers of advisors to be provided by the individual donors are still to be negotiated among the donors and between the donors as a group and the Kenyan Government, it is not possible to be specific about the particular requirements for the US-funded personnel at this time. It is anticipated that the technical services would be recruited under terms of a host country contract similar in its terms to that with HIID.

D. Studies:

The Structural Adjustment Program Grant will provide $650,000 in FY 1983 to fund a number of studies or consultancies required by the Kenya Govenment to lay the groundwork for further implementation of structural adjustment programs. In FY 1984 an additional $2.4 million will be programmed for studies and consultancies which require skills beyond the staff capacity of the TAP or the donor aid unit in the Ministry of Finance. The majority of these studies/consultancies will be contracted for directly by USAID operating as the agent of the Government of Kenya.

The studies component of the program is intended as a flexible response mechanism which will provide to the GOK analyses of options and recommendations for action in a number of fields related to structural adjustment. Finding ways of reducing the Government's active participation in the economy would provide the central theme for these studies. Individual parastatals would be analyzed to provide the basis for GOK disinvestment and sale to the private sector. Additional consultancies would be made available to each of the newly-divested companies in order to help it improve management efficiency, research markets, and finding alternative resources of input supply.

An important early study to be funded would develop terms of reference for the establishment of a Monopolies and Price Commission responsible for recommending reductions in items under price controls.

A consultancy of particular urgency would be for an information specialist to review the present import monitoring system and to recommend a series of changed procedures necessary to establish an information system which provides import data to the GOK (Ministries of Commerce, Planning, Finance and the Central Bank) considerably faster and with greater accuracy than in the past. The urgency is created not only by the unfortunate experience of February-July 1982 (when the GOK did not have available the data on actual import increases in relation to foreign exchange availability until it was too late to correct the situation) but also by the soon-to-be announced mid-June 1983 changes in the import schedule which will require much closer monitoring and supervision.

Another group of studies would focus on reducing the imported content of local production, comparative advantage, and/or raising the level of exports through market surveys and feasibility studies. Some technical assistance would be provided to increase the effectiveness of Kenya's own export advisory and export promotion services.

Funds from this component will also be used to finance feasibility studies of major foreign exchange savings or foreign exchange-earning agribusiness investment opportunities that could be financed by local currency generations from the 1984 and 1985 programs.

E. Microcomputers

Funds totalling $150,000 are provided in FY 1983 for the purchase of microcomputers, related equipment, software, training and consultant's services for use by the TAP and the Ministry of Finance to speed the processing and analysis of data. The work of the TAP has already involved the limited use of microcomputers with very good results. The grain marketing study now underway has utilized this technology as have several exercises dealing with budgetary compliance with the IMF and studies related to liberalizing imports. A plan for increased utilization of microcomputers in data analysis and budgeting is being finalized and the Government has decided to increase the utilization of this relatively inexpensive technology in many aspects of the structural adjustment process. Training of Kenyan professional staff and the services of consultants will be provided to help adapt existing software to Kenyan requirements or to develop new programs. In the FY 1984 program grant $100,000 will be made available for the purchase of additional microcomputer hardware and software and $50,000 will be available for training and short-term consultancies to help establish the most efficient utilization of these microcomputers.

F. Evaluation

Fifty thousand dollars will be made available from the FY 1983 program grant for the first evaluation. It will assess Government performance in satisfying the conditions and covenants included in the FY 1983 Structural Adjustment Grant and performance in meeting the World Bank and IMF targets. The evaluation will be performed in November. Following reviews of progress, the IMF will be establishing the conditions to be associated with the next Stand-By (assuming the Kenya Government remains in compliance with the requirements of the present Stand-By) and the World Bank will have measured progress in satisfying the conditions for release of the second tranche of the SAL. A consultative Group meeting is planned for October. The evaluation will focus specifically on progress in meeting the fiscal policy targets of the IMF Stand-by and in the following categories relating to the SAL:

1. Rationalizing the Tariff System
2. Preparation of a public investment program
3. Promulgation and administration of investment incentives
4. Implementation activities of the National Council on Population and Development
5. Establishment of an external borrowing plan
6. Decisions on and implementation of agriculture pricing policies
7. Completion of studies and decisions on the grain marketing study
8. Land issues.

In addition, the evaluation will evaluate progress in other areas identified in the U.S. Structural Assistance Grant. These are:

(a) deregulation of imports of agricultural inputs;

(b) movement to establish a priority listing of donor-assisted projects in the context of an overall GOK investment plan.

(c) establishment of a Monopolies and Prices Commission that will recommend reduction in price controls;

(d) reduction of government participation in public enterprises;

(e) continuing adjustment of the exchange rate.

The evaluation will also look at the performance of the personnel in the TAP and in Finance and at progress made in establishing improved procedures for dealing with donor flows including utilization of microcomputers and other data analysis and processing techniques. The findings of the evaluation team will form the basis for development of the 1984 program grant including the conditions precedent and the covenants to be incluaed in the grant.

The evaluation will be undertaken by a team of approximately three PSC or IQC contractors with participation from AID/Washington and the Mission, and will require about four weeks of in-country reseach and report writing.

An additional $50,000 will be provided in FY 1984 to fund an evaluation of GOK performance in meeting the targets established in the 1984 agreement.

G. Budget

	1983	1984
TAP Support	900	1,100
Ministry of Finance	250	300
Studies	650	2,400
Computers	150	150
Evaluation	50	50
Totals	2,000	4,000

Attachment 1

Technical Assistance Pool Staff

1. Ministry of Agriculture

a) Agricultural Strategy Advisor (Economist). He/She is required to:

- assess, analyze, develop and monitor longer-term policies and strategies for the agriculture sector focusing attention on longer-term problems and issues

- assess established priorities and advise on their revision to reflect new information, and developments

- establish operational procedures for the appraisal and evaluation of development projects by the staff of the Ministry

- liaise with the Research Division of the Ministry and other bodies concerned with agricultural research to ensure that such research reflect national priorities

- help establish a system linking planning activities and priorities with the budgetary procedures of the Ministry to ensure that these priorities are reflected in the Ministry's budgetary expenditure allocations.

b) Management Specialist. He/She is required to:

- analyze and develop improved and more effective budget and finance system

- analyze and develop management information system that improve decision making and implementation

- analyze the management of support services in the Ministry and make recommendations to improve their effectiveness and efficiency

- analyze management aspects in the Ministry's supervision of parastatals and make recommendations for their improvement

- review the management capacity of projects developed by the ministry in coordination with the Head of the Project Preparation Division

- undertake management improvement analysis for programmes and field projects.

c) <u>Crops Economist</u>. He/She is required to:

- liaise with the parastatal boards and authorities responsible for the production and marketing of food crops to ensure that their plans and activities are consistent with the plans of the Ministry of Agriculture, and that the Ministry is kept fully appraised of their operations

- assist with the preparation and review of national food policies

- develop a consistent analytical frame work for determining input, producer and retail prices for food crops

- develop and advise on production and pricing policies in the food crop sector.

