PD BAP 133

CLASSIFICATION: UNCLASSIFIED

AID 1120-1 **PAAD**	AGENCY FOR INTERNATIONAL DEVELOPMENT **PROGRAM ASSISTANCE APPROVAL DOCUMENT** AMENDMENT	1. PAAD NO. PROJECT NO. 615-0213 2. COUNTRY Kenya 3. CATEGORY Commodity Import Program Technical Assistance 4. DATE May 25, 1984

5. TO: M. Peter McPherson, A/AID	6. OYB CHANGE NO. Not Applicable
7. FROM: Mark Edelman, AA/AFR (Acting)	6. OYB INCREASE None TO BE TAKEN FROM: Not Applicable
8. APPROVAL REQUESTED FOR COMMITMENT OF: $ 40,000,000	10. APPROPRIATION – ESF - FY 1984

11. TYPE FUNDING	12. LOCAL CURRENCY ARRANGEMENT	13. ESTIMATED DELIVERY PERIOD	14. TRANSACTION ELIGIBILITY DATE
☐ LOAN ☒ GRANT	☐ INFORMAL ☒ FORMAL ☐ NONE	6/1/84 - 5/30/87	

15. COMMODITIES FINANCED

:$34,000,000 AID Eligible Commodities
: $400,000 for microcomputers
(funded under the t.a. component of the Grant)

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only: $40,000,000 (CIP-TA)	U.S. $40,000,000 (CIP- TA)
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash:	Other:

18. SUMMARY DESCRIPTION

The purpose of this Structural Adjustment Program Grant Amendment is to provide additional balance of payments and budget support required by the Government of Kenya while it continues to promote the structural changes needed to redress the underlying problems of the economy. The Grant consists of a commodity import program and consultant services. Counterpart shillings resulting from the program will be used for mutually agreed development activities in the public and private sectors. (Cont'd.)

19. CLEARANCES	DATE	20. ACTION
		☒ APPROVED ☐ DISAPPROVED
		Allison R Herrick — AUTHORIZED SIGNATURE — 14 May 84 DATE
		Director USAID/Kenya — TITLE

CLASSIFICATION:

Cover

The proposed grant will provide $34 million of balance of payments support to enable Kenya to continue its structural adjustment program. This program level will contribute approximately 7 percent of the $520 million of annual gross commitments of total donor assistance required during 1984-85. $6 million will be utilized for technical assistance and supporting commodities to help implement announced structural adjustment policies. Shilling proceeds generated by the $34 million Commodity Import Program will be applied in part to the budget, and in part to private institutions, for mutually agreed upon development purposes in the areas of rural development, agricultural development, rural private enterprise, housing, health, and family planning.

A commodity import program grant in the amount of $34 million and a technical assistance grant in the amount of $6 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. These conditions and covenants are in futherance of the conditions and covenants agreed to in the FY 1983 Structural Adjustment Grant.

<u>Conditions Precedent to Disbursement</u>: Prior to disbursement of funds under the 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:

<u>Agriculture</u>

(1.) In order to promote increased rural incomes and investment, the controls on the distribution and sale of maize between districts shall be reduced. Specifically, the Government shall increase the limit on the number of bags of maize that can be shipped by private traders between districts, without need of permits, from three to ten bags. The Government shall make a public announcement of this action.

<u>Family Planning</u>

(2.) In order to lower costs to consumers and promote the distribution, sale and use of family planning commodities, the Kenya Government shall waive all import duties and eliminate taxes on commodities used for family planning services. A public announcement to this effect will be made in June of 1984.

Trade

(3.) In order to promote private investment and trade, the Kenya Government will direct that all applications for licenses to import goods on Schedule IA will no longer be reviewed by the Import Management Committee for overstocking. A public announcement of this action will be made by the end of July 1984.

(4.) In order to speed import approvals, the Kenya Government will direct that a schedule for the implementation of the system for annual allocation for imports listed on Schedule IB will be established, and will provide USAID a copy of the implementing instructions.

(5.) In order to speed export procedures, the Kenyan Government will implement the "Green channel" documentation procedure for exporters by which exporters can obtain complete documentation for export approvals from Government in one office. The Government will announce this action, including advice to exporters on where to submit applications for export approvals.

The Shilling Counterpart Program

(6.) The Kenya Government will open a special account into which shilling deposits as agreed will be deposited.

Commodity Import Program

(7) The Government will provide:

(7a.) A list of all importers registered with the Customs and Excise Department;

(7b.) Copies of the Letter of Invitation to participate in the program to each registered commercial bank in Kenya;

(7c.) Copies of letters to registered commercial banks notifying them of their selection to participate in the program; and

(7d.) Copy of a notice to importers that, since no Societe General Surveillance inspection will be required for CIP commodities, the usual one percent import license fee paid to the Central Bank will be reduced to one half of one percent for CIP commodity import license applications.

II

Covenants: The Government of Kenya agrees as follows:

Agriculture

To ensure that Kenyan producers can obtain remunerative an timely cash payments for their crops:

(1.) The Kenya Government covenants that it will provide to USAID a report specifying how the problem of timely cash payments by parastatal and cooperative bodies to producers for the principal food crops is being resolved, and

(2.) The Kenya Government covenants that it will consider the proposal that the Kenya Farmers Association, cooperatives, and maize processing firms may purchase maize from producers and traders directly.

The Domestic Budget and Public Investment Priorities

(3.) In order to strengthen and coordinate the Government's annual budget process, the Government covenants that it shall submit a report to USAID by the end of 1984 assessing progress towards improved interministerial budget coordination and requirements for staff strengthening and equipment.

(4.) In order to foster an expansion of private sector credit, the Kenya Government covenants that it will restrict the level of the public deficit during its FY 1984/85 to not more than 4.2% of GDP as stated in the new Plan.

(5.) The Kenya Government covenants that it shall incluc the recurrent and development budgets of all 25 major parastatal bodies in the Budget Estimates for 1985/86.

Foreign Trade

(6.) The Kenya Government covenants that it will maintai an active review of exchange regulations and exchange rates with the object of strengthening the competitive position of Kenyan exporters in world markets.

X III

U.S. Commodity Imports

(7.) The Kenya Government agrees that all disbursements from the special account will be made subject to AID approval

(8.) The Kenya Government agrees that with respect to Exchange Control Notice No. 19, guarantees issued to Kenya-registered companies, regardless of owner nationality, will not be considered as local borrowing under the Commodity Import Program (CIP).

(9.) The Kenya Government covenants that it will inform importers that funds from the Grant are available for marine insurance to cover goods financed herein, provided that the insurance is placed in the U.S.

(10.) The Kenya Government covenants that the Import Management Committee will not review any Import License application for goods financed under this program, except those goods included on Schedule IIB.

(11.) The Kenya Government covenants that it will provide USAID a copy of: (a) each approved Import License Application for goods financed under this program, (b) a copy of the "Import Entry" form for each consignment of goods financed under this program, and (c) a copy of the "Out-Turn" report for each ocean vessel carrying goods financed under this program.

(12.) The Kenya Government covenants that the Ministry of Commerce and Industry will review and process all Import License applications under the Grant within a maximum of ten working days after receipt from importers.

(13.) The Kenya Government covenants that the Central Bank of Kenya will process all applications for Foreign Exchange Allocation Licenses under the Grant within a maximum of two working days after receipt from the Ministry of Commerce and Industry.

(14.) The Kenya Government covenants that the shilling deposits shall be placed into the special account no later than 90 days (or such other period as USAID may subsequently agree to in writing) after the U.S. dollar payment is made by the U.S. Government to the bank holding the Letter of Commitment for goods financed under this program. A monthly statement showing all deposits into and withdrawn from this account shall be supplied to USAID no later than 30 days after each monthly period ends.

FY 1984 ESF Structural Adjustment Program Grant

615-0213 Amendment

May 14, 1984

USAID

KENYA

Program Assistance Approval Document
(PAAD)
Structural Adjustment Program Grant Amendment
(615-0213)
for
FY 1984

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Supplementary Annexes (available from USAID/Kenya and from AFR/PD/EAP)

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I. Summary of the FY 1984 Program

The purpose of this Structural Adjustment Program Grant Amendment is to provide additional balance of payments and budget support required by the Government of Kenya while it continues to promote the structural changes needed to address the underlying development problems facing the economy.

The Grant contains three basic components: a $34 million commodity import program (CIP) for the Kenyan private sector tied to U.S. procurement, $6 million for consultant services t help the Government implement structural adjustment policies (and to administer the CIP), and a program of shilling generations from the $34 million CIP for mutually agreed upon development activities in the public and private sectors.

The conditions precedent to disbursement, covenants, consultant requirements, and agreed use for the shilling generations are contained in the body of this Amendment.

This second increment of the Structural Adjustment Program Grant is justified on the basis of U.S. interests that include support for Kenya's stability and growth. The immediate justification continues to be Kenya's foreign exchange and budgeting requirements. Given recent Government performance under an IMF stand-by, these requirements, though still large, have lessened in magnitude. Assuming that the Government continues to curtail public expenditures sharply, as it has in the last two years, the budgetary picture during 1984/85 will be somewhat brighter than it has been in recent years. However, the country continues to require large levels of concessional assistance to finance the balance of payments deficit on current account. Export earnings have yet to recover sufficiently to finance projected import levels. The budget and balance of payments analyses justifying the proposed level of program aid are contained in Section II B.

Governmental demand management has been termed successful by the IMF and is so regarded by the donor community. The Government has not yet acted vigorously, however, to implement structural reform measures which it has adopted in principle. Certain decisions taken over the last three years, largely for budgetary reasons, which are central to the restructuring process, are not in themselves sufficient to mobilize the economy to effect growth and employment expansion. The macromanagement reforms which have been implemented and which lay the groundwork for structural adjustment, include devaluations of the shilling and sharp increases in the prices of food and fuel and cost of credit. Additional policies still needing to be implemented are liberalization of price and marketing controls, reorganization of the roles of parastatal bodies and possible divestiture of Government interests in them, and enhancement of private sector investment and trade.

Government implementation of announced policy decisions has been less than expected because of their complexity, because of the crisis atmosphere surrounding macro-management during 1981, 1982 and 1983, and because it is now evident that there has been less political support for the policy announcements and less management capacity, than had been originally indicated.

The Structural Adjustment Program Grant of 1983 was provided at a time when the budgetary crisis was most severe. U.S. material support was a contributing factor in ensuring compliance with a hard won IMF agreement. With the easing of the budgetary crisis, the restructuring purpose of the FY 1983 Grant can be seen more clearly, and in light of the Mission's FY 1986 CDSS analysis, must be given greater weight than was formerly possible.

In the absence of significant Governmental performance on structural adjustments during the last year, the U.S. proposes an FY 1984 Amendment that contains a somewhat reduced degree of flexibility. Although the total program amount is larger, by $10 million, reflecting continued U.S. support for Kenya, the foreign exchange is now to be tied to U.S. procurement. To help strengthen and possibly speed policy implementation, the consultancy component is enlarged. To ensure more effective use of shillings generated, the Amendment proposes greater USAID control over the counterpart shillings and a proportional allocation to private sector uses.

Having achieved macro-management targets and a renewed sense of confidence within Government and in the private sector, the Government is in a position to move aggressively during the remainder of 1984 and in 1985 to effect the policies discussed and supported in this Amendment. Such actions would enable the U.S. to continue to support Kenya's development with significant resource levels.

II. Statement of the Problem and Government Response

A. Introduction

It is important to distinguish the immediate from the longer term problems facing Kenya. It is necessary to address financial crises in order to create a foundation for more significant, structural change. Yet, unless the tougher structural adjustment decisions are taken, there is little likelihood that Kenya can lessen its dependence on significant levels of concessional assistance in the longer term.

The longer term challenge Kenya faces is described in the USAID/Kenya FY 86 Country Development Strategy Statement:

> The relationship between the ability of the Kenyan economy to respond adequately to the demands of its people and the rate of increase in the numbers of people making those demands is seriously out of balance and becoming more so. The overall objective of the AID program over the next several years will be to help reestablish a more sustainable balance and relationship between overall supply of goods, services, employment and income on the one hand, and the numbers of people making demands on the economic, social and political systems, on the other. The AID program will be characterized by its orientation to growth in production of goods and services by people and by more aggressive involvement in programs to help reduce the rate of population increase.
>
> As explained in the FY 86 CDSS, and as restated in greater detail in later sections, structural adjustment is the key to growth.
>
> To promote the well-being of its people, the Government of Kenya must improve ways in which the economy utilizes domestic and foreign resources to support the production of goods and services and provide additional employment opportunities. This will require improved implementation of policy reforms already announced but not forcefully implemented. Equally, if not more important, will be decisions by the private sector to begin employing resources in activities that increase productive capacity and total output.

As the Kenyan Government recognizes, this challenge requires the restructuring of Government's role in the economy and the encouragement of private investment. The Government also acknowledges that the challenge is exacerbated by the rapid growth in the population and that the birth rate must be reduced through family planning.

Since the budget crises of 1979 and the early 1980's, the Government has come to recognize the seriousness of mounting structural imbalances between present resource availabilities and the resource levels required to sustain further growth. As important as the overall resource imbalance is its composition. One imbalance arises between the foreign exchange requirements for economic growth and the actual availability of foreign exchange earnings at present, an imbalance caused in part by the present structure of domestic production and demand.

A second structural imbalance was created in the 1960's and 1970's by the many economic tasks the public sector assumed and the subsequent realization that the public sector cannot continue to carry out these tasks effectively, nor expand them to a growing population. Related to this second imbalance is a corresponding under-utilization of private investment and of private installed capacity.

A third fundamental imbalance stems from the effects of rapid population growth on the gap between available resources and the resources required for employment, income, and the satisfaction of basic needs.

One objective of this Amendment is to promote increased Government commitment to structural reform through conditions and covenants and to help the Government to correct structural imbalances by providing financial and technical support for policy decisions taken to redress these imbalances. The state of Government efforts to date is described in the following section.

B. Macro-Economic Update

During 1982 and 1983, Government management of the economy showed definite improvement. Since the attempted coup of August 1982, the Government has achieved a period of stability and a return of business confidence. Public expenditures have been curtailed, foreign exchange reserves are up, imports flow more smoothly, and price inflation has subsided. Underlying these trends have been sharp adjustments in the prices of foreign exchange, food and imported oil. The Government has been given high marks by the IMF in early 1984 for meeting agreed-upon expenditure, domestic credit, and borrowing targets

Further steps are required. The sharp curtailment of effective demand in the economy has compressed the level of economic activity in Kenya, and has brought the disadvantages of reduced employment and living standards, and even of a stall in the development process. The preferable alternative, to which the Government subscribes, is to encourage economic growth by changing patterns of production and demand along lines that will reduce Government's role and expand private investment, and at the same time reduce the requirement for imports and increase the level of exports produced from Kenyan resources.

Successful demand management is not sufficient in itself because of the limited natural resources at Kenya's disposal in comparison to its population. Kenya does not have sufficient arable land or mineral wealth to allow its population to find employment opportunities within the economy's present policy structure. Both domestic and foreign private investment are required to effect prosperity.

The Government laid the foundation for its structural adjustment program in the Report and Recommendations of the Working Party (the "Ndegwa Report") of July 1982, in the KANU political manifesto of August 1983, in the new fifth Development Plan released in December of 1983, and in Consultative Group statements. However, Government has announced, but not implemented, policies to further decontrol selected domestic retail prices, to liberalize domestic market and trade controls, to divest interests in some public parastatal bodies and to expand credit for private investment. These are the underpinnings for a more active development role for the private sector.

1. The Balance Between the Public and Private Sector

a. Government Expenditure

Kenya's chief structural adjustment success to date has been a large scale shift of resources from the public to the private sector over a brief period of three fiscal years. Government expenditures were reduced from 35 percent of GDP in 1980/81 to 27 percent of GDP in 1982/83, sharply reversing an upward trend that had lasted for more than a decade. The Government has taken a substantial risk in reducing its relative share in the economy by more than a fifth in such a brief period of time. Between FY 1980/81 and FY 1982/83, total Government expenditures decreased by approximately 19 percent in real terms, and real development expenditures fell by some 29 percent. In the meantime, population has continued to grow by 4 percent per annum, along with the demand for jobs, services, and development activities.

Government's investment program has borne the brunt of the financial cutbacks of the past two years. Although an attempt was made to give priority to completing on-going development projects, implementation of projects inevitably suffered. During the course of FY 1982/83, the Government had to revise its budget three times as revenue estimates declined in line with faltering economic growth. Shortfalls in local matching funds caused donors and Government to reconsider priorities and to revise or reschedule individual projects. As a result development project disbursements, which should have been up in a time of crisis, instead declined. Since most externally financed development projects contribute more foreign exchange to the Kenyan economy than they absorb, budget austerity indirectly contributed to an increased need for austerity in the external accounts as well.

Despite the painful nature of recent budget cutbacks, Government intends to consolidate the gains of the past two years. Government will limit expenditure during the 1984-1988 Development Plan to an average of 28.6 percent of GDP -- below the 31.7 percent average of the previous five-year plan, and well below the level of 35 percent reached in 1980-81.

