PDBAY 030

CLASSIFICATION:

AID 1120-1

AGENCY FOR INTERNATIONAL DEVELOPMENT

PAAD

PROGRAM ASSISTANCE APPROVAL DOCUMENT

AMENDMENT

1. PAAD NO.	615-K-606B (615-0213)
2. COUNTRY	KENYA
3. CATEGORY	Commodity Import Program (C]
4. DATE	September 13, 1985
5. OYB CHANGE NO.	N/A
6. OYB INCREASE	None
TO BE TAKEN FROM:	

TO: Charles L. Gladson, Director, USAID/KENYA

7. FROM: Joseph F. Stepanek, Program Officer, USAID/KENYA

8. APPROVAL REQUESTED FOR COMMITMENT OF: $ 25,000,000

10. APPROPRIATION — 72-1151037 BPC GESA-85-31615-KG32

11. TYPE FUNDING: ☐ LOAN ☒ GRANT

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

13. ESTIMATED DELIVERY PERIOD: 1 OCT 85-30 APR 88

14. TRANSACTION ELIGIBILITY DATE:

15. COMMODITIES FINANCED

$13,000,000 AID Eligible Commodities
$ 8,000,000 Manufactured Fertilizers

16. PERMITTED SOURCE		17. ESTIMATED SOURCE	
U.S. only:	$25,000,000	U.S.:	$25,000,000
Limited F.W.:		Industrialized Countries:	
Free World:		Local:	
Cash:		Other:	

18. SUMMARY DESCRIPTION

The purpose of this Structural Adjustment Program Amendment is to provide additional balance of payments and budget support to the Government of Kenya as it continues to undertake the structural changes needed to redress the underlying problems of the economy. The Grant consists of two parts: a $13 million Commodity Import Program for the Kenyan private sector tied to procurement from U.S. sources of AID eligible commodities; and a $12 million Agricultural Development Program tied to procurement from U.S. sources of manufactured fertilizer, with distribution open to Kenyan private sector. Counterpart Shillings resulting from the sale of commodities financed under the Grant will be used for mutually agreed development activities in both the public and private sectors. Policy measures associated with the Grant address basic development problems described in the original FY 1983 Program Assistance Approval Document (PAAD), and supplement conditionality established under FY 1983 and FY 1984 Structural Adjustment Program Agreements.

(Continued on following page.)

19. CLEARANCES	DATE
PRJ:R. Rifenburg	17 SEP 85
RFMC:G. Eidet	9-19-85
REDSO:P. Scott	9/19/85
AGR:D. Lundberg	16 Sept '85

20. ACTION: ☒ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE — DATE 9-20-85

TITLE

CLASSIFICATION:

1

SUMMARY DESCRIPTION: (Continued from Facesheet)

This second Amendment to the FY 1983 Structural Adjustment Program will complete a three-year program of balance of payments and budget support to the Government of Kenya (GOK) that was originally budgeted at $117 million. The slow start-up of the Commodity Import Program due to GOK implementation delays, and the modest GOK performance on structural adjustment issues, have combined with budgetary considerations to reduce the overall dimension of the three-year program to $76 million, including this FY 1985 Amendment for $25 million. To accelerate the analysis, planning, and implementation of structural adjustment measures, the overall level of funding for technical assistance was increased from $6 million in the original PAAD to $8 million in the FY 1984 ESF Agreement. No additional technical assistance funds are required or requested under this FY 1985 Amendment.

Part One of this FY 1985 Amendment will add $13 million to the $12 million general Commodity Import Program (CIP) initiated in FY 1984. Part Two of this FY 1985 Amendment will fund the procurement of approximately $8 million of manufactured fertilizers from U.S. sources, together with approximately $4 million of associated shipping. Part Two funding will continue the successful program to expand and privatize fertilizer marketing in Kenya which was begun under ESF conditionality in FY 1983 and which was expanded under the FY 1984 Agricultural Development Program (615-0230).

USAID recognizes the significant progress made by the Government of Kenya in macroeconomic management over the past several years, and recognizes both the complexity of the structural adjustment issues facing Kenya, and the disruptive effects on the economy and on Government operations of the 1984 drought. This FY 1985 Amendment provides significant additional U.S. support to the Government of Kenya as it intensifies its efforts to restructure the Kenyan economy in order to stimulate growth and to provide productive employment opportunities to its rapidly growing population. Recognition of the economic and political complexities of policy making and policy implementation, and acknowledgement of the additional burden imposed by the recent drought, do not imply that the Government or the donor community can afford to remove fundamental issues from the development agenda.