- assist with the Annual Producer Price Review

d) <u>Export Commodity Production and Trade Economist</u>. He or She is required to:

- liaise with the parastatal bodies and authorities responsible for the production and marketing of and trade in agricultural export commodities to ensure . at their plans and activities are consistent with the plans of the Ministry of Agriculture and to ensure also that the Ministry is kept fully appraised of their activities

- develop, and advise on, production, pricing and fiscal policies towards the export crop sector

- monitor trends in the production and export by other countries of commodities exported by Kenya

- monitor developments and new initiatives in international and commodity trade negotiations of interest to Kenya; develop export strategies for the main export crops.

e) <u>Food Crop and Export Commodity Specialist.</u> He/She is required to:

- identify crop production, processing and marketing projects which have a high pay-off in terms of reaching national objectives

- assist with developing proposals in cooperation with other government departments and parastatals

- carry out economic appraisals of these projects

- assist with the establishment and maintenance of links with donors and financial institutions and work with them in the development and appraisal of project proposals.

f) Financial Management Specialist. He/She is required to:

- establish improved systems for issuing and accounting for Authority to Incur Expenditures, expenditure accounting and district level budgets and financial systems

- assist in establishing a system for submission of claims to Finance on donor funded projects

- develop ways to deal with the diverse donor systems for donor rules and ensure donor projects are included in development and warrants budgets

- develop more effective ways for better utilization of MOA/MOLO staff, land and plant

- implement micro computer applications to improve management and finance systems. Provide computer support for all aspects of the TAP program.

2. Ministry of Livestock Development

a) Livestock Policy Economist. He/She is required to:

- undertake analysis of meat production and pricing policies in the livestock sector

- analyze the processing of livestock products and develop policies to promote or improve them

- liaise with the Kenya Meat Commission, the KCC and other parastatals concerned with the livestock industry to ensure that their plans and activities are consistent with the plans of the Ministry of Livestock Development and that the Ministry is kept appraised of their operations

- work with the Livestock Development Branch of the Ministry of Livestock Development to ensure that policies towards parastatals are consistent with those developed for production in high potential areas

- assist with the Annual Producer Price Review for Livestock products

b) <u>Livestock Projects Economist</u>. He/She is required to:

- identify livestock production, processing and marketing projects which have a high pay-off in terms of reaching national objectives

- assist with developing livestock project proposals in cooperation with other government departments and parastatals

- carry out economic appraisal of these projects

- help establish and maintain links with donors and work with them in the development and appraisal of livestock project proposals.

c) <u>Livestock Strategy Economist</u>. He/She is required to:

- assist in the assessment and monitoring of longer-term policies and strategies for the livestock sector focusing particular attention on longer-term problems and issues

- assess established priorities and advise on their revision to reflect new information and developments

- establish operational procedures for the appraisal and evaluation of development projects by the staff of the Ministry

- liaise with the Research Division of the Ministry and other bodies concerned with livestock research to ensure such research reflects national priorities

- help establish a system linking planning activities and priorities with the budgetary procedures of the Ministry to ensure that these priorities are reflected in the Ministry's budgetary expenditure allocations

d) Management Specialist. He/She is required to:

- analyze and develop more effective budget and finance systems

- analyze and develop management information systems that improve decision and implementation

- analyze the management of support services in the Ministry and make recommendations to improve their effectiveness and efficiency

- analyze management aspects in the Ministry's supervision of parastatals and make recommendations for their improvement

- review the management capacity of projects developed by the Ministry in coordination with the Head of the Project Preparation Section

undertake management improvement analysis for programmes and field projects.

3. Ministry of Economic Planning and Development

a) Agriculture Planning Economist. He/She is required to:

- advise and assist in the formulation of policies and strategies for the development of the agricultural sector

- liaise closely with the Ministries of Agriculture, Livestock Development, Natural Resources, and Cooperative Development, the Treasury and the Office of the President, and assist in the planning and formulation of the budget as it relates to agricultural activities

- work closely with the members of the Natural Resources Section and render assistance to any member of that Section, particularly in relation to agricultural development

- advise on the allocation of planning functions and the improvement of the planning structure, as it relates to agricultural and allied development.

ANNEX F

FACESHEET

THE 1980-81 FERTILIZER C.I.P. REVIEW:

ANNEX F

THE 1980-1981 FERTILIZER C.I.P. REVIEW

I. PROGRAM OBJECTIVES

In 1980 the United States initiated an annual Commodity Import Program (C.I.P.) to provide fertilizer to Kenya. A total of $20 million was allocated to the program in FY 1980 and 1981. An additional $4.4 million was obligated in FY 1982 but the fertilizer to be financed by that amount has not yet been imported. The purpose of the 1980-1981 $20 million C.I.P. was to " help mitigate Kenya's current balance of payments problem" (Authorization Memorandum for the Administrator signed September 26, 1980) and to supply fertilizer because "Kenya faces a considerable shortfall in donor supplied fertilizers" (PAAD page 20). In addition, funds generated would provide budget support. These objectives were achieved, albeit somewhat belatedly in the case of budget support. Achievement of a fourth, unstated, objective, that of increasing agricultural production is indicated by the available evidence. This review will first discuss the three stated program objectives: balance of payments support, fertilizer supply and budget support. It will then analyze the agricultural production impact of the program, recognizing that policy, credit, markets and the existence of a multitude of micro climates make it difficult to isolate the effects of single production factors.

A. Balance of Payments:

The Program Assistance Approval Document 615-0200, approved in September 1980, projected a deteriorating balance of payments for Kenya, suggesting that the overall balance of payments deficit would reach its peak in 1981 and decline thereafter. This pattern has subsequently been verified. (See Table 2 in main text above). The PAAD reported the official projection of the overall balance of payments deficit for 1981 ($222 million), but noted that "current Mission analysis indicates that estimates presently available from Government may in fact be overly optimistic given the oil price increases announced in July, and given the likely continued fall in the unit price of coffee exports, together with a possible drop in the quantity of coffee available for export of up to one-third". (PAAD p.19.) In the event, the overall balance of payments deficit for 1981 amounted to some $232 million.

The original PAAD submission requested authorizations of a $20 million commodity import program grant, equivalent to 9.0 percent of Kenya's overall projected 1981 balance of payments gap. A 1980 authorization of $14.5 million and a June 1981 amendment of $5.5 million provided the required assistance on a timely basis.

.A total of $19.68 million dollars disbursed during CY 1981 covered 8.5 percent of Kenya's overall balance of payments gap for the year. In addition to providing the intended level of direct balance of payments support in CY 1981, the CIP program assured the timely importation of key manufactured fertilizers in a period of food shortages, thus indirectly contributing to further improvements in the current account balances in CY 1981 and CY 1982 by contributing to increased food output and reduced food imports. The 1980-1981 CIP clearly met its first objective of mitigating the balance of payments problem.