Table 1

Government Expenditures as a Share of GDP at Market Prices

Actual		Projected	
1978/79	32.3%	1983/84	27.5%
1979/80	32.2%	1984/85	28.7%
1980/81	35.0%	1985/86	28.7%
1981/82	32.2%	1986/87	28.9%
1982/83	27.0%	1987/88	28.9%

Recovering somewhat from the severe cutbacks of 1982/83, total budget expenditures during the 1984-1988 Development Plan will grow by 6 percent annually in real terms, with the real development budget growing by 8 percent. This relatively faster growth rate for development expenditures results in large part from the low base established for such expenditures during the substantial cutbacks of 1982/83 and 1983/84. During the Plan period, development expenditures will account for 7.3 percent of GDP at market prices, and for 25 percent of total Government expenditure.

Projected Government expenditures during the period of the new Five Year Plan are conservative in scope, and generally consistent with overall macroeconomic targets. However, Government's investment plan has significant sectoral distortions and lacks a system of priority ranking that would indicate which projects would be eliminated if foreign and domestic financing fails to reach target levels. Moreover, the proportion of expenditures going to parastatal activities during the plan period cannot be estimated from the planning documents submitted by Government to date. The IMF, the World Bank, USAID and other donors will have an important role to play in encouraging Government to meet its own expenditure targets, and in helping Government to adjust its development priorities within acceptable spending limits.

b. Revenue and the Deficit

Expenditure cutbacks were combined with tax increases to produce significant reductions in the overall budget deficit from 9.6 percent of GDP in 1980/81 to 3.3 percent of GDP in 1982/83 (well below the IMF target of 4.7 percent).

Table 2

Government Budget Deficit as a Share of GDP at Market Prices

Actual		Projected	
1978/79	7.4%	1983/84	4.4%
1979/80	5.7%	1984/85	4.2%
1980/81	9.6%	1985/86	4.0%
1981/82	6.5%	1986/87	3.9%
1982/83	3.3%	1987/88	3.6%

Fluctuations in Kenya's budget deficit have been caused more by variations in expenditures, however, than by variations in recurrent revenues. In fact, recurrent revenues rose from 23 percent of GDP in 1978/79 to a peak of 25.3 percent in 1980/81 (just when the budget deficit was at its highest). Similarly, although recurrent revenues fell to 21.9 percent of GDP in 1982/83, expenditure cuts were sufficiently large to produce the lowest budget deficit during the last Five Year Plan. During the 1984-1988 Development Plan, Government plans to limit the average budget deficit to no more than 4.0 percent of GDP, declining from 4.4 percent in 1983/84 to 3.6 percent in 1987/88.

c. Financing the Budget Deficit

The fall in the budget deficit will lead to substautially reduced requirements for domestic financing. As a result, the crowding out of private sector borrowing, which has been evident in recent years, can be reversed. Although the private sector is responsible for over 70 percent of Kenya's GDP, it accounted for only 57 percent of total domestic credit outstanding at the end of calendar year 1982 compared with 75 percent only two years earlier.

Table 3

Kenya: Monetary Indicators, 1979-83
(Millions of Kenya Shillings)

As at End of	Money Supply	Net Foreign Assets	Domestic Credit Total	Domestic Credit Public[a]	Domestic Credit Private	Private Sector Share	Commercial Bank Liquidity Ratio
June 1979	14,445	2,868	12,430	3,123	9,308	74.9%	23.0
Dec. 1979	16,396	3,588	13,835	4,061	9,774	70.6%	23.4
June 1980	15,890	3,464	14,284	3,301	10,982	76.9%	18.4
Dec. 1980	16,208	2,264	15,599	3,840	11,759	75.4%	18.2
June 1981	16,479	1,360	16,922	4,897	12,025	71.1%	19.3
Dec. 1981	18,364	300	19,378	6,352	13,025	67.2%	20.1
June 1982	18,323	-803	21,481	7,535	13,946	64.9%	17.2
Dec. 1982	21,324	2,019	25,047	10,691	14,357	57.3%	25.9
June 1983	20,166	-0	22,838	8,016	14,822	64.9%	21.7
Nov. 1983	21,790	-45	25,530	10,282	15,248	59.7%	22.0

Note: [a] Includes Parastatal.

Source: Central Bank of Kenya. Annual Report, June 1983.
Central Bureau of Statistics. Monthly Statistical Bulletin, July-December, 1983.

As Table 3 indicates, recent fiscal restraint has in fact reduced total outstanding domestic credit to Government from 10.7 billion shillings at the end of 1982 to 10.3 billion shillings at the end of 1983, a decline of nearly 20 percent in real terms (based on a 1983 GDP deflator of 15.8 percent). The relative share of the private sector in total domestic credit has also begun to recover, although the depressed state of the economy at the end of calendar year 1983 was still limiting private demand for credit, despite improvement in overall commercial bank liquidity. It is the intention of Government to ensure that the private sector has access to a share of bank credit during the Plan period at least equal to its share in national output.

Table 4 provides a summary of Central Government revenues, expenditures, and deficits for FY 1982/83, and for the Development Plan, FY 1983/84-1987/88. The budget deficit to be financed during the Plan period totals some 1.5 billion U.S. dollars (equivalent to nearly 55 percent of the total development expenditure of 2.8 billion). Net external long-term borrowing by the public sector will amount to 727 million dollars. This will finance 48 percent of the total deficit, with the annual share rising from 32.4 percent of the total in 1983/84 to 54 percent in 1987/88. Such borrowing is in addition to an expected $490 million in foreign grants during the Plan period. As a result, net domestic borrowing is expected to fall in relative and absolute terms, from $185 million in 1983/84 to $151 million in 1987/88.

Table 4

Kenya: Central Government Finances, 1982/83-1987/88
(Millions of U.S.dollars [a])

Year	1982/83[b]	1983/84	1984/85	1985/86	1986/87	1987/88	Total 1983/84-1987/88
Total Revenue and Grants	1,324	1,455	1,658	1,845	2,074	2,330	2,363
Recurrent Revenue	1,224	1,350	1,570	1,753	1,975	2,225	8,873
Foreign Grants	101	105	87	93	99	105	490
Total Expenditure	1,511	1,729	1,945	2,144	2,396	2,664	10,877
Recurrent [c]	1,126	1,310	1,439	1,600	1,787	1,976	8,111
Development	385	419	507	544	609	687	2,766
Overall Deficit	-187	-274	-287	-298	-321	-333	-1,524
Financing (net)	187	274	287	298	321	333	1,514
Domestic Long-Term	-3	52	59	61	67	70	308
Domestic Short-Term	93	133	96	81	86	81	479
Foreign Long-Term	96	89	132	156	169	182	727
Memorandum Items:							
GDP at Market Prices	5,578	6,286	6,782	7,465	8,284	9,222	38,040
Deficit as % of Revenue	15.2	20.3	18.3	17.0	16.3	15.0	17.1
Deficit as % of GDP	3.3	4.4	4.2	4.0	3.9	3.6	4.0

[a] Based on Government's estimated exchange rate of 1 U.S. dollar = 13.5 Kenya shillings.
[b] Provisional.
[c] Includes Consolidated Fund Service.

Source: Republic of Kenya. Development Plan 1984-1988, Nairobi; December 1983, p.83.

At the Consultative Group Meetings held in Paris in January and February, 1984, Government provided additional data required to define gross external resources required for the budget to finance the 1984-88 Development Plan ($1584 million, or approximately $317 million per annum).

Table 5

Kenya: Central Government Budget;
Gross External Resource Requirements, 1983/84-1987/88
(Millions of U.S. Dollars)

Total Expenditure		10,877
Less:	Recurrent Expenditure	8,111
Equals:	Development Expenditure	2,766
Less:	Current Surplus	761
Less:	Domestic Borrowing	788
Equals:	Net External Resources Required	1,217
Plus:	Estimated External Repayments and Start-up Funding for Projects at End of Plan	366
Equals:	Gross External Resources Required	1,584
Less:	External Commitments Outstanding	840
Equals:	Additional Gross External Resources Required	744
	Of Which: Additional Gross Project Assistance Required	388
	Additional Gross Program Assistance Required	356

Source: Speech by Hon. Prof George Saitoti, M.P., Ministry for Finance and Planning of the Republic of Kenya. Paris: Republic of Kenya for the Consultative Group Meeting, January 31, 1984.

The proposed ESF Commodity Import Program of $34 million for FY 1984 would account for 11 percent of the $317 million annual gross external resources required. When the Agricultural Development Loan of $15 million and the PL 480 Title I Loan of $5 million are included, the U.S. contribution rises to 17 percent.

By Government's calculations, some $840 million of outstanding commitments from donors will be drawn down during the Plan period, leaving some $744 million of additional external resources to be found (or approximately $149 million per annum). According to Government estimates, new gross project assistance required is estimated at some $78 million annually. New gross program assistance required is somewhat less at an estimated $71 million annually. The proposed $34 million U.S. Commodity Import Program for FY 1984 would supply approximately 48 percent of the additional average annual program assistance required to support the five-year Development Plan. U.S. program assistance in all forms would contribute 76 percent of requirements. In this context it should be noted that not all the assistance will result in shilling generations, not all shilling generations will accrue to budget, and that very little of it will accrue in Government of Kenya FY 1984/85.

Other donor contributions to the Government of Kenya's requirements are detailed in Table 6 below. Quick disbursing program assistance in FY 1983/84 and FY 1984/85 will account for more than one-third of the average $317 million of gross external resources required annually. The U.S., the IBRD and Saudi Arabia will provide the bulk of such assistance in 1983/84-1984/85, with the U.K., the Netherlands and other donors providing the remainder. It should be noted that even at an overall average of $317 million of external financing per annum during the Plan, external resources required to finance budgetary shortfalls are significantly less than new commitments of external resources which Kenya will need for balance of payments support. These levels are estimated by Government and World Bank at an average of $520 million per annum for the next two years (see Section IIB 2 c. below).

Table 6

Kenya: Central Government Budget
Estimated Receipts of Quick Disbursing Program Assistance,
1983/84-1984/85
(Million U.S. Dollars)

	1983/84	1984/85
U.S.*	45.9	44.4
IBRD	50.4	-
Saudi Arabia	-	51.1
U.K.	4.4	11.1
Netherlands	8.6	3.0
Norway	1.3	3.3
W. Germany	0.7	3.7
Sweden	1.3	1.3
France	2.5	-
	115.1	117.9

Note: * Includes Government's current estimates of actual flows to the budget from all sources of U.S. program assistance including cash grant, commodity import programs, and PL 480 Title I. U.S. commitments of program assistance in its FY 1984 will total $54 million ($34 million Commodity Import Program Grant; $15 million Agricultural Development Loan; $5 million PL 480 Title I).

2. External Balance

a. Overall Trends

Since 1980, smaller Government deficits, higher interest rates, and slower growth have contributed to a strong overall trend toward improvement in Kenya's trade and current account balances. In the past year, slower growth in the monetary aggregates has contributed to the process as well. In addition, there were devaluations of 5 percent in February 1981, 15 percent in September 1981, and 15 percent in December 1982. These had the effect of reversing the 7 percent appreciation that had taken place in the real effective exchange rate between 1976 and 1978. By the end of 1982, the purchasing power parity of the Kenya shilling was back to its 1976 level. Government has now committed itself to periodic exchange rate adjustments as necessary to maintain the purchasing power parity of the shilling (exemplified by the 2.5 percent mini-devaluation of July 1983). A series of tariff adjustments have also been made. However, controls in the form of import and exchange licenses, which continue to be applied, contribute artificially to improvements in the trade and current account balance.

Kenya experienced a cumulative current account deficit of some $3.2 billion during 1978-82. Financing of the deficit has resulted in an increase in outstanding external debt from $1 billion at the beginning of 1978 to about $2.6 billion at the end of 1982. The debt service ratio has risen from about 7 percent in 1977 to 25 percent in 1983 and is expected to remain at this level for the next few years assuming continued high levels of donor assistance, particularly assistance in program form.

Table 7

Kenya: Current Account and Trade Balances

	Trade Balance		Current Account Balance	
	m. U.S. $.	% of GDP	m. U.S. $	% of GDP
1979	-801	13.2%	-488	8.2%
1980	-1390	19.6%	-893	12.6%
1981	-1093	16.3%	-686	10.2%
1982	-836	13.4%	-512	8.2%
1983	-679	13.1%	-290	5.6%
1984	-673	10.3%	-293	4.5%
1985	-718	10.2%	-311	4.4%
1986	-782	9.9%	-348	4.4%
1987	-831	9.5%	-369	4.2%
1988	-913	9.4%	-417	4.3%

b. Merchandise Trade

Despite continued deterioration in Kenya's external terms of trade, the country's merchandise trade deficit has been reduced by more than $700 million dollars in the past three years, falling from minus $1,390 million in 1980, to minus $679 million in 1983 (a reduction from 19.6 percent of GDP to 13.1 percent). Such improvements, however, have been more than accounted for by reductions in imports which fell by $987 million from $2632 million to $1645 million during the same period. Such a reduction in imports reflects continued application of import controls and significant improvements in demand management (including devaluations). However, the effect of structural adjustment on export growth, and therefore on the balance of payments account is, as yet, extremely limited.

Exports have fallen in dollar terms by $276 million from $1242 million in 1980 to $966 million in 1983. Although changes in the exchange rate make such comparisons somewhat misleading, other measures essentially confirm the dollar evidence. The volume of exports during the first half of 1983 was some 14 percent lower than it was three years earlier during the first half of 1980. Part of this poor performance is due to reduced exports of petroleum products, but other sectors have performed poorly as well. Indices for 1983 are not yet available, but the volume of manufactured exports fell by 10 percent between 1980 and 1982 and the volume of machinery and transport equipment fell by 35 percent during the same period. More time may be required for Kenyan industry to respond to changing exchange rate, price and credit signals. Some positive response is already evident in exports of non-traditional agricultural products. It is apparent, however, that continued improvement in the merchandise balance of trade in the future must come from reduced export regulation and further improvements in exchange and price signals which promote structural change.

c. Current Account Deficit and Financing

As Table 7 above indicates, Kenya's current account balance has also shown strong improvement, falling from 12.6 percent of GDP in 1980 to 5.6 percent of GDP in 1983. Reductions in the current account deficit, however, have been partially offset since 1980 by reductions in the surplus on capital account. Net private long-term capital fell by some $90 million between 1980 and 1983, and net public long-term capital flows fell by some $300 million (reflecting reduced willingness by Government to borrow externally on commercial terms, as well as some shift by external donors from loan to grant financing of development activities). The current account deficit for 1984 is now estimated at 4.5 percent of GDP, a level which would be sustainable in the long term, and which Government plans to maintain throughout the 1984-1988 Plan period. (See Table 8.)

Table 8

Kenya: Government Balance of Payments Estimates, 1982-88
(Millions of U.S. Dollars[a])

Year	1982[b]	1983[c]	1984	1985	1986	1987	1988
Exports	951	966	1,033	1,156	1,308	1,489	1,689
Imports	1,788	1,645	1,705	1,874	2,090	2,320	2,602
Trade Balance	-836	-679	-673	-718	-782	-831	-913
Freight and Insur.	51	51	53	57	62	68	78
Other Transport	213	178	172	178	189	202	216
Foreign Travel	216	221	237	257	277	296	316
Investment Income	-223	-182	-194	-203	-223	-248	-277
Other Services	-1	-5	-3	-12	-16	-17	-19
Transfers	67	126	115	129	145	160	184
Invisibles Balance (net)	324	389	380	407	434	461	496
Current Account Balance	-512	-290	-293	-311	-348	-369	417
Change in Reserves (Minus =Increase)	-14	-26	-28	-32	-32	-41	-6
Financing	526	316	321	343	380	410	423
Private, Long-Term (net)[d]	117	66	73	76	83	91	99
Public (net)	320	185	194	208	232	248	245
(Central Government)	(105)	(84)	(126)	(254)	(171)	(180)	(200)
(Central Bank)	(205)	(63)	(18)	(0)	(0)	(0)	(-29)
(Guaranteed[e])	(10)	(38)	(50)	(55)	(61)	(67)	(75)
Other incl. Short-Term (net)	88	65	53	59	65	72	79
Memorandum Item: Current Account Balance as % of GDP at Market Prices	8.2	5.6	4.5	4.4	4.4	4.2	4.3

Notes: [a] 1982 exchange rate = 10.922 Kenya shillings per dollar.
1983 exchange rate = 13.264 Kenya shillings per dollar (first eleven months).
1984-88 exchange rate = 13.5 Kenya shillings per dollar (Government estimate).
[b] Provisional.
[c] Estimated.
[d] Includes parastatal borrowing not guaranteed by Government.
[e] Mostly parastatal.

Source: Republic of Kenya. Kenya's Development Programme, Nairobi, Government Printer, 1983, p.13.

At the Consultative Group meetings in January and February, 1984, the Government for the most part held to its lower level projection of the current account deficit for calendar years 1984-88 ($1738 million U.S. dollars, or an average 4.4 percent of GDP). Given such a net current account deficit (plus required amortization payments and necessary reserve increases), gross donor and IMF balance of payments financing during calendar years 1984-88 would total $2413 million U.S. dollars. This is some 50 percent greater than the $1584 million U.S. dollars of budgetary assistance discussed in Part 1.a. above. Moreover, at higher levels of current account deficits, additional financing would be required from the IMF, the commercial banks, and donor sources. At the Consultative Group meetings, the World Bank reiterated its belief that the Government's upper level (or more pessimistic) projection of the balance of payments deficit ($3392 million U.S. dollars) is more likely to be realized. This would imply the need to find additional concessional financing of $1652 million U.S. dollars.