Conditions Precedent to Initial Disbursement

Commodity Import Program

Prior to first disbursement of assistance for the Commodity Import Program under the Grant, or to the issuance by AID of documentation pursuant to which disbursement may be made, the Grantee will, except as the Parties may otherwise agree in writing, submit to AID, in form and substance satisfactory to AID:

1. A statement of Grantee commitment to utilize, in its FY 1986/87 and FY 1987/88 budget years, five million dollars equivalent of the counterpart Shillings generated under the FY 1985 Structural Adjustment Program Amendment for mutually agreed family planning activities, and five million dollars equivalent of such counterpart Shillings for mutually agreed private sector activities, such as agricultural, housing and export promotion. The Grantee will notify AID of the Forward Budget commitments for FY 1986/87 by March 30, 1986;

2. Evidence that the Grantee has established and staffed by March 30, 1986 an Office of the Auditor and Controller-General for parastatal organizations; and

3. Evidence that the Grantee has established by March 30, 1986 a donor subcommittee for transportation.

Agricultural Development Program

Prior to first disbursement of assistance for the Agricultural Development Program under the Grant, or to the issuance by AID of documentation pursuant to which disbursement may be made, the Grantee will, except as the Parties may otherwise agree in writing, submit to AID, in form and substance satisfactory to AID:

1. Evidence that the Grantee announced by October 1, 1985 the wholesale and retail prices of AID-financed diammonium phosphate (DAP) fertilizer sold in 50, 25, and 10 kilogram bags.

Covenants

Local Currency Programming

1. The Grantee will devise a new system for the collection, deposit, management and utilization of local currencies generated from externally funded assistance programs, and introduce the proposed system for discussion at a donors meeting to be held in Nairobi by early 1986.

Donor Coordination

2. The Grantee will undertake a formal review of all its internally funded development projects by April 30, 1986 to determine how effectively current projects are being implemented, and to enable the Grantee to decide which projects to terminate and which project funds should be reprogrammed.

Private Sector

3. The Ministry of Finance will undertake by April 30, 1986 an assessment of new and existing legislation and regulations that attract private foreign investment.

4. The Grantee will continue to transfer items from more restrictive import schedules to less restrictive schedules in conjunction with the introduction of the FY 1986/87 budget in June 1986.

Agriculture

5. The Grantee will submit its requests to AID to finance the procurement of fertilizer each year no later than April 1 for fertilizer to be used during the short rains and no later than August 1 for fertilizer to be used during the long rains.

6. The Grantee will develop and make available as public information: a fertilizer import plan which includes current stock levels; requirements by type, area, and seasonality of use; donor financing intentions; and commercial import intentions. This plan will be developed annually by April 1.

7. The Grantee will carry out a review of the current pricing structure for fertilizer in order to provide adequate margins at the wholesale and retail level, and to promote wide distribution of fertilizer. The Grantee will implement the recommendations as appropriate.

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8. The Grantee will:

a. Promote the formation of the Kenya National Fertilizer Association (KNFA) by assisting with its expeditious registration as an Association with the Office of the Attorney General, and the development of its Constitution.

b. Inform the KNFA when and where Fertilizer Committee meetings are to be held, provide an agenda for each meeting, and request the KNFA to be represented and to submit written recommendations at each meeting.

9. The Grantee will develop and provide educational leaflets on fertilizer use to distributors of AID financed fertilizer by December 1, 1985.

10. The Grantee will enforce the following criteria for distributors to receive AID financed fertilizer, and to remove those firms from the list of eligible distributors who do not conform:

a. Distributors will have in place or be willing to develop during the present period, a distribution network;

b. Distributors will demonstrate access to storage capacity for fertilizer allocated by the Commodity Aid-Allocation Monitoring Committee (CAMC);

c. Distributors will be capable of securing the necessary bank guarantees;

d. Distributors will agree to distribute educational leaflets on how to apply fertilizer. Leaflets will be developed and provided by the Grantee;

e. Distributors of AID financed fertilizer will not be prevented from receiving allocations for commercial imports. Likewise, commercial importers will not be barred from receiving allocations of AID fertilizer.

f. Distributors receiving allocations of AID fertilizer from the CAMC will be prohibited from reselling all or any part of their allocations to other distributors, unless approved in advance by the CAMC.

11. The Grantee agrees that all fertilizer purchases from the Grantee by private distributors will be paid for in cash in advance or via a bank guarantee not to exceed 180 days.

Special Accounts

12. Shillings generated under the Commodity Import Program portion of this Amendment will be deposited to the Paymaster General special account set up for FY 1984 Commodity Import Program. Counterpart generated by the fertilizer imported under the Agricultural Development Program portion of this Amendment will be deposited to a special FY 1985 Agricultural Development Program Account in the Paymaster General.