B. <u>Fertilizer Supplies</u>:

The second objective, that of supplying fertilizer, was also clearly met. The first shipment (for which funds had been obligated in September 1980) arrived in Kenya in November 1980 and were 60-70 percent sold between February and April of 1981 for use during the long rains of that year. Fertilizer financed by FY 1981 funds arrived from September through November of 1981 for sale and use during the long rains of 1982. Although not all U.S.-financed fertilizer was sold quickly (inappropriate pricing of 10,000 tons of TSP delayed sale of this commodity until the price was adjusted in 1983), the vast majority of U.S.-financed fertilizer was expeditiously imported, distributed, sold, and used by farmers.

The impact of U.S.-financed fertilizer on overall fertilizer availability and use is more difficult to gauge because Kenya import statistics are kept on a calander year basis. This system presents a somewhat distorted picture because reported imports have no predictable relationship to cropping seasons or fertilizer use. Published data for 1977-81 are presented in Table F.1 below.

Table F.1.

IMPORTS OF MANUFACTURED FERTILIZER 1977/1981

COMMODITY	Import Volume ('000 tons)					Averag 1977-8
	1977	1978	1979	1980	1981	
Sulphate of Ammonia	15.0	21.7	9.4	7.6	2.7	
Ammonium Sulphate Nitrate	32.2	17.5	2.0	16.7	25.9	
Urea	-	0.5	-	6.9	4.8	
Calcium Ammonium Nitrate	17.7	15.5	13.3	29.1	27.6	
Ammonium Nitrate	-	1.0	2.2	1.0	2.0	
Other Nitrogenous Fertilizer (NPK)	23.2	22.0	11.5	29.7	36.7	
Sub-total Nitrogenous	88.2	78.2	38.4	91.0	99.7	79.1
Single Superphosphates	10.2	10.4	2.0	14.9	9.1	
Double and triple Superphosphates	22.8	9.1	1.0	3.1	22.1	
Other Phosphatic Fertilizers	0.5	0.1	8.5	7.6	5.0	
Sub-total Phosphatic	33.5	19.6	11.5	25.6	36.2	25.3
Potassium Chloride	0.8	1.5	-	.3	1.4	
Potassium Sulphate	0.7	9.3	-	-	3.5	
Other Potassic Fertilizers	5.9	-	0.1	.6	2.2	
Sub-total Potassic	7.3	10.8	0.1	.9	7.1	5.2
Ammonium Phosphates	15.3	11.0	-	9.0	41.2	
Other Fertilizers	11.7	35.6	10.8	3.2	22.7	
Sub-total Other	26.9	46.6	10.8	12.2	63.9	32.0
Total	155.9	155.2	60.8	129.7	206.7	141.66
Total Value K.Sh Million	189	200	107	317	482	259
Total Value U.S.$ Million*	26.25	27.77	14.86	44.7	66.94	35/97

NOTE: Some totals do not agree because of rounding errors.
SOURCE: Customs and Excise Departments.
* 7.2 KSh = $1.00

No national level data on sales by crop season or year are kept but it is possible to estimate from non published sources. Estimated fertilizer use July-June Crop Years is as follows:

1977/78	150,000 MT
1978/79	160,000 MT
1979/80	140,000 MT
1980/81	142,000 MT
1981/82	170,000 MT
1982/83	180,000 MT

In the last two crop years it is clear that USAID's 62,000 MT of fertilizer was important in keeping supplies at or above historical levels.

C. Budget Support:

As with most commodity import programs, the budget support intended to result from the sale of the commodities imported under the 1980-1981 fertilizer C.I.P. occurred substantially later than the actual disbursement of foreign exchange by the United States. What is more, the sale of the imported fertilizer to farmers on credit through the Agricultural Finance Corporation (AFC) has resulted in even later than anticipated local currency generations. The result is that although the initial funds were obligated in September, 1980, the real budget impact did not occur until the Kenya Fiscal Year 1982/83. Thus although budget support has resulted from the program, there has been a very substantial lag between foreign exchange disbursement and effective budget support. A more detailed discussion of local currency use under the program is included in Section II.E. below.

II. AGRICULTURAL PRODUCTION OVERVIEW

A. Crop Production

A strong recovery in the agriculture sector was seen in 1981 (sector growth was 6.2 percent) and 1982 (estimated growth of 6 percent) following a relatively poor performance in the two previous years. The main factors supporting the increased production were improved weather, increased producer prices and improved input supplies. Table F.2 provides details of agriculture input and output in current and constant prices as well as price and quantity index numbers.

Although accurate data from this series are not available for 1982, it is fairly certain that price relationships between outputs and inputs will show improvement. Up to 1981 input prices were rising much faster than output prices. In 1982/83 input price rises should moderate somewhat (fertilizer for instance should be only 5 percent above 1982) while the official marketing agency prices of domestic crops (Table F.9) particularly maize, wheat and rice were up between 17 and 53 percent in 1982 and a further 4-25 percent in 1983.

Table F.2.

AGRICULTURAL OUTPUT AND RECORDED INPUT, 1977-1981
(Calendar Years)
(K£ million)

	1977	1978	1979	1980	1981
AT CURRENT PRICES--					
Total Output	755.32	732.93	747.58	791.19	917.48
Less Inputs	87.31	101.21	98.80	103.05	125.74
Value Added	668.01	631.73	648.78	688.13	791.74
AT CONSTANT (1976) PRICES--					
Total Output	591.68	614.99	607.55	594.27	629.12
Less Inputs	78.09	81.68	78.50	72.25	74.23
Value Added	513.60	533.31	529.05	522.03	554.89
Quantum Indices (1976=100)					
Output	111.0	115.4	114.0	111.5	118.1
Input	117.1	122.5	117.7	108.3	111.3
Price Indices (1976=100)					
Output	127.7	119.2	123.1	133.1	145.8
Input	111.8	123.9	125.9	142.6	159.4

Source: Economic Survey 1982

Marketed production also made a strong recovery. Table F.3 presents data on sales of major crops to Marketing Boards.

Table F.3.