USAID believes that Government export projections for coffee, tea, and other non-petroleum export volumes are unduly high. In the case of coffee and tea, growth rates projected by Government would represent a widening of Kenya's overall share of world markets. An expansion of other non-petroleum exports by nearly 10 percent per annum also seems unlikely given the actual declines in total export volumes recorded over the past decade. In a similar fashion, a 10 percent annual increase in net travel receipts may also be too high without extraordinary efforts on the part of Government to promote tourism.

Given the large uncertainties regarding balance of payments projections for the entire period 1984-88, the World Bank presented its calculations of required gross balance of payments financing for the two calendar years 1984 and 1985 at $910 million U.S. dollars per annum (see Table 9). This figure includes capital required to finance the current account deficit, amortization, and increases in reserves. The Bank's financing projections for 1984-85 are consistent with its overall current account deficit projections for 1984-88 of 3.5 billion U.S. dollars. Of the $910 million U.S. dollars required annually during 1984 and 1985, private non-guaranteed loans would account for $100 million. Of the remaining $810 million, the IMF could provide $100 million, and commercial loans to government and parastatal bodies would provide another $250 million. Gross financing required from donor sources, therefore, would amount to $460 million annually.

The Bank estimates that in order to provide disbursements of $460 million annually, new commitments of donor assistance will have to average about $520 million each year in 1984 and 1985. This would imply an increase of about 20 percent over the average level of donor commitments in 1981-83. The Bank estimates that approximately 25 percent of these new commitments (some $130 million annually in 1984 and 1985) would have to be in the form of quick-disbursing assistance. The proposed U.S. Commodity Import Program of $34 million for FY 1984 would supply approximately 26 percent of the average annual quick-disbursing assistance required during 1984-85 or 7 percent of the $520 million of annual gross commitments required from donors. In addition, the proposed $15 million Agricultural Development Loan (615-0230) and the proposed $5 million of PL 480 Title I assistance would raise U.S. program assistance in FY 1984 to $54 million, and would supply 41 percent of required quick-disbursing assistance or 10 percent of the annual gross commitments required from donors.

Table 9

Kenya: Balance of Payments
Average Annual Gross External Financing Requirements,
CY 1984 and 1985
(Million U.S. Dollars)

Gross Financing Requirements		910
Less:	Private Non-Guaranteed Loans	100
Equals:	Public and Publicly Guaranteed Loans and Grants	810
Less:	Commercial Loans	250
Less:	IMF Loans	100
Equals:	Gross Donor Financing required	460
Of Which:	Quick-Disbursing	130
	Other	330

Source: Based on Statement on External Aid Requirements by World Bank Delegation, Paris, February 1, 1984.

3. Structural Adjustment

Progress toward structural adjustment in Kenya has been incremental, rather than dramatic, in the ten months since the Structural Adjustment Program Grant Agreement was signed on June 25, 1983. Macroeconomic management has continued to show substantial improvement, and realignment of key prices has continued (exchange rate, real interest rates, real wage rates, agricultural pricing, energy pricing). Structural adjustment in Kenya, however, will require more than improved macroeconomic management and "getting prices right," although both these approaches are important and necessary. A number of key institutional changes required are in areas where political consensus is weak, alternative solutions are not always clear to the Kenyans or donors, and required managerial and technical skills must be strengthened or developed. Such areas include Government planning, budgeting and accounting; management of internal and external debt; coordination of aid commitments; divestiture of Government interests in parastatal bodies; mobilization of domestic resources; decontrol of pricing and marketing for agricultural inputs and outputs; incentives to industry and trade; and population growth and family planning. The current situation is summarized below.

a. Fiscal Policy and Budget

Improved balance in resource use between the public and private sectors is a key element of structural adjustment in Kenya. The distinction between demand management and structural adjustment is not clear cut, and will become less so as the processes which have led to reduced Government budgets and deficits become institutionalized. Despite the improvement since 1980/81 in keeping to budgetary targets, complete institutionalization of the process has far to go. Improved budgeting in line ministries has been limited (more progress has been made in the Ministry for Agriculture and Livestock Development with the help of the "Technical Assistance Pool" of advisers which is partly ESF-funded). Treasury review and control of line ministry budgets has improved, and the practice of providing annual supplementary budgets to cover unbudgeted shortfalls has been sharply curtailed. Decisions regarding the budget deficit and its financing are being facilitated by improvements in the computerized Kenya Internal Debt Reporting System (KIDRES), in part financed through ESF-funded technical assistance.

In spite of a period of continually falling revenue estimates, which disrupted planning efforts, a forward budget and investment program was prepared with World Bank assistance in 1983. Integration of Development Plan objectives with the realities of the forward budgeting process is still far from ideal, however, and there are significant distortions in the sectoral priorities of the Plan itself. Nevertheless, planned levels of expenditure do not imply excessive demands on national resources or absorptive capacity.

The extent and direction of divestiture of Government interests in parastatals is an issue receiving serious study by a presidentially appointed Task Force, yet it is too early to expect results. The process of incorporating parastatals in the forward budgeting process has begun with an initial focus on 25 parastatals accounting for 70 percent of parastatal investments. Proposed parastatal investment and financing programs have now been prepared in an internally consistent form. Government has established sectoral ceilings for budgeted outlays on parastatals and global ceilings for guaranteed borrowing. More complete forward budgeting of the selected 25 parastatals is planned for the upcoming FY 1984/85 budget. With ESF-funded technical assistance, estimates of parastatal borrowing guaranteed by Government are being incorporated into the Kenya Internal Debt Reporting System.

b. External Balance

An important determinant of balance in the external accounts has been the adoption by Government of a more active exchange rate policy. Devaluation of the shilling against the SDR by 45.6 percent between January 1981 and July 1983 has been supplemented by a depreciation in the exchange rate between the SDR and the U.S. dollar. Partly as a result, the shilling depreciated against the dollar by 77.5 percent between January 1981 and mid-April 1984. Government has up to now placed too much reliance on depreciation in the SDR/U.S. dollar ratio. It is now time to consider additional adjustments directly in the shilling/SDR ratio in order to stimulate exports (which have been stagnant) and to further ration and allocate imports.

Government has continued to permit the full cost of imported energy (which is normally denominated in U.S. dollars in international markets) to be passed on directly to consumers. As a result, domestic consumption of petroleum products was only 1 percent higher in 1982 than in 1976 despite a 34 percent increase in GDP during the same period.

Government has also improved administration of its 10 percent export compensation scheme during the past year, although the proposal to pay an additional 15 percent compensation on new or incremental exports has to date proved administratively infeasible. Over the past year Kenya has made a series of tariff reforms and with technical assistance funded by the ESF program is preparing legislation on anti-dumping procedures as a prerequisite to implementing a tariff-based import regime. Government has also begun to implement a new system of import licenses and schedules which gives preference to agricultural inputs, essential goods, spare parts, and imports needed to produce export goods. ESF-funded technical assistance is helping establish administrative procedures. An automatic mechanism to move more items to the "free" list as reserves increase has not yet been implemented, however, and the "free" list is still subject to scrutiny for "overstocking" and for goods competing with local production. Nonetheless, import licenses are in fact flowing more freely.

The Government of Kenya has, in addition, made a major effort in the past year to settle the question of distribution of the assets of the former East African Community. As relations improve, Kenya expects to regain a portion of its markets in the former Community states, as well as to improve access to additional African markets to the west and south. Decisions regarding the level, timing, and costs of foreign borrowing are now being facilitated by improvements in the computerized Kenya External Debt Reporting System (KEDRES) which were in part financed through ESF technical assistance. The system is now being extended to cover grant as well as loan-financed development projects, and will provide valuable information for budgeting and donor coordination as well.

c. Productive Employment

Structural adjustment has lagged in matters that would encourage productive employment of Kenya's rapidly growing labor force through a more rapid and efficient pattern of agricultural and industrial growth. The population problem itself has been only partially addressed during the past year through improved staffing of the secretariat of the National Council on Population and Development, and through an upgrading of its Director's position to Deputy Secretary level. In addition, as a matter of practice, oral contraceptives are now being supplied to first time users in selected trial areas without physician screening and prescription.

Expanded employment in the modern sector continues to be promoted by a gradual reordering of relative factor prices. In order to promote employment, it has been Government policy to permit increases in modern sector wages at a rate that only partially reflects increases in consumer prices. As a result, real modern sector wages have decreased over the past decade. A particularly tight domestic wage policy has been followed recently, with no overall increase in wages in the economy in the past two years.

Although credit policies have been tight, Government has attempted to allocate an increasing proportion of credit to productive purposes. Since 1981, nominal interest rates have been increased sharply, in part at IMF urging, while inflation has fallen. As a result there has been a significant improvement in the pattern of real interest rates. Most major deposit and lending rates were positive by the end of CY 1983 (see Table 10).

In the industrial sector, attempts to improve efficiency and competitiveness have been largely confined to reordering of the credit and trade regimes as discussed above. Procedures for approval of Government investment in commercial enterprises have been strengthened, however, and only 3 percent of Government's development expenditures during the 1984-1988 Plan are allocated to the manufacturing sector. With ESF-funded technical assistance, draft legislation has been prepared to establish a Monopolies and Prices Commission for the ultimate purpose of reducing anti-competitive practices and for ensuring reasonable prices for goods and services whose production or distribution are not freely subject to competition in Kenya's limited market.

In the agricultural sector, reforms to date have been insufficient to prevent a continued fall in the agricultural terms of trade which declined by nearly one-quarter during 1979-83. Nonetheless, Government has permitted increased prices for export crops on world markets to be passed on to farmers. Based on advice provided by Ministry of Agriculture planners, and the Technical Assistance Pool, Government has also raised internal producer prices for maize and wheat, the major food grains, to levels prevailing in world markets. Price increases have been more than offset by increases in the price of purchased inputs and consumer goods, however, evidence of the extent to which high costs and inefficiencies elsewhere in the economy act as an effective tax on the agricultural sector. In accordance with the conditions and covenants of the FY 1983 Grant, Government has now placed most agricultural inputs on the "free" list of scheduled imports, and continues to broaden the role of the private sector in the import and distribution of fertilizers. Reform of the marketing system for key agricultural outputs remains a major policy failure to date. Lack of payment, late payment, excessive deductions, and corruption continue to characterize the system of parastatal and cooperative marketing for nearly every major agricultural product in Kenya. To the extent that such features of the marketing system are not reflected in official price data, the agricultural terms of trade data cited above, although discouraging enough, are an incomplete picture of the current state of the agricultural sector. Improvements in the grain marketing system, to which Government has committed itself, would be an important first step toward improving returns to employment in agriculture. Liberalization of the marketing process for grains by encouraging competition between the private and public sectors, by easing restrictions on maize transport, by increasing the use of licensed agents, by limiting price regulation, and by limiting the role of the National Cereals and Produce Board to maintenance of a security food reserve, are steps which have yet to be taken. Such steps are not only the key to the rural incentive structure, but to the successful utilization of agricultural research and to the expansion of private investment in input delivery, in processing, and in trade. Government action in this area will figure prominently in this year's policy conditionality.

Table 10

Kenya: Trends in Selected Interest Rates, 1979-1983

	Year	Nominal Interest c/	Consumer Price Index d/	Real Interest Rate e/
Commercial Banks 1 Year Time Deposit a/	1979	5.63	12.3	-5.9
	1980	5.63	12.8	-6.4
	1981	6.35	20.0	-11.4
	1982	12.25	17.4	-4.4
	1983	13.79	10.3	3.2
Commercial Bank b/ Savings Deposit	1979	5.00	12.3	-6.5
	1980	5.00	12.8	-6.9
	1981	6.00	20.0	-11.7
	1982	10.00	17.4	-6.3
	1983	12.50	10.3	2.0
Commercial Bank Loans and Advances	1979	10.00 b/	12.3	-2.0
	1980	10.00 b/	12.8	-2.5
	1981	11.00 b/	20.0	-7.5
	1982	14.00 a/	17.4	-2.9
	1983	16.00 a/ f/	10.3	5.2
Hire Purchase and Merchant Bank Deposits a/	1979	8.75	12.3	-3.2
	1980	8.75	12.8	-3.6
	1981	11.00	20.0	-7.5
	1982	14.50	17.4	-2.5
	1983	16.25	10.3	5.4
Hire Purchase and Merchant Bank Loans a/	1979	12.00	12.3	-0.3
	1980	12.00	12.8	-0.7
	1981	14.00	20.0	-5.0
	1982	14.00	17.4	-2.9
	1983	16.00	10.3	5.2

Notes: a/ Maximum, b/ Minimum.

c/ Beginning of calendar year.

d/ Percentage increase in Nairobi consumer price index, December over December, based on weighted average of High (77.8), Medium (18.9), and Low (3.3) income groups.

e/ Computed as 100((1+i))/(1+p)-1) where i is the nominal interest rate and p is the percentage change in the weighted average consumer price index for Nairobi.

f/ End of year rate = 15 percent. Finance companies permitted to lend at up to 20 percent.

Source: Central Bank of Kenya: Economic and Financial Review, April-June, 1983. Central Bureau of Statistics: Monthly Statistical Bulletin, July - December, 1983.

III. Assesment of Donor Support for Structural Adjustment

A. Introduction

The international donor community became more heavily involved in supporting the recovery of the Kenyan economy at the time of the Government budget crises of 1980 and 1981. Measured in macroeconomic terms, a combination of support, advice, and action has been successful so far. With the support of significantly larger levels of program aid, the Government has been able to make sharp fiscal, monetary, trade and other policy adjustments. However, judged in the context of the rate and composition of development needed to ensure prosperity for Kenya's people in the year 2000, Government policymakers face the need for additional changes. There is general agreement that the Government and the donor community are dealing with the right policy issues, and that the right priorities are being established, but much greater attention needs to be given to the complicated details of implementation.

B. The IMF

Throughout the difficulties of recent years, Kenya has received considerable advice and support from the International Monetary Fund. Kenya's attempts to deal with deteriorating internal and external situations were not initially successful. A one-year IMF stabilization program in 1979 and a two-year Stand-By arrangement in 1980 were not completed. Some performance criteria were not met, nor were all of the contemplated SDR purchases carried out. A new IMF program approved in January 1982 was interrupted by failure to meet credit ceilings in June 1982 and by an abortive coup attempt in August of the same year.

Kenya's failure to meet individual quarterly performance criteria has marred a general pattern of improved macroeconomic management during the past three years. Given such progress, the IMF has continued its close cooperation with Kenya. The Fund has supported Kenya's adjustment efforts in 1982 and 1983 in the form of two Stand-By arrangements. During this period, Kenya has made purchases from the Fund totaling SDR 219.8 million (c. $235 million), the most recent purchase taking place in November 1983. The amount of Fund support is sizeable in view of Kenya's present quota in the Fund of SDR 142.0 million (c. $152 million). The current Stand-By arrangement which totals SDR 152.8 million (c. $163 million) includes two further purchases to be made before September 1984. Following the last purchase under the current Stand-By, the Fund's holdings of Kenya shillings under tranche policies will amount to SDR 332.8 million or 234.4 percent of quota.

Under the current Stand-By arrangement, Kenya has successfully met its fiscal, monetary, and credit targets for March, June, September and December 1983. All targets for March 1984 have also been met although the March performance criterion for total domestic credit was revised upward to accommodate higher than expected demand for credit by the National Cereals and Produce Board. It now appears that June 1984 targets will also be met. The Government proposes to negotiate an Extended Fund Facility with the IMF under which public expenditure and foreign exchange policies will continue to be met. Kenyan repayments to the Fund during the period of the 1984-1988 Development Plan are estimated at some $300 million. Most of this will fall due during the next three years, suggesting a likely request for an Extended Fund Facility at annual levels approaching Kenya's present quota with the Fund. This reliance on and dialogue with the Fund should ensure that Government remains committed to the demand management policies needed for further progress on structural adjustment.

C. The World Bank

The two-year Stand-By arrangement, approved by the IMF in October of 1980, was supported by a World Bank Structural Adjustment Credit and an EEC Special Action Credit totaling $70 million which was approved in March 1980. A second World Bank Structural Adjustment Loan ($60.9 million) and Credit ($70 million) were approved in July 1983. The first tranche of $80 million was made available upon effectiveness of the Agreement. Release of the second tranche was delayed from March, 1983 until January, 1984 due to slower than anticipated progress in a number of critical areas.

By the time of the first performance review in March 1983, the Bank concluded that conditions had been satisfactorily fulfilled regarding: (1) revised investment incentives for industry; (2) improved functioning of the Population Council; (3) an acceptable external borrowing program; (4) improved agricultural pricing; (5) improved management and budgeting of agricultural programs; and (6) establishment of new guidelines for project evaluation and Government investment in parastatals. Performance was found to be lagging in: (1) preparation of a forward budget and public investment program; (2) preparation of a new tariff structure; (3) carrying out of associated industrial transitional strategy studies meant to chart policy for amelioration of adverse effects of reduced protection; (4) developing an export promotion program; (5) reviewing large farm subdivisions and other land issues; and (6) taking action on the future structure of grain marketing.