Program Assistance Approval Document (PAAD)

Structural Adjustment Program Grant Amendment (615-0213)

for

FY 1985

Facesheet

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I. Summary of the FY 1985 Program

The purpose of this Structural Adjustment Program Amendment is to provide additional balance of payments and budget support to the Government of Kenya (GOK) as it continues to undertake the structural changes needed to redress the underlying problems of the economy.

The Grant consist of two parts: a $13 million Commodity Import Program for the Kenyan private sector tied to procurement from U.S. sources of AID Eligible Commodities; and a $12 million Agricultural Development Program tied to procurement from U.S. sources of manufactured fertilizers, with distribution open to the Kenyan private sector. Shilling payments due from importers under both the commodity and fertilizer components of the program shall be in cash or shall be guaranteed by commercial banks, and shall be paid into separate, uniquely identified special accounts. These "counterpart Shillings" resulting from the sale of commodities financed under the Grant will be used for mutually agreed development purposes in both the public and private sectors. Public sector uses shall include $5 million equivalent of support during the two GOK FYs 1986/87 and 1987/88 for Kenya's expanded program to deliver family planning services. An additional $5 million equivalent shall be utilized during the two GOK FYs 1986/87 and 1987/88 for mutually agreed private sector activities such as agricultural, housing, and export promotion. Remaining local currencies shall be utilized durin the two GOK FYs 1986/87 and 1987/88 for mutually agreed activities, including agriculture and rural development.

The Conditions Precedent to disbursement and Covenants under the CIP portion of this program are contained in Part One, Section IV.A of the PAAD Amendment, and serve to supplement the conditionality established under the FY 1983 and FY 1984 Structural Adjustment Program Agreements. The FY 1985 CIP conditionality addresses basic development issues related to family planning, private sector development, parastatal management, and donor coordination, as well as local currency generation, deposit, and programming. The Conditions Precedent and Covenants under the Agricultural Development portion of this program are contained in Part Two, Section VI.B of the PAAD Amendment, and serve to supplement the conditionality established under the FY 1983 Structural Adjustment Program Agreement, and the FY 1984 Agricultural Development Program Agreement (615-0230). The FY 1985 Agricultural Development Program conditionality addresses specific steps required to expand overall levels of fertilizer use in Kenya, to increase private sector participation, to increase the overall level of price and non-price competition, and to improve outreach and services to fertilizer users in general, and to smallholders in particular.

This Amendment represents the third and final increment to the planned $117 million Structural Adjustment Program which was initiated in U.S. FY 1983. The relatively slow start-up of the Commodity Import Program, due to GOK implementation delays, and the modest GOK performance on structural adjustment issues, including response to AID's own conditionality, have combined with budgetary considerations to reduce the overall dimension of the three-year program to $76 million, including this FY 1985 Amendment totaling $25 million. To accelerate the analysis, planning, and implementation of structural adjustment measures, the overall level of technical assistance was increased from $6 million in the original PAAD to $8 million in the FY 1984 ESF Agreement. No additional technical assistance funds are required or requested under this FY 1985 Amendment. Technical assistance resources provided under the first two years of the Structural Adjustment Program are reviewed in Part One, Section III.A.2. Current and planned technical assistance addresses policy formulation and policy implementation in the Ministry of Agriculture and Livestock Development, the Ministry of Finance and Planning, the Central Bank of Kenya, and the Ministry of Commerce and Industry. Improved analysis, planning, budgeting, and financial management are basic elements of current and planned technical assistance supporting a number of on-going GOK programs. Essential studies are also being funded. Introduction of microcomputer technology and training is proving to be of particular importance in helping to achieve the improvements in analytical and management functions which Government has continued to pursue since the early 1980's.

This proposed third increment of the Structural Adjustment Program in FY 1985 is justified on the basis of U.S. interests that include support for Kenya's continued stability and growth. The immediate justifications continue to be Kenya's budgetary and foreign exchange requirements. The overall GOK Budget deficit declined from 9.5 percent of GDP in FY 1980/81 to 4.2 percent in FY 1983/84, but rebounded to 5.0 percent of GDP in FY 1985/86 under the impact of the drought, the introduction of the 8-4-4 education system, and the East African Community settlement, among other expenditures. The overall budget deficit is projected to fall to 4.3 percent of GDP (or less) in FY 1985/86, but such projections are based on an increase in external grant financing of approximately 15 percent. With regard to the external account, an overall balance of payments deficit of some $97 million is expected in CY 1985 due in part to expanded food import requirements, and to the desirability of liberalizing other imports in order to sustain expansion in the non-agricultural sectors of the economy during the recent drought. Of the $97 million required, some $59 million of financing has already been arranged. However, closing the balance of payments gap in CY 1985 will still require additional financing amounting to some $38 million. Similarly, the additional financing which must be found in CY 1986 is estimated to be some $126 million. This

$25 million FY 1985 ESF Amendment would supply Kenya with balance of payments support equivalent to one-fifth of the required additional financing needed in 1986, providing substantial U.S. support for continued improvements in macroeconomic management and further structural adjustment in Kenya.