SALES TO MARKETING BOARDS OF MAJOR CROPS, 1977-1981
(Calendar Year Metric Tons)

CROP	YEAR				
	1977	1978	1979	1980	1981
Maize	423,964	236,268	241,717	217,887	472,909
Wheat	169,880	65,941	200,968	215,674	214,437
Rice Paddy	41,415	35,816	37,466	36,408	41,153
Sugar-Cane	1,888,140	2,349,206	3,147,580	3,987,428	3,821,980
Pyrethrum(Extract Equivalent)	131.1	114.0	113.7	162.2	232.8
Cotton	16,257	27,190	27,597	38,129	25,484
Coffee	97,066	84,328	75,082	91,334	90,746
Tea	86,291	93,373	99,275	89,893	90,941
Sisal	33,196	31,456	36,457	46,910	41,326

Source: Economic Survey 1982

The recovery has continued into 1982/83 and the figures in Table F.3 which are based on calendar years mask the upsurge in production in crop year 1982. For example, maize production in the crop year June, 1981 to July, 1982 jumped from 1.7 to 2.3 million MT and marketing to the National Cereals and Produce Board from about 200,000MT to 690,000MT. The improvement in maize and wheat production is evident from Table F.4 below under Cereals 1981-1982.

Table F.4.

KENYA: QUANTITIES INDICES FOR MARKETED CROPS 1978-1982
(Calendar Year)

1976=100

YEAR	TOTAL CROPS	CEREALS	TEMPORARY INDUSTRIAL CROPS	PERMANENT CROPS
1978	103.5	61.6	125.7	114.6
1979	104.1	68.9	153.2	108.8
1980	115.3	68.9	192.2	121.1
1981	119.2	92.2	191.4	119.8
1982	124.0	115.5	190.0	120.0

Source: Economic Survey 1982. USAID estimates for 1982

Table F.5 presents production estimates for the main cereal crops of maize, wheat and rice by crop year (i.e. 1981 = June 1981 to July 1982).

Table F.5.

ESTIMATED CROP PRODUCTION BY CROP YEAR
(million MT)

	1978	1979	1980	1981	1982	1983
MAIZE	2.000	1.400	1.700	2.300	2.500	2.500
WHEAT	.165	.130	.140	.225	.220	2.25
RICE	.022	.025	.025	.026	.027	.028

Source: Economic Survey 1982. Mission estimates for 1983

The improvement in production and marketed output can be explained by better weather, more credit and improved input supplies, but as Tables F.6 and F.7 indicate there was a substantial increase in price incentives for cereals particularly for 1982. This has been followed by further increases in 1983.

Table F.6.

KENYA: PRICE INDICES FOR MARKETED CROPS 1978-1982
(Calendar Years)

1979=100

YEAR	TOTAL CROPS	CEREALS	TEMPORARY INDUSTRIAL CROPS	PERMANENT CROPS
1978	123.2	113.3	134.8	123.5
1979	120.5	112.6	141.8	118.7
1980	124.5	130.5	147.4	119.4
1981	124.8	134.4	161.2	115.5
1982	131.7	174.6	177.5	116.2

Source: Economic Survey 1982. USAID estimates for 1982

Table F.7 presents the government producer prices from 1978 to 1983.

Table F.7.

CROP PRICE PER KG.KSH
(Crop Years)

	1978	1979	1980	1981	1982	1983
MAIZE	.75	.65	.90	.95	1.30	1.58
WHEAT	1.25	1.35	1.50	1.60	1.90	2.20
RICE	1.60	1.60	1.70	1.70	2.70	3.10

The large increase in prices for maize and wheat gave rise to the strong response in production in 1982. The price increases in 1982/83 will also serve to maintain incentives. Rice production is constrained by the slow growth expected in irrigated area.

B. Kenya Crop Prices and World Market Prices

Three basic price systems operate in Kenya. For the export crops the world markets determine prices. For domestic crops traded in local markets (75 percent of maize for example) prices are determined by supply and demand. For the additional 25 percent the GOK sets prices that the marketing agencies will pay. Table F.8 below presents average prices paid to farmers. For sugar-cane, cotton, maize, wheat, rice and milk these are the marketing agency prices.

Table F.8.

AVERAGE GROSS COMMODITY PRICES TO FARMERS, 1977-1982
(Calendar Years)

KSh. per stated Unit

	Unit	1978	1979	1980	1981	1982
Coffee	100kg.	2,818	2,815	2,634	2,258	2,309
Tea	"	1,583	1,357	1,591	1,774	1,786
Sisal	"	272	361	414	412	320
Sugar-Cane	tonne	133	133	133	145	170
Pyrethrum (Extract Equivalent)	kg.	720	1,006	1,200	1,200	N.A.
Seed Cotton	100kg.	315	328	331	341	380
Maize	"	89	77	95	100	135
Wheat	"	133	144	164	167	189
Rice Paddy	100kg.	145	151	151	148	222
Beef (third Grade)	100kg.	676	689	795	960	1,190
Bacon Pigs	"	764	778	859	975	1,200
Milk	100lit	132	132	146	186	216

*Source: Economic Survey 1982. USAID estimates for 1982

For those crops over which Kenya has some price control, prices have been raised substantially in 1982 and 1983.

In dollar terms the prices of maize and wheat exceed current depressed world prices while the current rice price is close to recent trading levels. Maize is currently selling at $100 MT and wheat $160 MT ex gulf ports USA. Shipping (currently also a depressed market) ranges from $25 (bulk carrier) to $100 (US Flag) from gulf ports to Mombasa. It can be concluded from this that Kenya's internal prices are about as high as they should be under current world market conditions. Indeed if these prices continue to stimulate production beyond domestic consumption needs (Kenya will export 100,000 MT maize in 1983), then these exports would be made at a slight loss. Given the fact that the average import content of locally produced maize is probably about 25 percent, exports in limited quantities may be justified given the current foreign exchange shortages.

Table F.9 presents 1981, 1982 and 1983 prices and gives the equivalent price in US dollars per metric ton to show the effect of the recent devaluation of the Kenya Shilling. Finally, the percent change in Kenya shilling prices is calculated.

Table F.8.

GAZETTED CROP PRICES 1981 - 1983
(Crop Years)

CROP	1981	$MT(a)	1982	$MT(b)	% Change KSh	1983	$MT(c)	% Change KSh
MAIZE	95	140.6	130	144.3	+ 37	158	135	+21
WHEAT	160	236.8	190	216.5	+ 22	225	192	+13
RICE	1.30-1.70	226.6	2.0-2.70	270	+ 53	2.35-2.8	208	+ 4
SUGAR	150	20.0	170	17.0	+ 13.0	215	16.5	+25
COTTON	3.60	480	3.80	380	+ .5	4.30	330	+14
CASHEW	3.50	446	5.50	550	+ 57	N/A	-	-
MILK	1.8	246	2.15	215	+ 16	2.40	184	+11

(a) 7.5 = $1.00
(b) 10.0 = $1.00
(c) 13.0 = $1.00

The price increases reflect the GOK intention of making food production (i.e. cereals) more competitive with sugar and cotton.

The net result of the improved pricing policy, better weather and improved credit and input supplies is that Kenya is again self-sufficient in basic food supplies. It is expected that modest imports of wheat and rice will be just about offset by exports of maize and beans. Performance in the export crops is good despite stagnant or declining international prices.