By January 1984, the Bank had assisted the Government in preparing a forward budget and public investment program which was generally, if not entirely, consistent with the objectives of structural adjustment. A start had been made on tariff adjustment in the June 1983 budget which lowered most import duties above 30 percent by 14.7 percent. Work on industrial strategies was limited to one important sector (although a methodology was established for further studies). With regard to promoting exports, devaluations and export compensation were deemed to have provided the basis for disbursement of the second tranche. Improvements in import administration (which favored importation of inputs needed by exporters) and in the tariff structure (which improved the competitive position of exporters) were also made. The land issue remained intractable, but a Land Use Committee had completed the required comprehensive report covering subdivision problems on group farms and a wide range of other issues affecting land use. The consultant's study on grain marketing, which should have been completed by the end of 1982 was received in June 1983. Government has informed the Bank that it has decided to implement a grain marketing policy encouraging competition between the public and private sectors, changing the role of the National Cereals and Produce Board to a buyer and seller of last resort responsible for price stabilization, maintaining reserve stocks and conducting external trade in grain. Implementation of this policy has yet to begin, however. Based on these steps the Bank disbursed the second tranche in January 1984.

In retrospect, the Bank's list of conditions for the Second Structural Adjustment operation were too ambitious, too complex, and too politically charged to receive full and timely implementation by the Government of Kenya. Moreover, Government for the most part was unwilling to accept loan-funded consultants, even on IDA terms, who might have facilitated analysis and implementation of key features of the Structural Adjustment Loan. In considering a third Structural Adjustment operation, a shorter list of more specific adjustment steps may be desirable with more initiative being required on the Kenyan side. In light of such considerations, negotiations during mid-1984 are likely to be protracted, particularly if further steps are required in grain marketing, and in population, as logically they should.

D. The U.S. Program

In the several years the U.S. Mission has been supporting policy dialogue with program assistance and consultants, in coordination with the World Bank, IMF, and other donors, it has become apparent that Government implementation of policies, even of announced policies, is a lengthy, complicated and difficult process. The

.S.-Kenyan dialogue continues to focus on implementation issues of emand management and structural adjustment, and in effect serves as n implementation arm for selected Fund and Bank covenants as well.

Under the technical assistance portion of the ESF Grant for FY 983, the USAID is providing consultant services to assist the overnment in policy analysis and implementation. This grant ssistance is designed to help the Government implement the steps greed to in FY 1983 covenants and more fully implement actions aken as conditions precedent to disbursement.

The Mission believes U.S. technical assistance is being well eceived. The Government has had clear objectives and needs and has repared the scopes of work for consultants, the consultants have ad qualifications and experience known to Government, the quality f consultant productivity has been high, and Government has rovided counterparts and support for consultants activities. These onditions, as the Permanent Secretary for the Ministry of Finance nd Planning has stressed, have increased the likelihood that onsultants' analyses and recommendations are utilized.

The U.S. Mission recognizes that its dialogue with the Kenya overnment on policy issues is not one based solely or even mainly n "leverage" or one that allows the U.S. to force the pace or irection of Government policy pronouncements or implementation. owever, the supportive U.S. relationship enables the Government to nalyze options more fully and to implement some policies more apidly than it would otherwise. Many procedural steps have been aken under the FY 1983 Grant, signed less than a year ago, but a engthier time frame is required to judge the effects of decisions ade, or implemented, to restructure aspects of the economy.

- Progress Made on the FY 1983 ESF Structural Adjustment Program Grant

The FY 1983 Program Grant Agreement contained seven conditions recedent and eight covenants. USAID's review of progress achieved nder these conditions and covenants as defined in the context of ne priorities set in the FY 1986-1990 CDSS, sets the stage for ovenants and conditions contained in this ESF Amendment. The ollowing are keyed to the FY 1983 conditions. The covenants are lso identified.

(1) Export promotion has been encouraged by two significant and everal minor devaluations during 1982-1984 and by some implification of export procedures. An export incentive scheme rovides a 10% bonus on selected export products. Promotional rograms, including an additional 15% bonus, have been proposed or tudied, but no new ones have been implemented.

Despite 1984 being the Government's "Year of Exports", and the significant but short-lived tea boom in early 1984, there is little sign as yet that traditional exports have picked up following the world economic recovery, or that new markets and products are being developed.

The U.S. Mission believes that further steps to promote exports will continue to depend primarily upon shilling adjustments, and less upon promotional procedures (contrary to the emphasis on promotion given in the second covenant). Maintaining a realistically valued shilling is the cornerstone to structural adjustment. The policy approach supported by the Amendment therefore deemphasizes promotional approaches to increasing exports and fosters analyses of products and markets and associated conditions and constraints.

(2) Budget and Credit Targets. The Government met all IMF and USAID targets in 1983, and in 1984 to date. In coming years it will be necessary for the Government to ensure that public expenditure does not once again rise as a share of GDP and that private credit continues to expand in relative terms. Such an expansion in private credit will provide direct evidence that production and employment are recovering.

(3) Import administration is improving slowly following establishment of new import schedules for 1983/84. Further steps to eliminate controls, to implement expansion of the Schedule IA "free list", as foreign exchange reserves rise, and to liberalize import procedures, require immediate attention. The first covenant gives emphasis to further reform of import proceedures and to movement towards a more uniform tariff structure.

(4) Agricultural inputs were shifted to Schedule IA, except for fertilizers and pesticides, which require quality control and were placed on Schedule IIA Special where they require ministerial review and foreign exchange approval. Fertilizer importation has not been constrained by limitations on foreign exchange.

(5) Improved administration of fertilizer importation and distribution and private sector participation. The Government established a Fertilizer Advisory Committee with public and private members in late 1983. The Committee has met to confirm public sector estimates of the types and amounts of required fertilizer imports, to establish prices and to approve private sector distributors. The agreement giving monopoly control of distribution of donor fertilizers to a single organization has been terminated and substantial progress has been made in insuring private sector participation in distribution of imports. A system whereby

importation is privately determined and managed will not be fully operational until later this year. The sixth covenant calls for evaluations of the Committee, one of which has taken place to date

Private investment in agricultural inputs, such as in fertilizers, and associated transportation and storage facilities, will depend primarily on marketing margins, and on the decontrol of prices and marketing regulations for agricultural outputs. Relevant studies have been completed, but no significant decisions have been announced to date.

(6) Public investment planning and establishment of priorities. Assistance from the World Bank was required before Kenya could fulfill its commitment under Structural Adjustment Loan II to complete a forward public investment plan. The Development Plan 1983/84-1988/89 does not reflect curtailment or deletion of projects for which commitments have already been made, nor does it clearly delineate the criteria used to select new investment projects proposed for the Plan period. The Government has established and announced to the donors, however, the criteria for funding projects in annual budgets: that a project must be included in the Plan and Forward Budget, that it must yield economic and social benefit, that it must be adequately funded, with sufficient foreign exchange to cover all imports needed, and that funds for recurrent and local costs must be available. Following completion of a donor project compendium by the UNDP and AID, the Government is beginning to strengthen its capacity to analyze these data in conjunction with data on domestic and foreign debt and the forward budget planning process. In accordance with the third covenant, the Government is now giving high priority to strengthening its budget process. Government is also developing special mechanisms, according to the first covenant, to manage externally financed programs.

(7) Food security policy. Following completion of internal and external food policy studies, the Government is taking steps to strengthen emergency food reserves, and, with great reluctance and misgivings, to reduce its role in grain marketing and in food imports. Because of the current drought threat, food security is being addressed in a crisis atmosphere without adequate attention being given to strengthening information and response mechanisms. Food marketing controls are seen as a public responsibility ensuring urban price stability, preventing exploitation by private interests, and hindering unofficial exports. Steps to eliminate present controls on prices, assemblage and shipment are not readily adopted by Government, even though the development penalty of rural growth foregone may be high. USAID and other donors continue to believe that significant decontrol is a precondition to increasing rural incomes, investment and growth.

The establishment of a Monopolies and Prices Commission is the fifth covenant of the FY 1983 agreement. The Government has prepared a draft law to ensure orderly marketing practices, to secure fair prices for consumers, and possibly to help Government determine which basic commodity prices to decontrol. Price decontrol, should it take place, has obvious positive implications for private investment and the ability of the Government to undertake parastatal divestiture.

The preparation of strategies for Parastatal Body divistiture is the seventh covenant. Although Government has yet to actually divest itself of any parastatal body, a Task Force studying the legal and budgetary implications of parastatal reorganization, strengthening, and possible divestiture is to report its findings and recommendations to Cabinet.

In summary, the Kenya Government is beginning to lay the organizational and analytical groundwork needed in several ministries to improve Government efficiency and to undertake structural adjustment.

2. Supporting Technical Assistance in FY 1983

Technical assistance provided under the FY 1983 agreement has been the principal instrument for policy discussion and implementation and has thereby kept the Structural Adjustment Program Grant alive as a basis for dialogue between the Kenyan and United States governments. In the absence of this $2 million for consultants, the impact of the $28 million in foreign exchange and budgetary support for Kenyan stability would have been substantially reduced.

USAID has committed approximately one-half of the two million dollars in the ten-month period since the signing of the grant agreement, and plans to commit the remaining portion before the end of 1984.

The FY 1983 agreement covered five kinds of technical assistance support.

(a) Technical Assistance Pool.

In May 1984 USAID will commit $900,000 in support of the Technical Assistance Pool in the Ministry of Agriculture and Livestock Development. This long-standing source of advisory support has not been successful as yet in institutionalizing a policy planning capacity in the Ministry. However, consultants find that their advice is accepted on specific policy issues such as food pricing and grain reserve levels and in areas of budgetary and organizational reform. Under a revised plan for further support in FY 1985, USAID will support progress towards institutionalization of a policy-planning capacity.

(b) The Ministry of Finance and Planning has yet to request assistance for improved analysis, budgeting, and administration of donor and Government financed projects. Nonetheless, short term consultancies have been provided to improve implementation of a computerized reporting system for domestic and foreign debt (and such assistance is continuing). The AID/UNDP project compendium of donor assistance has been well received by the Ministry of Finance and Planning and should serve as the basis for increased rationalization of the donor coordination process. USAID anticipates that the Directors of External Affairs and of Budget in the Ministry of Finance and Planning will request a range of assistance to help Government strengthen its budgetary procedures. This strengthened capacity is needed to assess Government, parastatal and donor investments; and to underpin coordination of donor aid.

(c) Studies.

In order to facilitate policy implementation, the Government has called on consultants to help define and draft policy options in several areas. These include preparatory work for parastatal body divestiture, drafting of the terms of reference for legislation for a Monopolies and Prices Commission, improvements in import administration, and use of micro-computers in various parts of Government. In late 1983 the Central Bank requested two consultants to improve Central Bank management, improve inspection and management of commercial banks and establish a saver deposit protection scheme. The primary goal of these consultancies is to increase domestic resource mobilization by improving the efficiency and soundness of financial markets. Although it is unrealistic to expect the studies component of U.S. program assistance to lead directly to policy impact as early as 1984, the use of grant money for studies is contributing to the formulation, direction and possibly to the rate of policy implementation by the Government.

(d) A Government request for U.S. micro-computers was temporarily stalled in late 1983 by policy deliberations on the use in Kenya of sophisticated technology which is sometimes thought to have negative implications for employment. Nonetheless, by mid-1984 USAID expects a Government proposal to enable further work in donor coordination, budgeting, import administration, and Central Bank operations and management.

USAID has observed that a precondition to public sector decontrol, deregulation, and restructuring is often a greater degree of Government understanding and sense of control. Although increased confidence may not always lead to deregulation, there is no doubt that USAID consultants are playing a useful role. It is also apparent that micro-computers are a low-cost, easily utilized technology that are giving Government analysts and budgeters an informational, analytical and managerial capacity they have not had.

(e) Evaluation

The original schedule for an evaluation in January 1984 was unrealistically optimistic in its expectation that there would be concrete actions to examine. An outside team will conduct an evaluation in January 1985.

3. Counterpart Shilling Utilization in FY 1983

In the FY 1983 PAAD, the Mission had proposed that "The local currency made available under the program 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." Because of the Government's severe budget constraint at the end of FY 1982/83 and the importance of not exceeding IMF domestic borrowing limits in FY 1983, shilling generations in FY 1983 were directed to budget support.

Shillings were utilized to fund developmental activities mutually agreed upon by AID and the Government in the areas of rural development and agricultural production, rural private enterprise, and family planning in the Fiscal Year 1982/83 budget. Shillings were programmed for agreed upon uses by an exchange of letters between the Ministry of Finance and USAID dated August 1 and August 3, 1983, respectively. The Ministry of Finance letter itemizes the shillings released to six ministries for twenty-one project activities.

The counterpart funds represented 35% of the shilling budgets for these development programs. Without this allocation, the programs would have been under-financed and seriously impaired. As stated in the following section, the Mission proposes similar uses for FY 1984 generations, but with the addition of a number of activities in the private sector.

IV. FY 1984 ESF Structural Adjustment Program Grant Amendment

A. The FY 1984 Program

Following the FY 1984 Amendment adding $40 million to the FY 1983 Structural Adjustment Program Grant, the total Economic Support Fund program will be $70 million. A $34 million Commodity Import Program (CIP) will follow the FY 1983 cash grant of $28 million, and the technical assistance component will be increased by $6 million. The proposed technical assistance program is described in Section V; the CIP, in Section VI.

The shillings generated by commodities sold by private importers shall be deposited in a Special Account and shall allocated in part to the development budget amd in part to agreed upon private sector activities. The shillings will be programmed as described in Section VII, for mutually agreed upon activities.

The conditions precedent to disbursement and the covenants of this Amendment reflect assessment of structural adjustment requirements and support similar conditions expected to be under negotiation between Government and the IMF and the World Bank. A number of conditions and covenants will also be required to expedite implementation of the CIP.

Although the conditions and covenants of the FY 1983 Agreement are not explicitly linked to those in this Amendment, the FY 1984 conditions and covenants are analytically related to and serve to further implement those agreed to in FY 1983. USAID monitors the substantive and procedural progress of the bilateral dialogue, however funded, very closely The results of the January 1985 evaluation will also be utilized by USAID and Government to help shape the dialogue.

USAID support for structural adjustment is complicated by a basic dilemma: short-term program assistance in response to the Government's 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 help undermine prospects for the desired structural adjustment. Each program grant must therefore be based on a careful weighing of actual and projected progress towards structural adjustment.

While recognizing significant Government progress on macromanagement, it is USAID's view that overall Government progress on structural adjustment has been less than expected. The lack of progress reflects political difficulties, the complexity of relevant economic issues, the unrealistically short amount of time allowed for policy implementation, and what appears to be a lack of consensus within the Kenyan Government needed to support the structural adjustment that must be the key to development in a country for which population will double in less than twenty years.

Because actions identified in the original Grant Agreement have not been fully implemented this Amendment provides assistance in the less attractive, less fungible form of a commodity import program. It also provides a higher level of grant-financed technical assistance to support the adjustment process which Government requires and can effectively absorb.

The policy conditions address basic development problems and policy constraints identified in the CDSS. As in the CDSS, the principal focus is upon the kinds of policy change and public investments that enhance opportunities for private sector growth and employment expansion. The selection of conditions and covenants is determined by a careful weighing of the prospects for implementation in the near term and the relative importance of each covenant or condition in contributing to broad-based growth over the longer term. Given the urgency created by Kenya's population growth rate, finding avenues to increase income must be a near term priority. It is for this reason that such great importance is given to prices and other factors governing the market investment environment. Recognition of the political complexities of policy decisions, and they are complex, does not mean that Government or the donor community can remove fundamental issues from the development agenda.

B. Conditions Precedent to Disbursement

<u>Agriculture</u>

(1.) In order to promote increased rural incomes and investment, the controls on the distribution and sale of maize between districts shall be reduced. Specifically, the Government shall increase the limit on the number of bags of maize that can be shipped by private traders between districts, without need of permits, from three to ten bags. The Government shall make a public announcement of this action.

Family Planning

(2.) In order to lower costs to consumers and promote the distribution, sale and use of family planning commodities, the Kenya Government shall waive all import duties and eliminate taxes on commodities used for family planning services. A public announcement to this effect will be made in June of 1984.

Trade

(3.) In order to promote private investment and trade, the Kenya Government will direct that all applications for licenses to import goods on Schedule IA will no longer be reviewed by the Import Management Committee for overstocking. A public announcement of this action will be made by the end of July 1984.

(4.) In order to speed import approvals, the Kenya Government will direct that a schedule for the implementation of the system for annual allocation for imports listed on Schedule IB will be established, and will provide USAID a copy of the implementing instructions.

(5.) In order to speed export procedures, the Kenyan Government will implement the "Green channel" documentation procedure for exporters by which exporters can obtain complete documentation for export approvals from Government in one office. The Government will announce this action, including advice to exporters on where to submit applications for export approvals.

The Shilling Counterpart Program

(6.) The Kenya Government will open a special account into which shilling deposits as agreed will be deposited.

Commodity Import Program

(7.) The Government will provide:

(7a.) A list of all importers registered with the Customs and Excise Department;

(7b.) Copies of the Letter of Invitation to participate in the program to each registered commercial bank in Kenya;

(7c.) Copies of letters to registered commercial banks notifying them of their selection to participate in the program; and

(7d.) Copy of a notice to importers that, since no Societe General Surveillance inspection will be required for CIP commodities, the usual one percent import license fee paid to the Central Bank will be reduced to one half of one percent for CIP commodity import license applications.