Government demand management has been termed successful by the IMF, and is beginning to complement and to reinforce structural adjustment measures. The Government share in overall GDP has been reduced by one-fifth over the past five years, and the budget deficit as a share of GDP has been reduced by almost one-half. Improved control of the money supply has contributed to a reduction in consumer price inflation from a peak of 20 percent per annum in 1982 to 8 percent in 1984, despite continuing realism in food and energy pricing. Real interest rates have changed from strongly negative in 1981 (minus 11 percent) to significantly positive in 1984 (plus 4 percent). In order to generate employment, real wage rates in the modern sector have been allowed to fall by well over 2 percent per annum over the past decade. Liberalization of the trade regime (including reductions in quantitative controls and movement toward more uniform tariff rates) has coexisted with a reduction in the current account deficit by more than three-quarters (from a peak of 12.6 percent of GDP in 1980, to 3.0 percent of GDP in 1984). In the interim, a more flexible exchange rate mechanism, with more frequent periodic adjustments, has also been installed.

The necessity for continued application of sound demand management policies, and for additional implementation of structural adjustment measures, is suggested by the magnitude of the development problems which Kenya continues to face. Despite recent improvements in macroeconomic management, per capita income in Kenya has declined in four out of the past five years at an average annual rate of almost 1 percent (minus 1.5 percent when adjusted for declines in the external terms of trade). Growth of employment in the modern sector at 2.6 percent per annum over the past five years has been too slow to keep pace with the 4 percent growth in Kenya's population and labor force. Population growth, and a high dependency ratio, have placed insupportable demands on Government for delivery of basic social services. As a result, overall public debt has doubled in nominal terms over the past five years, and external public debt has more than trebled, despite improvements in fiscal management. With regard to the external sector, the volume of exports over the past five years has declined by 13 percent, and the purchasing power of such exports has declined by 22 percent. Import volumes have declined by 40 percent over the past 5 years (from the 1980 peak) and by 23 percent over the past decade. Continued import compression is not a viable long-term solution to Kenya's problems of external balance, and in fact import liberalization remains a key to expanded availability of industrial inputs, to industrial expansion, to improved capacity utilization, and to job creation.

Over the past several years, a good start has been made on improving demand management, and on implementing initial structural adjustment measures. Additional action must now be taken in a number of areas including: liberalization of pricing and marketing controls, particularly in agriculture; reorganization of the role of parastatal bodies, including divestiture; improvement in Government budgeting and financial control systems; improved donor coordination and budgeting of donor projects; development of financial markets; enhancement of private investment; and increased export promotion. Having achieved a good measure of macroeconomic progress, and having managed perhaps the worst drought in Kenya's modern history, the Government of Kenya is in a position to move aggressively during the second half of the 1980's to effect the policies of reform and renewal contained in its own Development Plan and Sessional Papers, which are supported by the IMF, by the World Bank, and by AID in this Amendment.

II. Statement of the Problem and Government Response

A. Introduction

The necessity for more rapid progress on structural adjustment in Kenya is underscored by the contrast between improved macroeconomic management since the early 1980's, and a clearly inadequate growth performance (once adjustments for rapid population increases and declining terms of trade are taken into consideration). Continuing a trend that began in the late 1970's, Kenya's real Gross Domestic Product (GDP) grew at an average rate of little more than 3 percent during the 5-year period 1980-84. (See Table 1.) Average per capita GDP declined nearly 1 percent yearly during the same period, indicating that improved demand management alone is not enough to produce a rate of growth consistent with the rising expectations of most Kenyans. Given the inflexibility and lack of diversification of Kenya's export portfolio, and given adverse price developments in international markets, Kenya's per capita output fell by an average 1.5 percent annually over the past five years when adjusted for income losses due to the declining terms of trade.

Table 1
Kenya: Annual Rates of Growth of GDP, 1980-84
(at factor cost)

	1980	1981	1982	1983	1984	1980-84 Average
Development Plan Target	7.0	6.5	6.7	6.9	3.9	6.2
Recent GOK Estimates	3.3	6.0	1.8	3.5	0.9	3.1
Per Capita GDP growth	-0.4	1.9	-2.1	-0.7	-3.1	-0.9
Adjusted for Terms of Trade	(-3.8)	(3.3)	(-2.1)	(-4.3)	(-0.5)	(-1.5)

Source: Economic Survey, Annual, 1984-85.