III. THE FERTILIZER PROGRAM

A Program Rationale:

In 1980-1981 the United States provided balance of payments support totaling $20.0 million to finance 67,000MT of fertilizer. The reasons for this choice are outlined briefly below. In 1980 fertilizer and fungicides made up 21 percent of manufactured imports from the United States. Adding construction equipment, industrial chemicals, aircraft and parts, oil and gas equipment, and trucks and buses brought the total to 65 percent of all U.S. imports. Although some of these additional imports could impact on the rural areas, the connection would be indirect at best. It appeared that for non-traditional U.S. imports (which might include steel for hoes, for instance) the volume would not likely be adequate to absorb the U.S. resources provided. USAID and AID/W wanted to link the C.I.P. program to the USAID strategy of increasing production, incomes and employment in the rural areas. In addition, the food shortages of the time suggested a need to focus on food production.

In most of Kenya's agriculture capital inputs are the most costly factor of production and their use is therefore low. The hoe and human labor are still the key factors in production. In seeking increased production the usual first step by farmers is the use of improved seed followed by fertilizer and simple chemical pest control. Further considerations in the choice of fertilizer for the C.I.P. were administrative feasibility and quick disbursement are major considerations in balance of payments programs.

B. Economics of Fertilizer Use:

While there is little hard data on the use of fertilizer by crop in Kenya its use has been economic in the last two years as demonstrated by the fact that fertilizer has been imported, sold and used. Table F.10 below presents quantity and price indices for fertilizer. The quantity index records imports, not usage and therefore can be misleading.

Table F.10.

KENYA: FERTILIZER INDICES 1978-1983
(Calendar Years)
1976=100

YEAR	FERTILIZER QUANTITIES INDEX	FERTILIZER PRICE INDEX
1978	155.6	98.3
1979	101.8	128.9
1980	109.9	128.9
1981	137.6	131.3
1982	151.2	145.6

Source: Economic Survey 1982. USAID estimates for 1982

Each year the Ministry of Agriculture prepares estimates of the cost of production and the probable returns to major crops. Table F.11 presents an adaption based on the 1981 data for commercial maize production. At lower levels of input use and resulting production the use of modern inputs is only marginally profitable while at high production levels and with weather cooperating high returns are possible.

Table F.11.

GROSS MARGIN FROM COMMERCIAL MAIZE 1982
(Crop Year)

Yield Level bags/ha	30	45	60
GROSS OUTPUT	3900	5850	7800
Variable Costs:			
Seed	138	138	138
Fertilizer DAP	206	492	811
ASN	375	625	875
Transport, Fertilizer	13	18	25
Chemicals:			
Insecticides	26	37	48
Herbicides	300	300	300
Costs of Machinery	1449	1502	1509
Labor	279	335	458
Gunnies	372	558	744
Transport, Maize	108	162	216
TOTAL	3266	4167	5124
GROSS MARGIN	634	1683	2676
INTEREST 14%	457	583	724
ADJUSTED GROSS MARGIN	177	1100	1952

Source: Adapted from Yields-Costs Prices 1981, Ministry of Agriculture.

Moving up the production function for maize requires improved cultural practices but it is clear that the variable cost of fertilizer is the major factor in the increased costs and returns. In the above example increased expenditure on fertilizer from Ksh 581 to 1686 (+ 1105) increased returns from Ksh 177 to 1952 (+ 1775). Table F.11 presents a commercial maize situation. It is difficult to generalize a production function in Kenya because of the diversity of conditions.

However, it is possible to suggest orders of magnitude for the response to fertilizer use. In grain crops, at Kenya's current level of fertilizer use of an additional kilogram of nutrient should yield between 8 amd 12 kilograms of grain. On a pure nutrient basis N and P-2 0-5 were selling in 1982 at about 10Ksh per kg. while maize was selling (officially) at Ksh 1.44 and wheat at Ksh 1.89 per kg. In areas of adequate rainfall fertilizer use is clearly economic for these main food crops. The real situation is that some farmers are heavy fertilizer users whereas others use little or none. U.S. fertilizer supplied in 1981 and 1982 was used on maize, wheat, barley and sugar-cane and lesser amounts on a wide variety of other crops.

Another indirect method of estimating which crops benefit from a fertilizer program is to trace deliveries to the Kenya Farmers Association (KFA) sales points and compare sales to the cropping pattern, crop calendar and known agronomic practices. This analysis also confirms the relationship DAP to maize and wheat, MAP to barley and TSP to those three and to sugarcane production.

Production from the 1981/82 long rains crop was far beyond expectations. Total maize production jumped from 1.7 million MT to 2.3 million MT. While the GOK tended to blame the weather for the two previous bad crops the real problems were poor prices, lack of credit and lack of fertilizer. With the timely arrival in January 1981 of USAID- supplied fertilizer as well as other donor supplies and high private imports, stocks were more than adequate. Past trends and the foreign exchange rationing in place at that time lead us to conclude that AID was instrumental in insuring these fertilizer supplies and the resulting high production. For example, if 75 percent of U.S. fertilizer (say 20,000 nutrient MT) were used on the 1981/82 maize crop, between 160,000 - 240,000MT of additional grain production was the likely result. To import that quantity of grain under PL.480 would cost $50 million plus shipping at GOK expense versus a cost of $7.5 million for fertilizer.

C. Fertilizer Pricing and Marketing:

Fertilizer prices are controlled in Kenya. In 1971 price control was established as a result of proven price collusion among the then limited number of importers (Havelock Report 1971). The present system is designed to control profit margins but not to serve as a subsidy scheme. The system uses the C&F price, all proven internal costs and a fixed maximum profit to establish retail price on each importation. The GOK has twice increased the price of fertilizer to adjust for devaluations and to make donor supplied stocks equal in cost to new importations. Average prices have therefore been higher than straight application of the formula would indicate. There are obvious problems with such a system since prices for fertilizer of the same type can vary widely depending on source, size of tender and shipping arrangements. GOK is reluctant to return to uncontrolled prices since the number of importers still remains relatively small and the potential for corrupt practices to resurface is great under such an imperfect market structure. GOK does admit to inefficiency in the system and has been open to and has held discussions with the fertilizer donor committee on possible changes.

The second major objective of the current system is to ration foreign exchange. Import licences must be approved by the Ministry of Agriculture on the basis of its perception of national requirements and then by the Central Bank. In theory there is no reason for the Ministry of Agriculture to turn down import requests and once permission has been received the Central Bank should provide the foreign exchange. In practise that has not been the case.

Fertilizer marketing has undergone changes in Kenya. At independence the major distributors were European manufacturers. These large companies have left and the Kenya Farmers Association (KFA) and small distributors have become the only market channels. KFA currently handles about 60 percent and six to eight other private importers handle the remainder.