C. Covenants

Agriculture

To ensure that Kenyan producers can obtain remunerative and timely cash payments for their crops:

(1.) The Kenya Government covenants that it will provide to USAID a report specifying how the problem of timely cash payments by parastatal and cooperative bodies to producers for the principal food crops is being resolved, and

(2.) The Kenya Government covenants that it will consider the proposal that the Kenya Farmers Association, cooperatives, and maize processing firms may purchase maize from producers and traders directly.

The Domestic Budget and Public Investment Priorities

(3.) In order to strengthen and coordinate the Government's annual budget process, the Government covenants that it shall submit a report to USAID by the end of 1984 assessing progress towards improved interministerial budget coordination and requirements for staff strengthening and equipment.

(4.) In order to foster an expansion of private sector credit, the Kenya Government covenants that it will restrict the level of the public deficit during its FY 1984/85 to not more than 4.2% of GDP as stated in the new Plan.

(5.) The Kenya Government covenants that it shall include the recurrent and development budgets of all 25 major parastatal bodies in the Budget Estimates for 1985/86.

Foreign Trade

(6.) The Kenya Government covenants that it will maintain an active review of exchange regulations and exchange rates with the object of strengthening the competitive position of Kenyan exporters in world markets.

U.S. Commodity Imports

(7.) The Kenya Government agrees that all disbursements from the special account will be made subject to AID approval.

(8.) The Kenya Government agrees that with respect to Exchange Control Notice No. 19, guarantees issued to Kenya-registered companies, regardless of owner nationality, will not be considered as local borrowing under the Commodity Import Program (CIP).

(9.) The Kenya Government covenants that it will inform importers that funds from the Grant are available for marine insurance to cover goods financed herein, provided that the insurance is placed in the U.S.

(10.) The Kenya Government covenants that the Import Management Committee will not review any Import License application for goods financed under this program, except those goods included on Schedule IIB.

(11.) The Kenya Government covenants that it will provide USAID a copy of: (a) each approved Import License Application for goods financed under this program, (b) a copy of the "Import Entry" form for each consignment of goods financed under this program, and (c) a copy of the "Out-Turn" report for each ocean vessel carrying goods financed under this program.

(12.) The Kenya Government covenants that the Ministry of Commerce and Industry will review and process all Import License applications under the Grant within a maximum of ten working days after receipt from importers.

(13.) The Kenya Government covenants that the Central Bank of Kenya will process all applications for Foreign Exchange Allocation Licenses under the Grant within a maximum of two working days after receipt from the Ministry of Commerce and Industry.

(14.) The Kenya Government covenants that the shilling deposits shall be placed into the special account no later than 90 days (or such other period as USAID may subsequently agree to in writing) after the U.S. dollar payment is made by the U.S. Government to the bank holding the Letter of Commitment for goods financed under this program. A monthly statement showing all deposits into and withdrawn from this account shall be supplied to USAID no later than 30 days after each monthly period ends.

V. Technical Assistance in Support of Structural Adjustment

The technical consultancies proposed for FY 1984 funding reflect experience under the FY 1983 Agreement and the strategic priorities of the FY 1986 CDSS. The FY 1983 PAAD proposed to continue the same technical assistance agenda in FY 1984 but to double the funding to $4 million. This Amendment proposes that the technical assistance level be increased to $6 million, reflecting progress achieved in establishing a bilateral policy dialogue during 1983 and 1984, the incorporation of policy-oriented projects under Program assistance, the number and dollar cost of Government requests for consultancies, and Commodity Import Program monitoring requirements.

The Technical Assistance Program and its implementation procedures are described in Annex E of the FY 1983 Agreement. Under the FY 1984 Amendment, USAID plans to maintain support for implementation of Government's macromanagement, sectoral and structural adjustment priorities.

The bulk of the funds in FY 1984 will support three relatively large policy-oriented efforts, two of which received funding under the FY 1983 Grant. The policy advice is offered throught the Technical Assistance Pool of advisors for the Ministry of Agriculture and Livestock (TAP II); a new activity in the Ministry of Finance and Planning, Resources Management for Rural Development, and technical implementation of import administration. In addition, USAID expects that assistance to the Central Bank will increase, and that support for the strengthening of the budgeting procedures within the Ministry of Finance and Planning will begin.

Under TAP II, USAID proposes to contribute to the pool of donor finance for the last year of the present agreement. With a strengthened budgetary and analytical capacity now in place, USAID expects that the Ministry of Agriculture and Livestock

Development will have the capacity to capture a larger policy role with regard to the many agriculturally-related institutions outside its direct control.

The new activity for the Ministry of Finance and Planning signals USAID's and Government's concern that District Focus be utilized as one vehicle for promoting private sector growth. In addition to continued assistance to strengthen budgeting and planning, the Resources Management Project will support advisors on rural resources utilization and on the environment for private sector growth in rural areas. USAID expects to support District Focus primarily in ways that promote private investment.

Government's efforts to implement its new import procedures have depended upon U.S. Bureau of Census advisers provided with FY 1983 funding. The work of the Bureau will continue to develop procedures to speed and simplify approvals of import licenses and train staff. Under the conditions of this Amendment we expect Government to streamline import procedures further by reducing the number of license reviews.

Additional areas identified for policy implementation or formulation are set forth below on an illustrative basis. Current requests from Government to which USAID expects to respond are indicated below by line item and tentative budget level. The total funding proposed for each category may be larger than the sum of the individual requests received to date.

As in FY 1983, the program will provide computers and associated support as well as training for individuals who have a direct and immediate responsibility for effecting implementation of policies.

A. <u>Sectoral Policy and Planning</u> $3,000,000

(1) Consultant assistance for agricultural policy formation and planning, rural resource mobilization, and drought management.

(i) Technical Assistance Pool II $ 800,000

(ii) Resource Mgmt. for Rural Development $2,100,000

(iii) Drought Management $ 100,000

B. Strengthening Policy Capacity of Central Ministries $1,500,000

(1) Strengthening of a unified budgeting system in the Ministry of Finance and Planning. The system would provide computerized accounting of domestic and foreign debt, and of donor loans and grants, and would be operationally coordinated with sectoral ministries throughout the budget cycle.

(2) Consultants, training and microcomputer support costs for the Central Bank to improve internal management, and improve capital markets.

(i) Central Bank $ 400,000

(3) Continued assistance is proposed to improve and liberalize import administration.

(i) U.S. Bureau of the Census $300,000

(4) Assistance shall continue, where requested, for parastatal body divestiture, and to further liberalize reliance on controlled prices. $200,000

C. Studies $700,000

(1) Export promotion including tourism $100,000

(2) Industrial sector and trade studies, analysis of effective rates of protection, and industry-specific feasibility studies. $200,000

D. Microcomputers $400,000

E. Evaluation $100,000

Total $5.7 million

Note: The proposed budget for Commodity Import Program monitoring is contained in Annex E; the total consultancy budget is contained in Annex B.

VI. The Commodity Import Program

To evaluate the feasibility of a Commodity Import Program for Kenya, and to assess the appropriate magnitude of such a program, in the fall of 1983 USAID commissioned a study of U.S. exports to Kenya over the last 5 years. Mr. Tribble, the study's author, reviewed U.S. exports to Kenya in commodity categories totalling over $100,000 in any sample year during the period 1978-1982, and analyzed those exports with reference to commodity eligibility, size and sector.

The Principal salient facts to emerge from this study were that:

- The United States exports an average of approximately $125 million of commodities to Kenya each year;

- Eliminating the high and low years for each product category, approximately $46 million of this amount would normally be eligible for AID CIP funding (excluding PL 480, ineligible commodities, and categories for which there were less than $100,000); and

- The sectoral distribution of eligible commodities is - Industry and Business (31%); Construction and Infrastructure (18%); Agriculture and Agricultural Industry (14%); and Health and Education (57%).

Based on these figures and his own experience with CIP programs, the study's author concluded that a CIP of approximately $46 million annually would be feasible provided that appropriate structures and incentives could be provided.

Given these factors, in part, USAID settled on a CIP of $34 million for FY 1984.

A. General Responsibilities

Overall responsibility for carrying out the Kenyan side of the Agreement rests with the Ministry of Finance and Planning. However, the success of this program depends greatly on the involvement of the several Kenyan commercial banks through which the CIP funds will be channelled. The Kenya commercial cooperating banks will be provided with an incentive to make quick use of these funds. The Central Bank's role is one that differs little from its role in ordinary foreign exchange operations.

USAID/Kenya's role will generally be one of program monitoring. For this purpose, contract help will be required, particularly in the area of reviewing import license application documents, arrival accounting, end-use accounting, and auditing deposits into and withdrawals from the special account. The Mission will also advertise the CIP through AID/W's Office of Small Business.

AID/W's involvement will include issuance by FM/BFD of Letters of Commitment to the U.S. correspondent banks. SER/COM will be involved in approving Form 11 applications and in reviewing payment documents for compliance with AID Regulation One. (Form 11 approval checks for commodity eligibility, source/origin, and reasonableness of price). SER/COM/SE will be responsible for performing post-payment audit of prices (including review of Form 282 and follow-up with suppliers concerning claims for over-pricing, as required). SER/COM/TS will monitor compliance with cargo preference and grant ad hoc transportation source waivers as needed. AID's certifying office in New York will process disbursements to correspondent banks.

B. Governing Regulations

AID's standard financing and procurement procedures (AID Regulation One in its entirety), will be applicable to all foreign exchange transactions under the grant.

1. Private Sector Procurement:

The Kenya CIP program will be run through the private sector. In Kenya many parastatal enterprises function essentially as private entities and are therefore to be treated as such under this program. Parastatals will be eligible to access CIP funding provided their applications are submitted through commercial banks and are treated by the Ministry of Commerce and the Central Bank in the same way they would treat any other applications. Should Kenya law or regulation require that a particular procurement be reviewed by the Central Tender Board that procurement will not be treated as a private sector procurement, and will not normally be considered for CIP financing.

a) Negotiated procurement:

All procurement undertaken by the private sector can be carried out using the negotiated procurement procedures described in AID Reg One, section 201.23. If a given importer, or group of importers, wish to use formal competitive bid procedures, USAID will assist.

b) Publicity requirements:

In order to proceed with negotiated procurement as described in AID Regulation One, USAID will first publicize the CIP in the United States in the manner sometimes referred to as the "Colombia Plan." The work already done by Know-How International in identifying Kenyan importers will be of significant help in carrying out this requirement.

All importers are registered with Customs. Each importer includes his registration number on any import license application. PD&S funds will be used to hire a local private firm to prepare a list of all these registered importers with additional details including: name of firm, name of proprieter address (postal and actual), phone number, telex number, type of usual import, special relationships with U.S. firms, and if possible, size of assets or size of imports or other appropriate size determinants. This list, when publicized and distributed in the U.S., will fulfill AID's Section 201.23(b) requirements.

2. Public Sector Procurement

At the present time, use by the public sector of CIP financing is not forseen. Nevertheless, should there arise in the course of this CIP a strong Government demand for an eligible commodity or commodities, to be used to reinforce viable development objectives, USAID/Kenya would consider a request for a diversion of some CIP funds for this purpose. In this case, the relevant Government entity must deposit into the USAID special account the local currency equivalent of the amount to be financed when the Finance Request is issued by the Ministry of Finance or its designee. All procurement will be conducted according to the formal competitive bid procedure described in section 201.22 of Aid Regulation One.

3. Eligible Source-Commodities and Freight

Inasmuch as this is a grant, the only source eligible for financing is USAID Geographic Code 000, the United States. Eligible shipping therefore is restricted to U.S. flag vessels. Most imports under this program will be shipped on liner vessels. Lykes Lines provides regularly scheduled liner service from Gulf ports to Mombasa. U.S. Lines, through their department which was formerly Moore-McCormack Lines, provides regularly scheduled liner service from East Coast ports to Mombasa. SER/COM/TS may find individual shipments eligible for shipment on non-U.S. flag vessels and will issue transportation surface waivers on an ad-hoc basis. Air freight will, however, also be eligible for AID financing, when such air freight is performed in accordance with section 201.13(b)(2) of AID Regulation One. The decision whether to use air transportation will be made by the importer, in accordance with the usual commercial practice for the type of commodity and depending upon the urgency with which it is required.

Kenyan importers may finance transportation themselves on Code 935 carriers rather than use CIP financing, provided that less than 50% of the total CIP cargo financed under this agreement is shipped on non-U.S. flag vessels. SER/COM/TS will monitor this requirement. Under no circumstances, however, will AID finance commodities shipped on a vessel of other than code 935 flag.

4. Size of Transactions

The minimum size of transactions under the grant will be set at $10,000. This relatively low minimum transaction size has been chosen since USAID's analysis (see Supplementary Annex A) suggests that the volume of imports in the $10,000-$50,000 range is likely to be large and to exclude them would unnecessarily delay disbursement. The maximum size will be $1,500,000, except with USAID's written consent. USAID has reserved the right to approve transactions above this amount in order to be able to require formal procurment procedures, if appropriate.

5. Eligible Commodities

All items in the "AID Commodity Eligibility Listing - 1983 Edition" will be eligible for financing under the grant, subject to the special provisions appended to that listing. This listing excludes from financing luxury goods, explosives items for police or military use, etc. This wide range of eligible commodities will facilitate fast disbursement.

6. Eligible Commodity-Related Services

(a) Insurance:

The current Kenya practice requires importers to purchase insurance only locally and in Kenya Shillings. USAID will require that importers be informed that CIP funds may be used to finance marine insurance for CIP-financed goods and that such insurance must be placed in the U.S.

(b) Ocean and air freight:

A.I.D. will finance 100% of the ocean freight or air freight of eligible commodities if importers so desire, subject to the source conditions contained in section 3 above.

(c) Commissions:

A.I.D. will finance, in dollars, eligible commissions of sales and service agents including Kenya and third country agents. Commissions to importers' purchasing agents in connection with a sale by a supplier to his dealer, distributor or established agent are not, however, eligible for financing.

(d) Inspection:

The current Kenyan practice is that all imports are checked for price reasonableness and inspected on a sample basis by Societe General Surveilliance SA (SGS), a Swiss registered international inspection firm. This requirement will not be applicable to CIP goods because the price check function performed by SGS will be performed by AID/W in its Form 11 and Form 282 reviews. If an importer desires to have CIP goods physically inspected then CIP funds will be available for the importer to hire a U.S. inspection firm.

(e) Banking charges:

A.I.D. will finance the banking charges of the banks to which Letters of Commitment pertaining to this grant are addressed. No counterpart shillings will accrue from these charges.

C. Implementation

1. Method of Financing

Since it is planned that all funds under the grant will be allocated to private sector importers, the A.I.D. bank letter of commitment/letter of credit method of financing will be used because to use direct letters of commitment for the hundreds of transactions likely to be involved would overwhelm AID/Washington. Government will solicit applications from commercial banks in Kenya which have financed more than $3 million in imports from the United States in at least one of the past three years. A committee of USAID and Government of Kenya representatives will select between 5 and 10 banks to participate in the program (based on financial soundness, commercial reputation, past business in U.S., and banking charges). Letters of commitment, initially in the amount of $2 million, will be opened in favor of each participating commercial bank. Further details concerning this process are included in Annex K. In the event an allocation is made to a public sector entity, the direct letter of commitment to supplier method of financing will be used.

2. Incentives

Many of the peculiar features of AID program commodity import assistance (AID marking requirements, requirement for proof of competition or special importer/supplier relationship, cargo preference rules, AID's right to audit or inspect commodities for end-use, AID's ability to only finance shipment on Code 000 flag vessels, longer delivery time from the U.S. than from many traditional markets, etc.) serve as disincentives for importers and commercial banks to take advantage of this type of assistance. These disincentives would not be as serious if the Kenya economy were in a far worse condition than it is and the shilling was substantially over valued. Presently, most importers can get import licenses approved and foreign exchange allocation from Government reserves, or from other donor aid. The importers and banks agree that the main impediments to using the present system with Government-supplied foreign exchange is that it takes too long for import license and foreign exchange approval, and sometimes the approval is not forthcoming at all, especially for other than category 1A goods.

USAID plans to ameliorate these AID-imposed and Government of Kenya disincentives. First, USAID will covenant that import license applications are reviewed and approved or rejected within ten days and that none of them are reviewed by the Import Management Committee and further that the Central Bank issue a Foreign Exchange Allocation License number within two days. Second, USAID will require that deposits of Kenya Shillings will be made by the cooperating commercial banks to the special account 90 days after the sight L/C is paid in the U.S. In effect this provides use of the Kenya Shillings for 90 days interest free in lieu of credit through usual channels. The benefits of the delayed payments will be shared between the importers and the cooperating Kenya commercial banks per their mutual agreement. Competition between banks should ensure that the importers receive an equitable share of the period. This 90 day interest free period incentive may be adjusted later, if funds are not disbursed rapidly enough (vis a vis the expected disbursement schedule provided in Annex G) but in no case will the period be extended beyond 180 days. A further incentive will be that since no SGS inspection will be performed, the importer will pay only a .5% application fee to the Central Bank, which is half of the usual charge of 1%.

3. Disbursement Period

Ninety-five per cent of the proceeds of the grant are expected to be disbursed within a 24 month period after the grant is signed. However, long delivery time for some capital goods and some spare parts preclude full disbursement within 24 months. The terminal disbursement date will therefore be set 36 months from the grant agreement date and the terminal date for requesting disbursement authorizations will be set at 24 months from the grant agreement date.