Table 2

Kenya: Wage Employment, Public and Private, 1975-84

(Thousands)

Year	Total Wage Employment	Growth in Total a/	Public Employment b/	Public Sector Growth a/	Public Sector Share b/	Private Employment	Private Sector Growth a/	Private Sector Share
1975	819.1	-0.9%	342.4	3.7%	41.8%	476.1	-4.1%	58.1%
1976	857.5	4.7%	356.4	4.1%	41.6%	501.1	5.3%	58.4%
1977	902.9	5.3%	376.4	5.6%	41.7%	526.5	5.1%	58.3%
1978	911.5	1.0%	390.0	3.6%	42.8%	521.6	-0.9%	57.2%
1979	972.4	6.7%	424.8	8.9%	43.7%	547.6	5.0%	56.3%
1980	1005.8	3.4%	471.5	11.0%	46.9%	534.3	-2.4%	53.1%
1981	1024.3	1.8%	484.1	2.7%	47.3%	540.2	1.1%	52.7%
1982	1046.0	2.1%	505.6	4.4%	48.3%	540.4	0.0%	51.7%
1983	1093.3	4.5%	527.8	4.4%	48.3%	565.5	4.6%	51.7%
1984	1114.7	2.0%	536.5	1.6%	48.1%	578.2	2.2%	51.9%

Note:

a/ Calculated as 100* (((Xt)/(Xt-1))-1), where Xt is the level of employment in year t

b/ Includes parastatal.

Source: Economic Survey, Annual, 1977-1985.

The relatively slow growth of the economy over the past five years may be contrasted with the sharply increased demands on Government to provide basic social services. The growth of these demands reflects not only rising expectations, but the inexorable pressure of a population growing at a rate of 4 percent or more, with one of the highest dependency ratios in the world. Despite generally good efforts in fiscal management, Kenya's public debt more than doubled in nominal terms from 17.2 billion Kenyan Shillings in 1980 to 44.2 billion Kenyan Shillings at the end of 1984. External debt alone more than trebled during the 1980-84 period. Kenyan expectations include not only broader access to basic social services, but broader access to employment opportunities. Over the past decade, wage employment has increased by an average 3.5 percent annually, less than the growth in the population or in the labor force. (See Table 2.) Moreover the share of the public sector in total wage employment has grown from 42 percent in 1975 to 48 percent in 1984, a progression which is not sustainable indefinitely. Whatever the positive effects of recent improvements in demand management, the growth of wage employment has been even slower over the past 5-years increasing at an average rate of only 2.6 percent, clearly inadequate, and in the long-run politically unsustainable.

As the summary above suggests, Kenya faces at least three closely inter-related structural adjustment problems:

1. the gap between the demand for and the supply of external resources;
2. the gap between the demand for Government services and the supply of Government resources; and
3. the gap between labor force growth and productive employment opportunities.

Although alternative presentations of Kenya's overall economic problems and prospects are possible, there are no analyses which provide for a solution to the Kenyan development problem without substantial structural adjustment, in addition to continued strong implementation of sound demand management policies.

B. Macroeconomic Update

1. The Balance Between the Public and Private Sectors

a. Government Expenditure

Kenya's chief structural adjustment success to date continues to be a large scale shift of resources from the public to the private sector over the past five fiscal years. Government expenditures were reduced from 35.5 percent of GDP in 1980/81 to 27.8 percent of GDP in 1982/83 and rose to only 28.4 percent of GDP in the drought year 1984/85 (thus 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 one-fifth in such a brief period of time, a period when population continued to grow rapidly, along with the demand for jobs, services, and development activities. Moreover, with the drought behind it, the Government of Kenya plans further reductions in its overall share of GDP to 27.7 percent in FY 1985/86. (See Table 3 below.)

Table 3
Kenya: Government Expenditures as a Share of GDP at Market Prices, 1978/79-1985/86

1978/79	32.2%	1982/83	27.8%
1979/80	32.2%	1983/84	28.1%
1980/81	35.5%	1984/85	28.4% a/
1981/82	32.7%	1985/86	27.7% b/

Note: a/ Provisional.
b/ Projected.

Source: Economic Survey, 1982-85.
Ministry of Finance and Planning, July 4, 1985.

b. Revenue and the Deficit

Expenditure cutbacks and tax increases produced significant reductions in the overall budget deficit from 9.5 percent of GDP in 1980/81 to 2.9 percent of GDP in 1982/83. The cutbacks in 1982/83 were more severe than had been planned, however, with the GOK miscalculating as it attempted to reach the IMF target of 4.7 percent of GDP which had been set for June 30, 1983. The overall deficit basically returned to planned levels in 1983/84 (reaching 4.3 percent of GDP), but exceeded planned levels in the drought year 1984/85 (when the deficit rose to 5.0 percent of GDP). As currently published, the Budget for 1985/86 calls for a return to a budget deficit of 4.3 percent of GDP. Following consultations with the IMF in August 1985, it is now believed that expenditures can be further cut, and revenues and external grants somewhat increased, to reach an overall deficit target of 4.1 percent of GDP. (See Table 4.)