Note: Louis-Berger International has just completed a study "Private Sector Fertilizer Marketing in Kenya" for AID/PPC. This study should be read by those with special interest in this subject. It is available from AFR/PD/EA.

D. Program Implementation:

1. Distribution 1980-1981

Importation and distribution of USAID fertilizers during 1980 and 1981 was handled by the KFA, a private and independent farmers association. KFA prepared tenders and conducted inspections, off loading, warehousing and final distribution. Fertilizer was distributed to KFA warehouses throughout the country on the basis of historical cropping patterns and the fertilizer requirements of individual crops. KFA's performance in all these tasks has been good. KFA handled approximately 100,000 MT of fertilizer in 1979/80 and 120,000 MT in 1980-1982.

End user data has been very limited to date. The Netherlands is currently conducting a study and the results should be ready in about six months. In six districts each KFA sale is being tabulated by fertilizer type and quantity, location and size of farm and crop for which applied. Initial data show the vast majority of sales are of one to three bags (number per sale not total quantity) which indicates small farmer use may be higher than was expected.

2. Credit

Fertlizer has been generally obtained from the KFA in exchange for financial instruments (so-called chits). The Agricultural Finance Corporation (AFC) makes credit available, and issues the required chits, to larger scale farmers . Such farmers present their chits directly to the KFA and receive their fertilizer. The AFC deals with smaller farmers indirectly through the Cooperative Bank of Kenya. Member co-op unions submit the chits of small farmers collectively to the KFA in exchange for fertilizer sold on credit.

The AFC seasonal credit program has not worked as well as it should mainly because GOK underfinanced the program. This is compounded by the overall lack of liquidity in Kenya.

A review of how the system works may also explain why problems arise and how they have been resolved. The 1980 fertilizer arrived in country in late November 1980. It was stored and about 60-70 percent sold in February-April 1981 on credit. KFA was to pay GOK quarterly but could not since AFC was short of funds until the 1981/82 budget in July. Payments began to KFA and as the harvest progressed in the period September to December 1981 payments accelerated. By March 1982 a very acceptable repayment had been achieved. As will be shown below, however, only part of the delay in generation and use of local currency is due to the credit system.

While performance in credit and generation of local currency should be improved, the program as currently established is working. With any fertilizer imports there will be time lags between arrival of commodity, sale, transfer to Treasury, and budget and expenditure on programs.

E. Local Currency:

Under the 1980-1981 fertilizer program the GOK and AID agreed to identify priority areas for local currency use in support of the current five year development plan. Such agreement was reached by an exchange of letters within the required six months.

The first shipment of $14.5 million in fertilizer was between February and April 1981 for use during the long rains of March to July 1981. Proceeds have therefore been contin' usly generated from then to the present as some fertil_zer is yet to be sold. The second shipment of $5.5 million arrived between September and November 1981, and was mostly sold during the long rains of March to July 1982.

Given this timing it only became possible to budget the funds to activities in the 1982/83 GOK fiscal year. Planning for that budget began in April 1982 for the June 1982 to July 1983 period. Between the time the original list of programs was developed and the time when the funds became available, several important events had occurred. Negotiations with the IMF on a Stand-By Agreement and with the World Bank on the Structural Adjustment Loan had reached an advanced stage. The fact that priorities changed under the rigors of these programs combined with the fact that additional shillings had to be made available to certain development projects following the devaluation required preparation of a new list of programs for CIP generations. That revised list appears as Annex D. The funds are budgeted in the 1982/83 Development Estimates published in June 1982.

The criteria followed in identifying eligible budget items included the compatibility with the USAID CDSS, the GOK Development Plan and its Food Policy Paper. USAID strategy is focused on programs to support increased production, employment and incomes in the rural areas. The programs supported to date include rural roads, the Rural Development Fund, agriculture extension and research and soil conservation. USAID has two ongoing rural roads projects and believes the additional effort very supportive of our objectives. The Rural Development Fund is administered with assistance from USAID's Rural Planning II Project and supports local small scale development efforts. In research the funds are being used to supply water and power to a USAID-supported project at the Kiboko Range Research Station which was identified as the highest priority action to be taken by GOK in the recent evaluation of that project. Soil conservation is a major objective of the strategy to improve productivity in the arid and semi arid lands. The relatively small amount allocated reflects the current austerity measures but at least provides support to the USAID ASAL Project.

F. <u>Fertilizer Program Performance 1980/81</u>:

The experience of 1980-82 reveals both positive impact and problem areas.

<u>Positive</u>

- The use of bulk tender and local bagging procedures has resulted in reduced costs and creation of local employment;
- overall availability of fertilizer has increased;
- fertilizer arrived when needed, was distributed efficiently by KFA and no unusual losses were incurred;
- agricultural production and farmer incomes have increased.

Problems

- With KFA as sole agent for GOK imports there has been limited competition and no expansion of other distribution networks;
- due to pricing policies the benefits of reduced import costs have not been fully passed on to farmers. In addition, there is no system to rationalize the price of plant nutrients in competing fertilizers;
- local currency generations have moved relatively slowly from the distributor to Treasury.

Coverage of productive farming areas by the KFA distribution system has been good. KFA has 42 main outlets and uses local stockists for areas of more limited demand. The generation of local currency for budget support was slower than projected. This was due to unforseen delays caused by the shipping schedule and credit system. Generations now deposited total about 110 million KShs out of expected total of 180 million. Those funds are being used to support the agreed list of development programs. The remaining fertilizer is being sold this crop season.

USAID believes that the fertilizer program has been very successful. Several possible additions and improvements to this program are discussed below.

G. Policy Change and Recommendations:

As a result of the USAID fertilizer program steady progress has been made in fertilizer handling and planning.

The first policy reform was to convince the Ministry of Agriculture to use private sector demand estimates as the basis for import levels. The past system aggregated District Agriculture Office estimates to reach a national requirement. It was inefficient, time consuming and did not reflect real demand. USAID collected the data on local stock and private sector import projections and convinced MOA (after careful comparison with their projections) to use the private sector figures (with minor adjustments). The benefits will be substantial: lower carry-over levels of slower moving types; reduced storage and handling; reduced losses from pilfering and damage. USAID estimates that without this change GOK would have imported 20,000 to 40,000MT of fertilizer which would not have been used in the coming season.

The second policy reform relates to the timing of the import plan, issue of private import licences and scheduling of donor imports. By moving the planning of imports forward just

6-8 weeks a reduction in port congestion was achieved and stock levels at up country distribution points were more adequate to meet the early planting dates recommended as the result of recent research.

A major change yet to be achieved relates to pricing policy. GOK does not subsidize fertilizer but attempts through price control to limit margins to what it considers reasonable levels. The current system takes the C&F price of each importation and establishes a maximum retail price allowing for transport and profit. Depending on source, shipping, etc. competing fertilizer prices can vary widely. Possible improvements are under discussion, and reduction in the price of overstocked TSP was a condition precedent to disbursement under the 1982 US program.