4. Commodity Arrival and Utilization

The Government's responsibilities with regard to clearing and accounting for CIP-financed commodities will be spelled out in the Agreement. In brief, these requirements include Kenya's responsibility to maintain, for at least three years, a system of records documenting the arrival and disposition of commodities financed by AID, ensuring clearance by customs within 90 days, ensuring effective utilization within one and a half years from arrival in Kenya, and ensuring that the goods are not exported from Kenya in the same form in which they were imported.

The Ministry of Commerce keeps records for import licenses they approve. The records are kept in file folders, one folder for each importer, filed alphabetically by importer's name. Statistics are compiled by SITC code and by preference category for applications approved monthly and yearly.

The Central Bank keeps statistics only on the amount of foreign exchange that has been authorized and expended. Files are kept only by foreign exchange allocation license number.

The Customs and Excise Department of the Ministry of Finance and Planning keeps statistics by SITC code of imports. The "Import Entry" form which is prepared in six copies has full details including the Import License number, the Foreign Exchange Allocation License number, the Bill of Lading or Air Waybill number, and a full description of the goods. 5% to 10% of all imports are physically inspected by Customs. A copy of this form will need to be obtained for preparation of the arrival accounting reports. The form reflects short shipments, short landings, and partial deliveries. The Government will covenant supplying this form to USAID.

The Kenya Port Authority prepares ship out-turn reports, usually within 14 days after a ship's departure. This report will also be useful in determining short shipments and short landings. The Government will covenant supplying this form to USAID as well.

Under the existing system of Government record keeping, there is no automatic way of determining which import licenses or letters of credit (L/C) have actually resulted in imports into Kenya. This is due primarily to the fact that the Ministry of Commerce keeps track of imports by import license application approval numbers, and it does not know if these approved applications result in L/Cs. The Central Bank uses Foreign Exchange Allocation License numbers for their records. The commercial banks use their own letter of credit (L/C) number, although on the L/C is noted the import license application approval number. The Customs and Excise Department tracks imports by vessel's rotation number, and Bill of Lading (B/L) number for ocean shipments; and by flight number, date, and Air Waybill number for air shipments.

It is only rarely that goods remain in customs for anywhere near 90 days because port storage charges are substantial (presently 12 shillings per ton per day). No storage fee escalation charge is applied to imports. Instead, if clearance documents are not submitted to the port within 21 days after the vessel starts discharge, then the goods are to be sent to customs for auctioning. This provides sufficient incentive to remove goods promptly from the port. The main reasons goods are not removed expeditiously from the port is improper or inadequate documentation, e.g., no original negotiable B/L has been presented, or the goods cannot be located in the port perhaps because the goods were shipped and manifested "break bulk" but are now in a container which has not yet been stripped. A port inspection has shown that it has more than adequate equipment to physically handle the imports, and has storage facilities reasonably secure from theft and weather.

A contractor will be hired to provide prompt and complete arrival accounting reports to AID because the Government's present arrival accounting system is not fully intergrated for AID's need to ensure that all AID-financed commodities clear the port within 90 days after arrival. USAID will require that the Ministry of Commerce give a copy of each approved import license to USAID, and will require each cooperating commercial bank to give USAID a copy of each L/C issued under the program, and further require that when payment documents are received by the participating local commercial bank, that a copy of each B/L is given to USAID. These records will be used by the contractor to compare with ships out-turn reports to determine when AID financed goods are landed and to compare to customs' "Import Entry" forms to determine when the AID financed goods have left each Kenyan port. The contractor will submit reports every two weeks to USAID showing which goods have cleared the ports, which ones have resulted in partial deliveries and therefore insurance claims should result, and which ones have been in the port for more than 30, 60, and 90 days. This system will enable USAID to follow up with importers and the Government to facilitate port clearance and to ensure that when CIP funds were used to purchase marine insurance any marine insurance proceeds are used to procure other eligible CIP commodities.

The Government presently performs no end-use utilization accounting, although the Ministry of Commerce does not issue licenses which in its opinion would result in imports of more than an 18 months' supply of goods by any one importer. The purpose of such controls is primarily to discourage hoarding. AID's policy (HB 15, Chapter 12) requires consumption or use by the importer or sale or transfer by the importer for consumption or use within one year from the date the commodities are removed from customs, unless a longer period can be justified to AID by reason of force majeure, special market situations, or other circumstances. USAID proposes a deviation from USAID's usual policy in this regard to coincide with Government policy. Thus the one year period will be increased to 18 months for goods financed under this agreement. A contractor will also perform end-use checks on imports to ensure that this requirement is being met. Twenty-five per cent of the imports financed under this agreement will be checked for utilization within the stipulated time period. The twenty-five per cent will be calculated separately for the value of the goods, for the number of transactions, and for the number of transactions outside of the metropolitan Nairobi area.

5. Technical Assistance for CIP Monitoring

USAID will identify a firm that is able to provide timely technical assistance for implementation, monitoring and reporting. Given the need for speedy initiation of contractor activity, USAID may hire a firm under the set aside provision of the Small Business Administration, following limited competition among 8a firms. To do this, USAID/Kenya will prepare a PIO/T authorizing REDSO/EA to negotiate the contract.

The first discrete task the contractor will perform is to assist importers, not fully familiar with the U.S. market, to locate suppliers. It is assumed that many of the smaller importers will be unable, without assistance, to locate manufacturers or other suppliers in the U.S., and even if they are used to doing business with a U.S. supplier, they will not easily be able to locate alternative suppliers to fulfill AID's requirement for competition. The contractor would locate supplier sources in the U.S. on the most commercially sound basis, e.g., if a manufacturer could provide the goods less expensively than retailers, the contractor will steer the importer to manufacturers and, if only distributors can provide installation services which are required, then the contractor will steer the importer to distributors. The contractor's role will be limited to matching potential suppliers and importers. The contractor will not assist importers to develop specifications, evaluate offers, or be involved in contract negotiations between potential suppliers and importers.

The second discrete task is arrival accounting. The contractor will be required to provide the reports mentioned in Section VI C4, for goods financed under this program (and possibly for AID-funded fertilizer arrivals).

The third discrete task will be to audit cooperating Kenya commercial banks deposits into the CIP special account. The contractor will be required to audit the deposits of each cooperating bank twice a year.

The fourth discrete task will be to perform the end-use accounting. The contractor will be required to provide reports for 25% of the transactions as detailed in Section VI C4, for CIP goods and for fertilizer financed under the Agriculture Development Loan (Project 615-0230).

D. CIP Monitoring and Evaluation

1. CIP Monitoring

The contractor hired to provide technical assistance under this program will provide virtually all of the reports required to monitor the CIP imports accurately. However, each of the cooperating banks will be required to supply monthly statements of import licenses issued and to secure from their U.S. correspondent bank a monthly statement showing disbursements against the relevant bank letter of commitment.

Using grant program funds available under this agreement USAID will rent a small office easily accessible to the importing public. A senior Kenyan employee, a local receptionist/computer operator and possibly a U.S. personal service contractor will be hired to answer importers' questions and to preliminarily review import license applications

2. CIP Evaluation

In keeping with Section 125 of the FAA, an evaluation of the CIP portion of this amendment will be held in early 1985, depending on the rate of disbursements. The evaluation team will consist, at a minimum, of a representative of M/SER/COM, a U.S. banker involved with private importers from the U.S. who is not associated with a correspondent bank participating in this program, and an economist with extensive experience in the private import sector of Kenya or other developing countries. The CIP and the FY 1983 ESF evaluations will be combined if the CIP rate of disbursement by January 1985 is sufficient to warrant an assessment.

VII. The FY 84 Shilling Counterpart Program

A. Proposed Program Procedures

Since 1980, Kenya shillings generated by U.S. program assistance have been designated for the Government account. An exception was $5.1 million, which was deposited to a special account in the Central Bank to finance rehabilitation of businesses adversely affected by the events surrounding the August 1982 attempted coup. Between 1980 and 1982 the amounts disbursed for Government development expenditures (net of freight and other costs) averaged around $15 million annually from fertilizer and PL 480 Title I commitments averaging $26 million per annum during the same period. In FY 1982 a direct grant generated $5.6 million for the Government budget, and in FY 1983 an exceptional one-year direct grant generated $28 million for the budget. Shilling generations from the FY 1983 and earlier agreements have been programmed.

For FY 1984, a portion of the shillings generated from all U.S. balance of payments programs will go toward designated development programs covered by the Kenyan budget during 1984/85 -1986/87, including those that are supported by the United States through its dollar contributions. However, considering the current determination of Kenya to curtail the Government's share of GDP, the fact that other donor programs will also generate shillings (and many donors do not specify any particular uses for those shillings), and the U.S. strategy to stimulate private sector development, USAID proposes to limit the total going to the budget each year to $25 to $35 million from all U.S. sources of counterpart shilling which equal approximately $51 million in FY 1984.

The FY 1984 PAAD Amendment will generate $34 million in shillings, of the $51 million, for public and private activities. In addition, the $5 million from PL 480 Title I and $15 million from the Fertilizer Development Loan will together generate approximately $17 million in shillings which will be deposited to the budget. (The $3 million is an estimated deduction for handling and U.S. shipping costs.) Accordingly, approximately $21 to $26 million in shillings from the Amendment can be committed to private sector activities (with the remaining $8 to $13 million for the budget). For purposes of the proposed activities contained in the following section VII B, we assume that of the $34 million, $13 million will go to budget and $21 million to the private sector.

In support of the Government's determination to establish priorities for the development budget and to limit operating ministry expenditures, the United States will not attempt to direct the Kenya-owned shillings to purposes not covered by approved budgets. Although the system for setting priorities is not yet very rigorous, it has improved, and discipline has been introduced to the budget amendment process. Moreover, the total budget contains sufficient development programs consistent with the CDSS to effectively utilize $25 to $30 million in shilling equivalents.

In accordance with the FY 1984 Amendment, the Government will maintain a special account for the deposit of shillings generated as a result of the issuance of Letters of Credit denoted in dollars by the cooperating Kenyan banks. The amount of shillings due into the account will be equivalent to the amount for each Letter of Credit at the exchange rate (dollars/shillings) on the day the U.S. commercial bank is paid by USAID. The Central Bank will supply monthly statements to USAID of deposits into and withdrawals from the account. The first $10 million will go to budget, with later amounts, in part, for private sector activities.

All withdrawals from the special account will be for public and private sector purposes mutually agreed upon between USAID and the Government and will require approval of an authorized representative of each. USAID plans to use contractor assistance in monitoring and auditing deposits and withdrawals from this account. (This contractor may also monitor the FY 1984 Fertilizer Development Loan.)

B. Proposed Shilling Uses

The shillings made available under the Amendment for the public budget will be applied to high priority development projects. Examples with illustrative budget levels are indicated below. Private sector activities proposed for shilling support include commercial bank funds for investment in rural private enterprise, voluntary agencies promoting income generating activities, health and family planning projects, private sector housing, and studies. Each of these private activities is ultimately justified by its contribution as a pilot to the Government's restructuring process, such as the expansion of private sector credit and reliance on lower cost service delivery systems. Because of the delay in deposi of shillings, USAID with Government has a year to develop thes proposed private sector activities.

Annex I contains a budget for the CIP-generated $34 million in shillings proposed for public and private use. Shillings generated in Kenyan FYs 1984/85 and 1985/86 will be available for budget and for private activities largely in FY 1985/86 and in following years. All estimates are in U.S. dollar equivalents.

(1.) Public Sector Uses

<u>The Budget</u>
(a.) USAID will continue to support priority programs listed by Sub-Vote and Head in the Development Estimates for development activities of the Office of the Vice President (Family Planning), and the Ministries of Agriculture and Livestock, Finance and Planning, Health Education, Culture and Social Services, Water Development, Environment and National Resources, and Energy and Regional Development. Allocations will be agreed to by an exchange of letters.

$11 million

<u>Egerton College</u>
(b.) USAID will establish procedures with Government for providing shilling support for Egerton College to finance the phase-in costs of the Agricultural Resources Center and for completion of curriculum reform, and associated staff and travel support. $2 million

<u>Sub Total $13 million</u>

(2.) Private Sector Uses

<u>Private Credit</u>
In order to promote expanded credit to the private sector, a portion of the shillings will be allocated to export credit and to medium-term agricultural credit. (These funds could ultimately reflow to the Budget or to an expanding fund in the Central Bank for on-lending through the commercial banking sector.)

(a.) <u>Export Credit</u>: A discount facility in the Central Bank is proposed for exporters to allow expansion of credit beyond the amounts permitted by the present 20% ceiling imposed on trade credit.

$5 million

(b.) <u>Agricultural Credit</u>: Lack of collateral sharply limits medium-term agricultural credit. Demand is said to be very high and could be collateralized by capital improvements. Government would make direct loans of shilling generations to commercial banks for on-lending to the private sector.

$4 million

(c.) Loan Guaranty: If commercial bank experience with USAID's Rural Private Enterprise Project shows that lending risks are significant and limit expansion of credit to rural enterprises, commercial banks may require a guaranty fund, which could be established with these shillings. (A study on this subject will be carried out under the Rural Private Enterprise Project).

$2 million

(d.) Family Planning: A family planning development fund for NGOs will be established with shillings and will be administered by the National Council for Population and Development.

$2 million

(e.) Health Delivery: A fund for Kenyan NGOs is proposed to develop or expand lower cost health systems and alternative financing mechanisms for health care.

$1 million

(f.) USAID's Agricultural Management Project (FY 1984): Partial support to private participants and training institutions can be provided as part of this project - in order to prevent the immediate application of full cost pricing from discouraging private participation. (If this use of shillings is successful, similar support and procedures could be used to support USAID's proposed Higher Technical Training Project in FY 1986 or 1987.)

$2 million

(g.) Lower Cost Housing: Shilling counterpart support to private sector housing projects would supplement Housing Guaranty borrowed dollars and help expand the portfolio of lower-cost private housing projects to the point of development of a secondary mortgage market in Kenya.

$5 million

(h.) Feasibility Studies: Expansion of Kenya Farmers Association credit system. $50,000

Sub Total $21 million

(3.) Commodity Import Program Monitoring and Management Costs. $315,000

Approximate Total $34 million

Annex A

REPUBLIC OF KENYA

MINISTRY OF FINANCE AND PLANNING

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

....10th..May....., 19...84.

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

Dear Allison

FISCAL YEAR 1984 E.S.F. STRUCTURAL ADJUSTMENT PROGRAMME GRANT 615-0213 AMENDMENT

In response to our recent discussions in connection with the Structural Adjustment Programme Grant for Fiscal Year 1984, a formal request is hereby made to your Government for a US$ 34 million Commodity Import Programme (C.I.P.) for the Kenyan private sector tied to procurements in the United States and US$ 6 million for technical assistance and consultancy services to help the Government implement structural adjustment policies and to administer the Commodity Import Programme.

I thank you for your co-operation and look forward to a favourable and early response.

Yours sincerely

H.M. MULE
PERMANENT SECRETARY/TREASURY

Annex B

Technical Assistance Program - Summary Budget

<u>Policy Dialogue</u>

A.	Sectoral Policy and Planning	$3.0 million
B.	Strengthening Policy Capacity of Central Ministries	$1.5 million
C.	Studies	$ .7 million
D.	Microcomputers	$ 400,000
E.	Evaluation	$ 100,000
	Sub Total	$5.7 million

<u>CIP Management</u>	$ 300,000

(In addition, CIP will be partially funded by shilling generations)

Total	$6.0 million

Annex C

CIP Implementation Plan

Implementation Schedule:

The following implementation schedule assumes
that the grant will have been authorized by.....May 25, 1984
Grant agreement signed.................................May 31, 1984
Contractor hired to provide list of importers......May 31, 1984
CP's satisfied...July 31, 1984
List of importers sent to AID/W to
fulfill AID's advertising requirement..........July 31, 1984
Bank L/Com's issued by AID........................August 15, 1984
Technical Assistance Contractor hired........September 15, 1984
Initial L/C's opened.............................October 1, 1984
First shipments from U.S.......................December 1, 1984
Imports start arriving in Kenya.................February 1, 1985
Initial Deposits made into Special Account........March 1, 1985
Evaluation of CIP...............................May-June, 1985
Terminal date for requesting FR's.................May 31, 1986
Final shipment from U.S.........................April 30, 1987
Grant fully disbursed..............................May 31, 1987
Final deposits into special account...............July 31, 1987
Final withdrawals made from special account.. December 31, 1987

Annex D

CIP Implementation Path

1. Government and USAID sign Agreement.

2. USAID, using PD&S funds hires a contractor to prepare a list of all Kenyan importers for use in meeting AID's advertising requirements.

3. Ministry of Finance designates cooperating local Banks. To determine the Kenya banks that will be used to handle the CIP funds, a solicitation from the Ministry of Finance will first be sent to each of the 21 registered Kenyan banks. The solicitation will explain the program and incentives in detail and will request the following information:

   (a) Willingness to handle CIP transactions, and to supply USAID copies of all Letters of Credit and Bills of Lading for CIP goods. (Solicitation would include a description of the USAID CIP management system).

   (b) Name and address of corresponding U.S. bank, and th corresponding bank's fee schedule for fees to be financed by AID under the Bank L/Comm.