Table 4
Kenya: Government Budget Deficit as a Share of GDP at Market Prices, 1978/79-1985/86

1978/79	7.4%	1982/83	2.9%
1979/80	5.7%	1983/84	4.3%
1980/81	9.5%	1984/85	5.0% a/
1981/82	6.6%	1985/86	4.3% b/

Notes: a/ Provisional.
b/ Projected. May fall to 4.1 percent.

Source: Economic Survey, 1982-85.
Ministry of Finance and Planning. July 4, 1985.

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Table 5

Kenya: Central Government Finance, 1980/81 - 1985/86

(Millions of Kenya Shillings a/)

Year	1980/81	1981/82	1982/83 (Revised)	1983/84 (Revised)	1984/85 (Prov.)	1985/86 (Proj.)
Total Revenue and Grants	14,789	16,623	17,894	19,545	22,017	25,152
Recurrent Revenue	14,338	15,737	16,768	18,548	20,445	23,165
Foreign Grants	451	886	1,126	997	1,572	1,987
Total Expenditure	20,155	20,912	20,137	22,978	26,713	29,781
Recurrent	13,984	15,031	16,156	17,131	19,136	22,005
Development	5,733	6,350	4,528	6,225	6,647	7,776
Adjustment c/	438	-469	-547	-378	930	-
Overall Deficit	-5,366	-4,289	-2,243	-3,433	-4,696	-4,629
Financing	5,366	4,289	2,243	3,433	4,696	4,629
Foreign Financing (net)	2,764	1,108	1,236	715	939	269
Drawings (gross)	3,498	2,238	2,718	1,887	3,164	2,397
Repayments	-734	-1,130	-1,482	-1,172	-2,225	-2,128
Domestic Financing (net)	2,602	3,181	1,007	2,718	3,757	4,360
Nonbank Domestic	1,028	1,487	1,127	2,060	2,790	2,360
Bank and CSFC	1,574	1,694	-120	658	967	2,000
Memorandum Items:						
Exchange Rate KSh./U.S. Dollar	7.894	10.162	12.102	13.749	15.593	17.329
Overall Deficit in U.S. Dollars	$680m	$422m	$185m	$250m	$301m	$267m
Overall Deficit/GDP at Market Prices d/	-9.5%	-6.7%	-3.1%	-4.2%	-5.0%	-4.3%

Notes:
- a/ Totals may not add due to rounding.
- b/ Printed Budget Estimate. Deficit may fall to 4374m. KSh. or 4.1% of GDP if foreign grant rise to 2244m. KSh. and recurrent expenditures are reduced to 21606 m. KSh.
- c/ Reflects the fact that revenue and expenditure data are not strictly on a cash basis. Positive adjustment is treated as an expenditure.
- d/ Utilizing updated GDP data from Economic Survey 1985 for fiscal years 1980/81 - 1983/84.

Source: GOK, Ministry of Finance and Planning, July 4, 1985.

c. Financing the Budget Deficit

Table 5 provides a summary of Central Government revenues, expenditures, and deficits for FYs 1980/81-1986/88. Financing requirements in Kenyan Shillings will remain substantially unchanged between 1984/85 and 1985/86, but increases in total output will cause the overall deficit to fall from 5.0 percent of GDP in 1984/85 to 4.3 percent or less in 1985/86. In terms of U.S. dollars, the overall deficit will fall from $301 million in 1984/85 to $267 million in 1985/86 (the difference being substantially due to estimated relative changes in the U.S. dollar/Kenya Shilling exchange rate). Net foreign financing of the deficit will fall rapidly as gross foreign drawings decline by nearly one-quarter, and as foreign repayments maintain the high level reached in 1984/85.

The decline in net foreign financing, however, will be nearly offset by increases in domestic financing. In order to halt the rapid rise in financing of the Government deficit by non-bank financial intermediaries which has been evident in recent years, bank financing will have to rise in FY 1985/86. The increase in required domestic bank financing may be reduced to a certain extent in FY 1985/86, however, if increases in foreign grant financing emerge as discussed above. Under such a scenario, the threat of additional crowding out of private sector borrowing may be somewhat reduced. Although the private sector normally accounts for over 70 percent of Kenya's GDP, it accounted for as little as 57 percent of outstanding domestic credit at the low point in December 1982. This figure had climbed to 61 percent of total credit by December 1984. Nevertheless, this was still well short of the goal set in the Development Plan to provide the private sector with a credit share equal to its overall share in the economy. (See Table 6.)