Further improvement in the fertilizer import, marketing and distribution system could be achieved by deregulating fertilizer imports. Adequate priority in foreign exchange allocation is needed to do this, however. If foreign exchange is inadequate the Central Bank must ration funds. Secondly, the volume of fertilizer use must be high enough to allow sufficient profit to importers. At levels of under 100,000MT per year the quantities of each type imported are inadequate to capture any of the savings inherent in large tenders and bulk shipping. At current levels of between 150,000 and 200,000MT expanded numbers of importers and distributors possible and the conditions which would allow for full play of competitive market forces could become operative. Major categories of fertilizer will be stocked in sufficient quantities to overcome the "lumpiness" caused by the economics of scale in large tenders and bulk shipping.

IV. CONCLUSION

The 1980-81 C.I.P met the macro economic objectives of balance of payments support and ensured fertilizer supplies would be adequate. Producer prices have been adequate, fertilizer use profitable and the sector has experienced renewed growth. Currency generations have been used in sector programs. An understanding of policy issues has emerged and limited progress in reform has been made.

The most important possible change would be the reduction of government regulation to allow expansion of the private sector and free market forces. This would require unrestricted imports and therefore adequate levels of foreign exchange. A C.I.P. by its nature is a government to government program which invites regulation and disrupts the orderly expansion of the private distribution system. GOK agreement to free fertilizer imports from administrative controls would best achieve improved fertilizer availability, marketing and distribution.

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ANNEX G

Disbursements of Foreign Grant Assistance
(Million Kenya Shillings)

	December 1982 IMF/GOK Projection	March 1983 GOK - Received or Certain	June 1983 GOK Projection
Appropriation-In-Aid	390	390	390
Project Aid	340	340	340
USAID (old)	117	121	121
(PL 480)	(25)	(25)	(25)
(615-0227)	(71)	(71)	(71)
(Past CIPs)	(21)	(25)	(25)
USAID (1983)	129	-	364
U.K.	224	-	-
Stabex	142	92	152
EEC	18	25	25
Italy	10	6	12
NCPB, KFA	-	-	43
Canada	-	15	15
Japan	40	-	-
WFP	20	-	-
UNDP	-	12	12
Other Donors*	140	23	91
Total*	1570 (U.S.$120.9)	1024 (U.S. $78.8)	1565 (U.S. $120.5)

* Included approximate 15 percent reduction in total expected disbursements to allow for possible shortfalls.

ANNEX H

BRIEF ON THE IMF PROGRAMME FOR FY 1982/83

The principal performance criteria under the terms of the Standby Loan Agreement entered into with the IMF staff in December 1982, and as formally ratified by the IMF board in March of 1983, are quantified ceilings on total banking system credit and on utilization of credit by Government for financing the budget deficit. The ceilings established for the two compliance checkpoint dates are as follows:

	End-March, 1983		End-June, 1983
	(Sh. Millions)		
	Ceilings	Actuals	Ceilings
Total Domestic Bank Credit	25,558	23,638	24,794
Credit to Central Government	8,198	7,177	6,225
Defined as sum of:			
a) Domestic Bank Credit	9,219	8,195	8,053
b) Less: CSFC Treasury Balance	-1,181	-1,178	-1,181
c) Use of Euro-currency borrowings	160	160	160

As indicated in the table, the actual results provisionally recorded for end-March were below the ceiling for total bank credit by Sh.1,920 million and below the ceiling for Central Government credit by Sh.1,021 million. While achievement of compliance with the total credit ceiling was not difficult, because of slack demand for credit from the private sector due to the depressed economic conditions, considerable difficulty was experienced in meeting the ceiling for Government credit. This was accomplished by ruthlessly cutting back expenditures, by accelerating revenue collections and foreign aid reimbursements to the fullest possible extent, and by mobilizing the maximum amount of credit from domestic non-bank sources through issues of Treasury bills and Government stocks.

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Compliance with the IMF ceiling on credit to Central Government for end-june will be equally difficult to achieve. According to the latest estimates there will be a shortfall in recurrent revenues of approximately Sh.2,000 million below the projection underlying the IMF programme, reflecting the recession in the domestic economy and also the limitation on imports due to shortage of foreign exchange. This substantial revenue shortfall necessitates continuation through the balance of FY 1982/83 of the severe cutbacks in expenditures. The projection of expenditures during FY 1982/83 as a whole is now approximately Sh.3,000 million below that envisaged when the IMF programme was formulated last December. The severe cutbacks in development expenditures are causing a corresponding shortfall in foreign aid receipts. While foreign grants are expected to be approximately equal to the level assumed in the IMF programme (assuming receipt before end-June of the $28 million in extraordinary support from USAID), net external loan financing is now projected to fall approximately Sh.700 million below the level envisaged in the IMF programme. Thus, while the overall budget deficit is expected to be below the level assumed in the IMF programme by some Sh.500 million, the financing of this deficit within the ceiling on bank credit to Government will necessitate drawing on domestic non-bank sources for approximately Sh.400 million more than was expected to be required at the time the IMF programme was formulated.

During the remainder of FY 1982/83 strenuous efforts will be made to maximize revenues (both tax receipts and external grants), and to minimize expenditures (with virtual cessation of development expenditures). Also, every effort will be made to exercise outstanding entitlements for foreign aid reimbursements. By these actions, and also by again pushing extraordinarily hard for financing from domestic non-bank sources, it is expected that we will be able to comply with the end-June IMF ceiling by a narrow margin.

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Finally, there are several additional performance criteria stated in the IMF Standby Loan Agreement which must be satisfied the most significant of which pertain to import administration procedures and external borrowing on commercial terms. No difficulties are anticipated in complying with these requirements during the current phase of the IMF agreement.

12th May, 1983.

- work with the Livestock Development Branch of the Ministry of Livestock Development to ensure that policies towards parastatals are consistent with those developed for production in high potential areas

- assist with the Annual Producer Price Review for Livestock products

b) Livestock Projects Economist. He/She is required to:

- identify livestock production, processing and marketing projects which have a high pay-off in terms of reaching national objectives

- assist with developing livestock project proposals in cooperation with other government departments and parastatals

- carry out economic appraisal of these projects

- help establish and maintain links with donors and work with them in the development and appraisal of livestock project proposals.

c) Livestock Strategy Economist. He/She is required to:

- assist in the assessment and monitoring of longer-term policies and strategies for the livestock sector focusing particular attention on longer-term problems and issues

- assess established priorities and advise on their revision to reflect new information and developments

- establish operational procedures for the appraisal and evaluation of development projects by the staff of the Ministry

- liaise with the Research Division of the Ministry and other bodies concerned with livestock research to ensure such research reflects national priorities

- help establish a system linking planning activities and priorities with the budgetary procedures of the Ministry to ensure that these priorities are reflected in the Ministry's budgetary expenditure allocations

d) Management Specialist. He/She is required to:

- analyze and develop more effective budget and finance systems

- analyze and develop management information systems that improve decision and implementation

- analyze the management of support services in the Ministry and make recommendations to improve their effectiveness and efficiency

- analyze management aspects in the Ministry's supervision of parastatals and make recommendations for their improvement

- review the management capacity of projects developed by the Ministry in coordination with the Head of the Project Preparation Section

undertake management improvement analysis for programmes and field projects.