   (c) Volume of U.S. business (value and number of L/C's opened) for past three years.

   (d) Bank's annual report.

   USAID and Ministry of Finance will jointly review responses and rank them. A recommendation will be prepared explaining how the banks were ranked and recommending that no more than ten and no less than five be given an opportunity to handle the CIP funds. Following selection of participating banks, selected banks will be notified by Government and the terms of their participation will be formally determined.

   Following confirmation of this list, the Ministry of Finance would sign FR's requesting that AID/Washington open letters of commitment in the amount of $2 million for each of the named correspondent banks. (The first banks to use their $2 million would be allocated another $2 million, and so on until the CIP funds are exhausted).

4. USAID/K transmits FR's to AID/Washington.

5. AID/Washington reviews FR, issues bank L/Comm to U.S. correspondent bank named in FR, and informs USAID/K that L/Comm's issued.

6. USAID/Kenya sends information brochures on CIP to all Kenya cooperating banks. The brochure will be distributed by the banks to their customers, thereby ensuring early identification of the types of commodities most likely to be financed by A.I.D. The brochure informs importers that unless they have a special relationship with the supplier (and can provide acceptable proof of that relationship), they will have to provide evidence of competition in a CIP transaction (they will be told that generally three offers will be considered such evidence).
Further, they will be informed that they should request each potential supplier to include on his pro-forma invoice the relevant Schedule B number, and to request the supplier to allow for shipment on a U.S. flag vessel and for AID markings because the transaction is likely to be AID financed. In addition, they should tell the potential suppliers that they will be paid by a confirmed irrevocable sight L/C upon presentation of commercial invoice, negotiable bills of lading, approved AID Form 11, and completed AID Form 282.

7. The importer then submits his application and in the box marked "Terms of Payment" fills in "U.S. CIP" instead of the usual "L/C". The application is then reviewed by USAID/Kenya for compliance with AID's requirements. The review consists of: (a) check against Eligibility Listing; (b) competition, or evidence of special supplier-importer relationship; and (c) U.S. source/origin. After review, the application is returned by USAID to the importer with a cover letter of conditional approval or rejection as appropriate. (Final approval will be provided by AID/Washington.)

8. The Ministry of Commerce then receives the application from the importer and reviews it. The review will assure that USAID has approved it, that it is not for importation of a prohibited item, etc.

9. The Ministry of Commerce then transmits the application to the Central Bank where a Foreign Exchange Allocation License number is issued in a pro-forma fashion. One copy of the approved Import License is given to USAID/Kenya.

10. The Kenya cooperating bank issues L/C to supplier through its U.S. correspondent bank. Confirmation of L/C is made by correspondent bank and L/C formally notifies supplier that import is to be AID-financed under Reg. One. L/C contains special AID-financed instructions (Shipping, Marking, Form 11 approval, etc.).

11. Correspondent bank pays U.S. supplier on presentation of documents specified in L/C (Form 11, Form 282, Commercial Invoice, Bill of Lading) and resubmits these to AID for payment.

12. Correspondent bank informs Kenya cooperating bank that payment to U.S. supplier has been effected. In lieu of request for foreign exchange, issues guarantee to Central Bank that deposit of equivalent shillings at the rate of exchange in effect on the day of disbursement by AID will be made into special account within 90 days, or within other agreed upon period. Turns documents over to importer upon receipt from U.S. correspondent bank (with one copy of Bill of Lading being given to USAID/Kenya).

13. Importer uses documents to clear commodities through customs. One copy of the "Import Entry" is given to USAID/Kenya.

14. Bank makes a deposit into the special account on due date. The AID contractor audits deposits.

15. AID Contractor monitors end-use to discourage hoarding.

Annex E

CIP Implementation Budget*

	$U.S.	Kshs. Equiv.
I. Review of Import License Applications (store front operation)		
A. Office Rent (2 years @ $12,000 for 1st year)	-	$ 25,000
B. Furniture and Equipment		
- IBM PC Computer with hard disk and software$	$10,000	-
- Office furniture (3 desks, 20 chairs, partitions, etc.)	-	$ 5,000
C. Personnel (2 years' costs)		
- Secretary/receptionist/ computer operator, (FSN 5 or 6)	-	$ 15,000
- Procurement specialist, CIP Program (FSN 10 or 11)	-	$ 25,000
	$10,000	$ 70,000
II. Bi-annual audits of deposits to special account (5 each)	-	$ 50,000
III. Arrival Accounting by contractor	-	$150,000
IV. End-use Accounting by contractor	-	$ 75,000
V. Contractor in U.S. to assist in locating suppliers	$200,000	-
VI. Evaluation	$ 75,000	$ 10,000
Subtotals	$275,000	$285,000
Contingency	$ 25,000	$ 30,000
	$300,000	$315,000**
	$615,000	

* This will cover two years work.
** The shillings will come from counterpart funds of earlier agreements.

Annex F

Description of Organizations, Committees, and Procedures Involved in Import Administration

1. Overview

The involvement of the various groups in the import administration process is best summarized by the sequence of events beginning with importer application and ending with the delivery of goods. Following this summary, the detailed operation of each group is described. The annex only describes current procedures as of April, 1984 which are subject to change. Importers expect a minimum of two months for the approval process before an L/C can be opened.
The overall process is:

a) Importer obtains a pro-forma invoice from the supplier, obtains ministerial approval (if necessary), and submits application for "Import License and/or Foreign Exchange Allocation License" (I/L App.) in seven copies, pro-forma invoice in four copies, and two copies of ministerial approval (if necessary) to the Ministry of Commerce, Import-Export Department;

b) Commerce/Import-Export Department verifies I/L App., submits to Import Management Committee, which has approval authority, if application is approved, issues an approval number (5 digit), and retains one copy of pro-forma invoice and septuplicate copy of I/L App.;

c) I/L App. is forwarded to the Central Bank of Kenya/Exchange Control Office (CBK/EC):

d) CBK/EC reviews and assigns (six digit) Foreign Exchange Allocation License number which authorizes use of foreign exchange (actual release of foreign exchange comes later) and returns original, duplicate and triplicate of approved documents to the importer, retaining the quintuplicate copy of the I/L App. for CBK use, forwards the quadruplicate copy to SGS in the country of origin, forwards the sextuplicate copy to SGS Nairobi;

e) Importer takes the documents to a commercial bank which issues a letter of credit (L/C) and retains copies of pro-forma invoice, original and duplicate copies of the I/L App.;

f) The commercial bank forwards the L/C to its correspondent bank in the country where the goods are to originate, the correspondent bank confirms the L/C and forwards it to the supplier, either directly or through it correspondent bank;

g) SGS performs a price check and perhaps visually inspects the goods and issues a Clean Report of Findings which will be submitted by the supplier to his bank;

h) The supplier ships the goods and presents the documents called for in his L/C to the correspondent bank in his country and is paid as called for in the L/C (at sight, or at a set time up to 180 days after presentation of documents);

i) The correspondent bank sends the payment documents to the local commercial bank who sends the documents to the Central Bank of Kenya/Foreign Exchange Department (CBK/FD) for release of the foreign exchange to the corresponding bank in the country of the good's origin (usually from CBK foreign exchange reserves held in that country), CBK/FD clears documents concerning transactions in excess of KShs 100,000 through CBK/EC to verify the authenticity of submitted documents against the original applications, and the commercial bank then releases the documents to the importer to use for customs clearances;

j) The commercial bank pays the Central Bank the Kenya shilling equivalent of the foreign currency remittance;

k) The importer turns over the triplicate copy of the I/L App. to the Customs, usually through his appointed clearing and forwarding agent, along with the commercial invoice and the negotiable Bill of Lading;

l) The clearing and forwarding agent then pays the customs duties and removes the goods from the port, delivering them to the importer; and

m) The Statistics Branch of the Customs Department compiles foreign trade statistics from the port release documents.

2. Import Quota System

In mid-1983, a new import quota system was introduced to: (1) reduce the amount of goods on the schedule free of administrative control; and (2) provide a scheme for reclassification of goods both from and to the free schedule, in which the timing and magnitude of reclassification would be based on the foreign exchange position. The present schedules are:

Schedule IA, a subdivision of the former Schedule I, which includes the highest priority imports. Goods on this schedule are subject to tariff only and are unrestricted by quota. Licensing procedures are supposed to be fully automatic, but the Import Management Committee still reviews each I/L App. It includes such goods as medicine, raw materials, spare parts, agriculture inputs and selected capital equipment, and commodities essential for export. Some goods one might think properly belong on this schedule are prohibited from import to protect local industries.

Schedule IB, the remaining portion of former Schedule I, which includes somewhat lower priority items. For these items, licenses and foreign exchange will be allocated subject to foreign exchange availability. As the foreign exchange position improves more of these goods are to be moved to Schedule IA, however, if the foreign exchange position worsens, the reverse is supposed to happen.

Schedule IIA Ordinary consists of non-luxury consumer goods. They do not contribute to exports and licenses are restricted based on the availability of foreign exchange. These items are lower priority than Schedule 1B. Examples are; sinks, whetstones, mosquito nets, yarn, and craft paper.

Schedule IIA Special includes goods such as oils, fertilizers and food grains which may only be imported by authorized importers. In addition it includes the old Schedule II items which require the approval of a designated Government ministry before a license can be issued.

Schedule IIB consists of luxury consumer goods and other items considered to be non-essential to Kenya's prosperity. This schedule is supposed to be highly controlled by giving specific quotas for each item to eligible importers.

3. Committees

There are three levels of interministerial committees that have various roles in import administration.

(a) The Ministers' Committee on Import Administration. This committee is composed of the Ministers of Commerce and Industry, Finance and Planning, and the Director of the Central Bank of Kenya. Overall policy regarding import administration is decided by this committee as are specific issues referred by subordinate committees.

(b) Permanent Secretary's Committee on Import Administration.

Having a similar composition at the Permanent Secretary (PS) level (the Permanent Secretary is the top career person in the ministry and generally has overall administrative and management responsibility within the ministry), this group deals with overall implementation plans for policy decisions emanating from the Ministers' Committee.

(c) Import Management Committee.

The Import Management Committee (IMC) has actual implementation responsibility and exercises actual approval authority over each and every one of the approximately 6,000 applications processed each month. IMC also has specific responsibility for developing procedures under the new schedules.

4. Ministry of Commerce/Import-Export Department (IED)

The following are the detailed procedures of IED. First the importer obtains from his commercial bank an I/L App. There are two types of application forms: (a) MCI/CBK 206 for raw materials, which is currently being revised; and (b) MCI/CBK 181 for all other goods. The forms are identical except for "RAW MATERIALS" being boldly imprinted on (a). Copies of these forms can be obtained from any commercial bank. The forms must be typed, 7 copies. For selected items, the consent of a ministry must be obtained. For example, the consent of the Ministry of Health is required for importation of drugs and pharmaceuticals. The consent form (unnumbered) must accompany the applications when they are submitted. In addition, 4 copies of an invoice from the supplier must be submitted and, finally, a check for one percent of the C&F value of the goods to be imported must be submitted with the I/L

App. This one percent is used primarily to fund the SGS inspection and only secondarily to offset Ministry of Commerce costs associated with administering import licenses.

In summary, four items must be submitted to initiate the licensing process:

-- The application forms (7 copies)
-- Ministry consent forms (2 copies if required)
-- Invoice from the supplier (4 copies)
-- A check for 1 percent of the C&F value of goods.

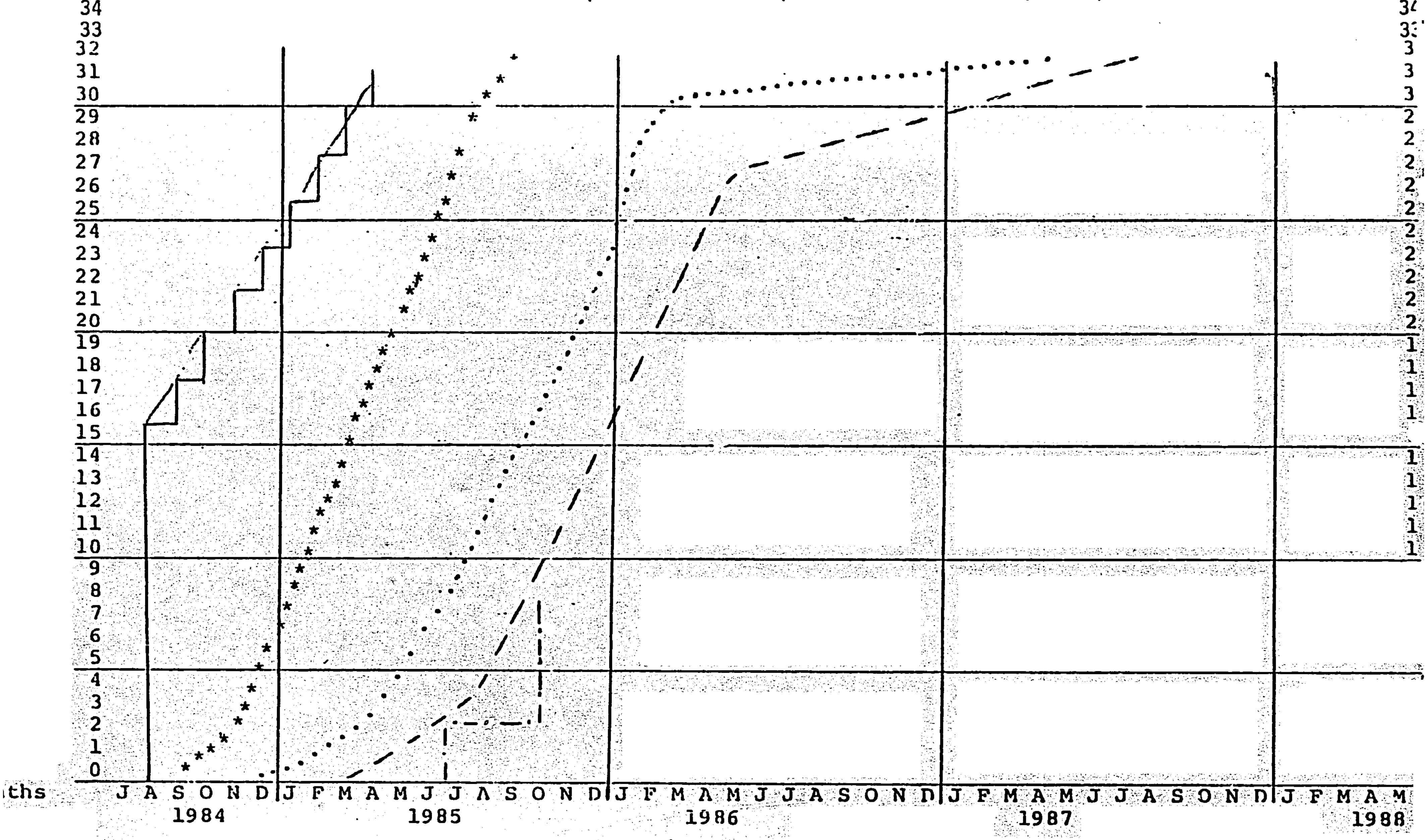
The seven copies of the "Application for Import License and/or Foreign Exchange Allocation License" are distributed after approval as follows:

1. Returned to importer to give to commercial bank;
2. Same as one above;
3. Returned to importer to give to customs for port release;
4. SGS Inspection Order to SGS in country of goods' origin;
5. Central Bank of Kenya retains;
6. SGS Nairobi for their use as necessary;
7. Retained by Ministry of Commerce, Import/Export Department.

The six copies of the "Import Entry" form are distributed after customs clearance as follows:

1. Kept by Customs at the port of entry;
2. Kept by Customs Long Room either in Nairobi or Mombasa;
3. Kept by the Statistics Section of the Customs and Excise Department;
4. Kept by Importer;
5. Kept by Ship's Agent for comparison with manifest; and
6. Kept by Importer and needed for re-export and claims.

EXPECTED COMMITMENT, DISBURSEMENT, AND DEPOSIT SCHEDULE FOR CIP



——— equals funds in Bank Letters of Commitment
***** equals funds in issued Letters of Credit
······ equals disbursements by U.S. banks against Letters of Credit
— — — equals deposits to Special Account of Kenya Shillings equal to U.S. $
—·—· equals withdrawals from the Special Account

Annex H

Internal Financial Analysis

Import flows financed under the three-year 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. 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 June 30, 1983, however, stood at some $1.5 billion U.S. dollars. Overall disbursements under the three-year program will total $117 million. The largest semi-annual disbursement ($28.0 million in June 1983) amounted to less than two percent of outstanding money supply, and no balances from this disbursement remain in the Paymaster General's Account. The schedules for disbursements against Letters of Credit, and for deposits to the special account, under the second year of the program are outlined in Annex G above. Deposits to the special account will increase slowly with approximately $2 million to be deposited during Government's FY 1984/85, an additional $25 million in FY 1985/86, and the remaining $7 million in FY 1986/87. 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 accumulation and subsequent expenditures of shilling counterpart 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 July 1983 and continuing further depreciation of the Kenya shilling. In consideration of this factor, it is proposed that approximately $13 million the of shilling counterpart generated under this PAAD Amendment will be utilized for items already planned for inclusion in Government of Kenya budgets, thus further reducing any possible medium-term inflationary effects of the program.