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Table 6

Kenya: Monetary Indicators, 1980-84

(Millions of Kenya Snillings)

As at End of	Money Supply	Net Foreign Assets	Domestic Credit Total[a]	Domestic Credit Public[b]	Domestic Credit Private	Private Sector Share	Commercial Bank Liquidity Ratio
June 1980	15,890	3,464	14,284	3,301	10,982	76.9%	18.4
Dec. 1980	16,208	2,265	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	-804	21,481	7,536	13,946	64.9%	17.3
Dec. 1982	21,324	-2,019	25,047	10,691	14,357	57.3%	25.9
June 1983	20,166	8	22,839	8,017	14,821	64.9%	21.7
Dec. 1983	22,365	-227	25,067	9,687	15,380	61.4%	20.3
June 1984	22,216	547	24,673	9,237	15,436	62.6%	19.9
Dec. 1984	25,242	404	27,777	10,833	16,944	61.0%	24.2

Notes: a/ Totals may not add due to rounding.

b/ Includes Parastatal.

Source: Central Bank of Kenya. *Economic and Financial Review*, Vol. XVII, No. 11, October-December, 1984.

2. External Balance

a. Overall Trends

Since 1980, smaller Government deficits, higher real 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 three years, slower growth in the monetary aggregates has contributed to the process as well. In addition, there were devaluations of 5 percent in February 1981, 18 percent in September 1981, and 18 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. Since December 1982, there have been 4 additional devaluations: 2.6 percent in July 1983; 2.6 percent in May 1874; 7.5 percent in March 1985; and a minimum of 9.3 percent in July 1985.

A more flexible exchange rate mechanism was introduced in July 1983 when upper and lower bands of plus or minus 2.25 percent were established around the official central rate. Government has now committed itself to periodic exchange rate adjustments as necessary to maintain the purchasing power parity of the Shilling. A series of tariff adjustments have also been made in each of the last three years. However, controls in the form of import and exchange licenses, which continue to be applied, have partially contributed to improvements in the trade and current account balance. Kenya experienced a cumulative current account deficit of some $4.3 billion during 1980-84. As a result, the debt service ratio has risen from the equivalent of 12 percent of the value of exports of goods and services in 1980 to about 28 percent in 1984. This level is expected to decline after 1985 as amortization of certain high-cost external loans is completed, despite the fact that additional large scale borrowings at commercial or near ...

Table 7
Kenya: Current Account and Trade Balances, 1979-86

	Trade Balance		Current Account Balanc	
	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	-787	-12.7%	-477	-7.7%
1983	-471	-8.1%	-134	-2.3%
1984	-515	-8.6%	-178	-3.0%
1985	-556	n/a	-268	n/a
1986	-567	n/a	-358	n/a

Source: Economic Survey, 1982-85.
Ministry of Finance and Planning, July 4, 1985.

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Table 8
Kenya: Balance of Payments, 1982-86
(Millions of U.S. Dollars a/, b/)

	1982 (Revised)	1983 (Prov.)	1984 (Prov.)	1985 (Proj.)	1986 (Proj
Exports	934	925	1,034	949	925
Imports	-1,721	-1,396	-1,549	-1,504	-1,492
Trade Balance	-787	-471	-515	-556	-567
Government Transfers	76	121	144	122	71
Other Invisibles (net)	235	216	193	166	139
Total Invisibles	310	337	337	287	209
Current Account Balance	-477	-134	-178	-268	-358
Government Capital (net) c/	132	108	99	44	68
Other Capital (net)	148	129	134	127	244
Total Capital	280	238	233	171	312
Errors and Omissions	5	-2	-1	-	-
Basic Balance	-192	102	54	-97	-46
Financing	192	-102	-54	97	46
IMF Credits	213	96	-2	27	-80
Increase in Reserves (-)	-33	-191	-56	30	-
Other Liabilities	12	-8	4	2	-
Required Financing d/	-	-	-	38	126
Memorandum Item: Current Account/GDP at Market Prices	-7.7%	-2.3%	-3.0%	N/A	N/A

Notes: See following page.

Table 8
<u>Kenya: Balance of Payments, 1982-86</u>
Explanatory Notes:

a/ Totals may not add due to rounding and exchange conversion.

b/ Exchange rate, Kenya Shillings per U. S. dollar:
1982 = 10.922;
1983 = 13.312;
1984 = 14.414;
1985 = 16.542 (includes actuals for Jan. - June 1985, and estimates for July - Dec. 1985, based on a 12 quarter linear trend, June 1982 - June 1985);
1986 = 18.207 (estimate based on a 12 quarter linear trend, June 1982 - June 1985).

c/ Includes parastatals.

d/ Based on a need for 2.5 months of reserves or 5.776 billion Kenyan Shillings, whichever is more.