3. Ministry of Economic Planning and Development

a) Agriculture Planning Economist. He/She is required to:

- advise and assist in the formulation of policies and strategies for the development of the agricultural sector

- liaise closely with the Ministries of Agriculture, Livestock Development, Natural Resources, and Cooperative Development, the Treasury and the Office of the President, and assist in the planning and formulation of the budget as it relates to agricultural activities

- work closely with the members of the Natural Resources Section and render assistance to any member of that Section, particularly in relation to agricultural development

- advise on the allocation of planning functions and the improvement of the planning structure, as it relates to agricultural and allied development.

ANNEX F

FACESHEET

THE 1980-81 FERTILIZER C.I.P. REVIEW:

ANNEX F

THE 1980-1981 FERTILIZER C.I.P. REVIEW

I. PROGRAM OBJECTIVES

In 1980 the United States initiated an annual Commodity Import Program (C.I.P.) to provide fertilizer to Kenya. A total of $20 million was allocated to the program in FY 1980 and 1981. An additional $4.4 million was obligated in FY 1982 but the fertilizer to be financed by that amount has not yet been imported. The purpose of the 1980-1981 $20 million C.I.P. was to " help mitigate Kenya's current balance of payments problem" (Authorization Memorandum for the Administrator signed September 26, 1980) and to supply fertilizer because "Kenya faces a considerable shortfall in donor supplied fertilizers" (PAAD page 20). In addition, funds generated would provide budget support. These objectives were achieved, albeit somewhat belatedly in the case of budget support. Achievement of a fourth, unstated, objective, that of increasing agricultural production is indicated by the available evidence. This review will first discuss the three stated program objectives: balance of payments support, fertilizer supply and budget support. It will then analyze the agricultural production impact of the program, recognizing that policy, credit, markets and the existence of a multitude of micro climates make it difficult to isolate the effects of single production factors.

A. Balance of Payments:

The Program Assistance Approval Document 615-0200, approved in September 1980, projected a deteriorating balance of payments for Kenya, suggesting that the overall balance of payments deficit would reach its peak in 1981 and decline thereafter. This pattern has subsequently been verified. (See Table 2 in main text above). The PAAD reported the official projection of the overall balance of payments deficit for 1981 ($222 million), but noted that "current Mission analysis indicates that estimates presently available from Government may in fact be overly optimistic given the oil price increases announced in July, and given the likely continued fall in the unit price of coffee exports, together with a possible drop in the quantity of coffee available for export of up to one-third". (PAAD p.19.) In the event, the overall balance of payments deficit for 1981 amounted to some $232 million.

The original PAAD submission requested authorizations of a $20 million commodity import program grant, equivalent to 9.0 percent of Kenya's overall projected 1981 balance of payments gap. A 1980 authorization of $14.5 million and a June 1981 amendment of $5.5 million provided the required assistance on a timely basis.

.A total of $19.68 million dollars disbursed during CY 1981 covered 8.5 percent of Kenya's overall balance of payments gap for the year. In addition to providing the intended level of direct balance of payments support in CY 1981, the CIP program assured the timely importation of key manufactured fertilizers in a period of food shortages, thus indirectly contributing to further improvements in the current account balances in CY 1981 and CY 1982 by contributing to increased food output and reduced food imports. The 1980-1981 CIP clearly met its first objective of mitigating the balance of payments problem.

B. Fertilizer Supplies:

The second objective, that of supplying fertilizer, was also clearly met. The first shipment (for which funds had been obligated in September 1980) arrived in Kenya in November 1980 and were 60-70 percent sold between February and April of 1981 for use during the long rains of that year. Fertilizer financed by FY 1981 funds arrived from September through November of 1981 for sale and use during the long rains of 1982. Although not all U.S.-financed fertilizer was sold quickly (inappropriate pricing of 10,000 tons of TSP delayed sale of this commodity until the price was adjusted in 1983), the vast majority of U.S.-financed fertilizer was expeditiously imported, distributed, sold, and used by farmers.

The impact of U.S.-financed fertilizer on overall fertilizer availability and use is more difficult to gauge because Kenya import statistics are kept on a calander year basis. This system presents a somewhat distorted picture because reported imports have no predictable relationship to cropping seasons or fertilizer use. Published data for 1977-81 are presented in Table F.1 below.

Table F.1.

IMPORTS OF MANUFACTURED FERTILIZER 1977/1981

COMMODITY	Import Volume ('000 tons) 1977	1978	1979	1980	1981	Average 1977-81
Sulphate of Ammonia	15.0	21.7	9.4	7.6	2.7	
Ammonium Sulphate Nitrate	32.2	17.5	2.0	16.7	25.9	
Urea	-	0.5	-	6.9	4.8	
Calcium Ammonium Nitrate	17.7	15.5	13.3	29.1	27.6	
Ammonium Nitrate	-	1.0	2.2	1.0	2.0	
Other Nitrogenous Fertilizer (NPK)	23.2	22.0	11.5	29.7	36.7	
Sub-total Nitrogenous	88.2	78.2	38.4	91.0	99.7	79.1
Single Superphosphates	10.2	10.4	2.0	14.9	9.1	
Double and triple Superphosphates	22.8	9.1	1.0	3.1	22.1	
Other Phosphatic Fertilizers	0.5	0.1	8.5	7.6	5.0	
Sub-total Phosphatic	33.5	19.6	11.5	25.6	36.2	25.3
Potassium Chloride	0.8	1.5	-	.3	1.4	
Potassium Sulphate	0.7	9.3	-	-	3.5	
Other Potassic Fertilizers	5.9	-	0.1	.6	2.2	
Sub-total Potassic	7.3	10.8	0.1	.9	7.1	5.2
Ammonium Phosphates	15.3	11.0	-	9.0	41.2	
Other Fertilizers	11.7	35.6	10.8	3.2	22.7	
Sub-total Other	26.9	46.6	10.8	12.2	63.9	32.0
Total	155.9	155.2	60.8	129.7	206.7	141.66
Total Value K.Sh Million	189	200	107	317	482	259
Total Value U.S.$ Million*	26.25	27.77	14.86	44.7	66.94	35/97

NOTE: Some totals do not agree because of rounding errors.
SOURCE: Customs and Excise Departments.
* 7.2 KSh = $1.00