Proposed Shilling Counterpart Budget, in $ million equivalent

I.	**Public Sector Uses**		
	(1.) The Development Budget		$11
	(2.) Egerton College		$ 2
		Sub Total	$13
II.	**Private Sector Uses**		
	(1.) Private Credit		
	- Export credit		$ 5
	- Agricultural credit		$ 4
	- Loan Guaranty		$ 2
	(2.) Voluntary Agencies		
	- Family Planning		$ 2
	- Health Delivery		$ 1
	(3.) Agricultural Management Projec		$ 2
	(4.) Lower Cost Housing		$ 5
	(5.) Feasibility Studies		$ .05
		Sub-Total	$21
III.	**Commodity Import Program**		$ .315
		Approximate Total	$34

Annex J

Commodity Procurement Instruction No. 1

June , 1984

Ministry of Finance and Planning
P. O. Box 30007
Nairobi, Kenya

Dear Sir:

Subject: A.I.D. Commodity Import Program of the Structural Adjustment Program Grant No. 615-0213 Implementation Letter No.

This letter, with its attached Commodity Procurement Instruction (Attachment 1), issued in accordance with Section of the Agreement, sets forth the procedures for utilizing the proceeds of the Grant and provides information to assist you in implementing the program. A.I.D. Regulation 1 (Attachment 2), as from time to time amended and in effect as of the time of each relevant transaction, also applies to the Grant as set forth in Section of the Agreement, unless otherwise provided in this or future implementation letters. Except as permitted by the Agreement, nothing in this letter or its attachments modifies the Agreement. This letter and its attachments may be supplemented or modified as necessary by subsequent implementation letters.

I. Procurement Procedures

A. A.I.D. agrees that the commodity categories listed as eligible in the attached Commodity Procurement Instruction (CPI) are eligible for financing under the agreement, subject to the restrictions indicated herein and in the CPI, and continuation pages thereof.

B. The codes of the United States Department of Commerce Schedule B shall be used on all pertinent documentation. The latest version of the Schedule B will be made available to interested Government of Kenya offices upon request.

C. Procurement shall be carried out in accordance with the provisions of the CPI. The Government of Kenya shall ensure that sufficient copies of the CPI are distributed among Government offices and approved applicant banks, with instructions that importers are required to strictly comply with the provisions contained therein.

D. All private sector procurement shall be performed in accordance with the negotiated procurement procedures specified in Section 201.23 of A.I.D. Regulation 1. For purposes of implementing this Agreement any statutory body or any entity which is owned in part or in full by the Government of Kenya, but which is permitted by applicable Government of Kenya regulations or practices to procure imported goods without reference to the Central Tender Board shall be considered as a private sector entity.

Negotiated procurement, when authorized, shall be in accordance with good commercial practice. Solicitations by importers for quotations and offers shall be made uniformly to a reasonable number of prospective suppliers and all quotations and offers received, whether or not specifically solicited, shall be given consideration before making an award or placing an order.

E. All public sector procurement, when authorized, shall be through formal competitive bid procedures in accordance with Section 201.22 of A.I.D. Regulation 1, unless A.I.D. and the Government of Kenya agree otherwise in writing. Further, A.I.D. reserves the right to require that any single procurement for more than $1,500,000 be in accordance with Section 201.22 of A.I.D. Regulation 1.

F. Procurement shall not be from suppliers whose names appear on U.S. General Services Administration's Office of Acquisition Policy "Consolidated List of Debarred, Suspended and Ineligible Contractors" (Attachment 3), as from time to time amended.

G. Compliance with the United States-flag vessel shipping requirement as set forth in Section 201.15 of A.I.D. Regulation 1 is solely the responsibility of the Government of Kenya. Applications for determination of United States-flag non-availability should be addressed to the Transportation Support Division, Office of Commodity Management, Agency for International Development, Washington, D. C. 20523.

H. Air and Sea Charters, whether or not financed by A.I.D., must have the prior approval of A.I.D. Washington in order to move A.I.D.-financed cargo under this Agreement. Requests for charter approvals should be submitted by airmail or telegram to the Transportation Support Division, Office of Commodity Management, Agency for International Development, Washington, D. C. 20523.

I. In accordance with Section 201.11 of A.I.D. Regulation 1, commodities otherwise eligible for financing under this Agreement will not be so financed if shipped on transportation media owned, operated, or under the control of any of the following:

Albania, Bulgaria, Cambodia, People's Republic of China, Cuba, Czechoslavakia, Estonia, East Germany, Hungary, North Korea, Latvia, Lithuania, Outer Mongolia, Poland, Rumania, North Vietnam, South Vietnam, and the Union of Soviet Socialist Republics (USSR).

J. A.I.D. will finance the cost of transportation of cargo to a point of delivery beyond the point of entry into Kenya provided the point of delivery, as stated in the carrier's bill of lading, is established in the carrier's tariff applicable to international shipments.

II. Disbursement

A. Requests for issuance of Letters of Commitment or for other forms of disbursement under the Agreement shall be submitted on the Financing Request Form (Attachment 4). The full identification number shown on the Letter of Commitment issued by A.I.D. must be shown on all subsequent correspondence and payments documents in connection therewith, including the Supplier's Certificate (Form A.I.D. 282) submitted to A.I.D. or United States banking institutions. Actions to be taken by the Government of Kenya after Letters of Commitment are issued, and the documentation required by A.I.D. as a basis for disbursing funds under the Agreement, are described in A.I.D. Regulation 1, Subpart F.

B. Except as A.I.D. may otherwise agree in writing, no disbursemernt shall be made against documentation received by A.I.D. after................. The terminal date for requesting A.I.D. to issue Letters of Commitment or authorizations to disburse funds by other means is.......................... No letter of credit may be established which has a terminal shipping date later than...............................

C. In accordance with Section....... of the Agreement, the eligibility date for transactions which will be financed under this Agreement is........................ No commodity or commodity-related services are eligible for financing under this Agreement which were the subject of an order placed or a contract entered into prior to this date.

III. Commissions, Service Payments and Discounts

Eligibility for financing of commissions, service payments, and discounts is governed by the provisions of Section 201.65 of A.I.D. Regulation 1. Payments to purchasing agents, including charges by an agency of the Government of Kenya purchasing on behalf of another agency of the Government of Kenya, are ineligible for financing under the Agreement.

IV. Records

The records required to be maintained under the Agreement concerning the arrival and utilization of the Eligible Items financed by A.I.D. must accomplish the following:

a. ascertain whether commodities are received in the quantity and condition for which payment was made by A.I.D.;

b. assure that AID-financed commodities clear customs within ninety (90) calendar days from the date they arrive at the point of entry into Kenya;

c. permit determination of the amount, nature and value of A.I.D.-financed commodities not cleared from customs and the reasons for their failure to clear;

d. have the capability of indicating adjustments resulting from importers' claims for loss, shortages, or damage to A.I.D.-financed commodities; and

e. assure availability of data for end-use verification, including information needed to monitor A.I.D. prohibition of re-exports. (See Section 201.42 of A.I.D. Regulation 1.)

USAID will hire a contractor to accomplish the foregoing, however, the Government of Kenya will be required to have:

a. The Department of Customs and Excise give to USAID a copy of each "Import Entry" form for each CIP commodity arrival;

b. The Central Bank of Kenya to give USAID a copy of each "Import License and/or Foreign Exchange Allocation License" form which is approved by the Ministry of Commerce and the Central Bank for each CIP import; and

c. The Kenya Port Authority give to USAID a copy of each ship's "Out-Turn" report for each ship carrying CIP commodities. Further, the Government of Kenya will be required to instruct each Kenya cooperating bank to give to USAID a copy of each

Letter of Credit issued under the CIP and when the payment documents arrive to give to USAID a copy of each Ocean Bill of Lading or Air Waybill for each shipment of goods financed under the CIP.

We would welcome the opportunity to discuss with you or your representative any questions that you may have concerning the implementation of the Agreement, or relative to this letter or its attachments.

Sincerely,

Charles Gladson
Director

Attachments:
1. Commodity Procurement Instruction
2. A.I.D. Regulation 1
3. Consolidated List of Debarred, Suspended and Ineligible Contractors
4. Financing Request Form (AID 1130-2).

Attachment 1 to Annex J

Department of State
Agency for International Development
Washington, D. C. 20523

Commodity Procurement Instruction

1. TO:
Ministry of Finance and Planning
P. O. Box 30007
Nairobi, Kenya

3. CP No.
1

4. Appropriation Symbol

2. Subject;
Kenya Structural Adjustment
Program Grant Agreement
No. 615-0213

5. Allotment Symbol

6.
Eligible Items: All items designated as "Eligible" in the A.I.D. Commodity Eligibility Listing - 1983 Edition, included herewith as Appendix A to the Special Provisions Applicable to Letters of Commitment.

7. CPI Amount
Previous..............
Increase U.S. $34,000,000
Decrease................
Total U.S. $34,000,000...

8. Area of Source and Code
U.S.A. (000)

13. X Letter of Commitment

14. AID Commodity Financing Procedures
AID's standard financing procedures are applicable, applying A.I.D. Regulation 1, as amended, in its entirety, except as otherwise authorized by A.I.D.

15. Special provisions set forth in the "Special Provisions Applicable to Letters of Commitment," and attached, are applicable, and will be incorporated by A.I.D., as appropriate, in all Letters of Commitment or other disbursing authorizations issued pursuant to this CPI.

16. Approved for A.I.D. (signature) 17. Date

Charles Gladson, Director, USAID/Kenya

SPECIAL PROVISIONS APPLICABLE TO LETTERS OF COMMITMENT ISSUED UNDER A.I.D. GRANT NO. 615-0213

A. This letter of commitment is available for the financing of the U.S. dollar costs of:

1. Eligible commodities identified by appropriate U.S. Department of Commerce Schedule B numbers in the Appendix A, hereto.

2. Marine (including war risks) insurance premiums in connection with insurance placed within the United States of America.

3. Ocean transportation (including air freight) costs incurred on U.S.-flag carriers.

4. Additionally, A.I.D. will finance the cost of transportation of cargo to a point of delivery beyond the point of entry into Kenya, provided the point of delivery, as stated in the carrier's bill of lading, is established in the carrier's tariff applicable to international shipment.

5. Any other delivery services, as defined in paragraph 201.01(1) of A.I.D. Regulation 1, as amended, if costs are incurred and services are performed within the U.S.A.

6 Banking charges of the U.S. banking institution to whom this letter of commitment is issued.

B. All letters of credit issued, advised, or confirmed hereunder must apprise the supplier that the authorized area of source for items in paragraph A., above, is the U.S.A. (A.I.D. Geographic Code 000).

C. Except when authorized by A.I.D. in writing, no letter of credit issued, advised or confirmed hereunder shall be in an amount of less than U.S. $10,000 or more than $1,500,000.

D. Eligibility Dates:

1. No letter of credit may be issued, advised or confirmed hereunder after unless the U.S. banking institution shall have received advice from the approved applicant that the underlying contract was entered into on or before the terminal contracting date. The foregoing also applies to any other arrangement for effecting payments hereunder.

2. Documents submitted for reimbursement hereunder must evidence shipment not earlier than and not later than

E. The supplier's invoice required under Section 201.52 of A.I.D. Regulation 1 shall, in addition to other required information, contain a statement by the supplier to the effect that he has airmailed one copy of the ocean or charter party bill of lading, supplier's invoice and packing list to:

Supply Management Officer
USAID/Kenya
Agency for International Development
Washington, D. C. 20523.

F. Responsibilities of the U.S. banking institution with respect to Appendix A are as follows:

1. The U.S. Bank may issue, advise, or confirm any letter of credit hereunder, provided that the commodity description includes a U.S. Department of Commerce Schedule B number which is not indicated as "Ineligible" in Appendix A.

2. The U.S. bank shall be responsible for obtaining the additional documentation required for reimbursement wherever specified in Parts II and III of Appendix A.

G. The following are the reporting requirements of the U.S. banking institution under this letter of commitment.

1. As of the close of business the last day of each month prior to the expiration date hereof, a report is to be furnished to A.I.D. giving the following information concerning this letter of commitment:

a. Letter of commitment serial number;

b. Dollar value of letters of commitment, as issued or amended;

c. Total value of letters of credit advised, issued, confirmed, including amendments as to value, to date; and

d. Total amount disbursed as of the end of the month. The status data furnished should, to the extent possible without delaying issuance of the report, include adjustments which have been recorded for unused balances in expired and cancelled letters of credit and refunded amounts which A.I.D. has authorized for reinstatement to the commitment document. This information is to be furnished to A.I.D. within 15 days after the end of each month. These reports, which may be prepared in a format most convenient to the bank, are to be forwarded to:

Chief, Banking and Finance Division
M/FM
Agency for International Development
Washington, D. C. 20523.

H. When submitting documentation for reimbursement hereunder the Voucher SF 1034 must cite the transaction to "APPROPRIATION SYMBOL NO. PROGRAM".

Annex K

Selection Procedures for Kenya Cooperating Banks

Draft CIP Implementation Letter No......

This letter sets out the procedures and criteria to be used by Government in selecting local cooperating banks to participate in the U.S. Commodity Import Program (CIP) under the Fiscal Year 1984 Amendment granting thirty-four million dollars for commodities and related services from the United States.

First, it will be necessary to send a letter of invitation to each of the registered commercial banks in Kenya. The letter should be sent by the Central Bank of Kenya and should invite each of the banks to participate in the CIP, but should caution them that no more than ten banks will actually be chosen to participate. They should be informed that in their reply to the invitation they should indicate a willingness to handle CIP transactions which will require that a copy of each CIP Letter of Credit be given to USAID, as well as a copy of each Ocean Bill of Lading or Air Waybill for each shipment. Participation will further require that all Letters of Credit include provisions for restricting shipments to U.S.-flag vessels, AID markings, etc. These details will be found in a publicity booklet which AID has prepared (enclosed) and which should be given to each bank. In their reply, each bank must include the name of its correspondent U.S. bank, as well as the correspondent bank's fee schedule for all fees to be financed by the CIP. Banks will also be required to submit a copy of their latest annual report, and a report on the volume of business they have handled in the U.S. during the past three years (value and number of Letters of Credit opened). Banks that have not done more than three million dollars worth of business in the U.S. in one of the last three years are not eligible to participate. A draft invitation letter is enclosed.

Second, it will be necessary to review the replies to the invitation and to select between five and ten banks to participate. The selection committee should be composed of five members, two from USAID and three representing both the Ministry of Finance and the Central Bank of Kenya. Please let us know who your representative will be. Each selection committee member should review each reply, first eliminating any that do not include all the requested information, or which reflect less than three million dollars worth of business in the U.S. within one of the last three years. Next, each selection committee member should assign a numerical value to each reply. Between one and ten points are to be given for the volume of U.S. business over the past twelve months. Between one and five points are to be given for the fees to be charged by their U.S. correspondent bank. Lastly, between one and eight points are to be given for the bank's financial soundness and general commercial reputation. Following this review by each committee member, a discussion will follow and selection of the participating banks will be made.

USAID will then entertain Financing Requests (FRs) in the amount of two million dollars each for each of the selected banks.

We expect that you will be able to issue the invitiation within the next two weeks. If you have any suggestions about these procedures or this timing, please feel free to contact us.

Sincerely,

Charles Gladson
Director

Attachment to Annex K

Draft Letter

Central Bank of Kenya
Haile Selassie Avenue
P. O. Box 60000
Nairobi, Kenya

Managing Director
...............Bank
P. O. Box.............
Nairobi, Kenya

Dear Sir:

This letter is to inform you that the Ministry of Finance has signed an agreement with the United States Agency for International Development (USAID) to finance thirty-four million U.S. dollars worth of goods from the United States. It is expected that a similar program will be agreed to next year. We would like to take this opportunity to invite your bank to participate in this program.

Details of the Commodity Import Program (CIP) can be found in the enclosed brochure. Any technical questions on how this CIP will operate can be referred to Mr. Gordon Bertolin of USAID (phone 331160). If your bank is interested in participating, your reply should indicate a willingness to do so and to abide by the restrictions which are peculiar to the CIP, including supplying USAID with a copy of each Letter of Credit financed thereunder, and a copy of each Bill of Lading or Air Waybill for shipments of goods thereunder. You will also need to include a copy of your latest annual financial report, a fee schedule showing all the fees that your U.S. correspondent bank will charge for handling USAID's Letter of Commitment and confirming your Letters of Credit, and a chart showing the number and value of Letters of Credit your bank has issued for U.S. suppliers within the past three years. Please be advised that banks that have not done more than three million dollars worth of business in the U.S. within one of the last three years will not be eligible to participate in the CIP. If you are not interested in participating, no reply will be necessary.

A selection committee including representatives from the Ministry of Finance and Planning, the Central Bank of Kenya, and USAID will meet to evaluate replies to this invitation. N more than ten banks and no less than five banks will be chosen to participate in the CIP. The selection committee will award between one and ten points for the volume of business in the U.S., one to five points for the charges which will be levied by the U.S. correspondent bank, and one to eight points for th bank's financial soundness and general commercial reputation. Each of the selected participating banks will receive an intitial allocation of two million U.S. dollars and, when less than five hundred thousand dollars of that sum remain unencumbered by Letters of Credit, we will entertain requests for additional allocations. We look forward to your reply in this regard.

Sincerely,