Source: GOK, Ministry of Finance and Planning, July 4, 1985.

b. Merchandise Trade

The volume of Kenyan merchandise exports over the past five years has fallen by nearly 13 percent, and the overall terms of trade have fallen more than 11 percent. As a result, the purchasing power of Kenyan exports over the past five years has fallen by nearly 22 percent. In fact, the purchasing power of Kenyan exports was also some 6 percent lower in 1984 than it was ten years earlier in 1975, further evidence of the need for additional structural adjustment reforms.

Despite such negative factors, the country's merchandise trade deficit was reduced from a peak of $1,390 million in 1980 (19.6 percent of GDP) to a low point of $471 million in 1983 (8.1 percent of GDP). The trade deficit is expected to rise slowly from its 1983 low point to $556 million in 1985 and to $567 million in 1986. Nevertheless a return to the inflated deficits of the past is highly unlikely. As indicated in Table 8, export values (measured in U.S. dollars) may be no higher in 1986 than they were in 1983. The growth in the trade deficit, therefore, is being contained largely through limitations on import growth, with the dollar volume of imports declining from $1,544 million in 1984 to $1,504 million in 1985; and to an estimated $1,492 million in 1986. Although exchange rate estimates affect to a certain extent the presentation of the data above, long-term trends in import volumes are as clear, and as negative, as those for export volumes described above. The volume of Kenyan imports in 1984 was some 23 percent lower than the volume imported in 1975, despite the significant overall growth of the economy in the interim. Continued compression of imports is not a viable avenue for future Kenyan development, and there can be no significant increase in exports without significant structural adjustment.

c. Balance of Payments Deficit, and Financing

Kenya's current account deficit reached a post-independence peak of $893 million (12.6 percent of GDP) in calendar year 1980. By CY 1983, this unsustainable deficit had been reduced to a low point of $134 million (only 2.3 percent of GDP). Moreover, the basic balance of payments deficit showed an overall surplus in CY 1983 for the first time in many years ($102 million or 1.8 percent of GDP). (See Table 8.) The impressive results obtained in 1983, however, resulted in part from a massive cutback in imports through a strict application of quantitative controls that could not be sustained in the long-run. In 1983, the Kenyan Government once again demonstrated that it is willing to apply severe import controls to reestablish balance in the external accounts. The consistent application of such methods, however, would not permit the external trade liberalization and internal structural changes required to achieve either long-term improvements in the balance of payments or acceptable levels of growth.

In response to the recent drought, substantial increases in imports were required both to supply needed foodstuffs, and to support a higher level of activities in non-agricultural sectors of the economy. Both efforts were successful, but the inevitable result was a worsening of the current account deficit to $178 million in 1984, and to an expected level of $268 million in 1985. The small surplus of $54 million in the basic balance of payments in 1984 was eliminated, and an overall basic balance of payments deficit o $97 million is expected in 1985 (of which some $38 million mus still be financed). With the drought behind it, the Governmen of Kenya is seeking to reduce the basic balance of payments deficit to $46 million in 1986. This reduction, however, will be offset by the need to rebuild reserves to replace those drawn down during the drought, and to maintain an acceptable ratio between reserves and imports. As a result additional required financing to be arranged in CY 1986 amounts to an estimated $126 million. The proposed $25 million FY 1985 ESF Amendment would provide Kenya with balance of payments support equivalent to one-fifth of the required financing which must b found for CY 1986, providing substantial U.S. support for continued improvements in macroeconomic management and further structural adjustment in Kenya.

Table 9
Nairobi: Consumer Price Index, All Goods, 1975-84

Year	Income Group: High	Income Group: Med	Income Group: Low	CPI Weighted Average a/b/	Consumer Price Inflation
1975	109.3	105.1	108.2	108.5	16.8%
1976	117.7	114.9	118.0	117.2	8.0%
1977	134.8	130.4	142.8	134.2	14.6%
1978	145.1	141.0	162.3	144.9	7.9%
1979	163.7	155.7	177.1	162.6	12.2%
1980	185.4	173.3	200.3	183.6	12.9%
1981	220.5	216.3	239.0	220.3	20.0%
1982	259.0	255.9	271.8	258.8	17.5%
1983	285.7	281.7	297.9	285.3	10.2%
1984	307.0	312.6	330.4	308.8	8.2%

Notes:

a/ January - June 1975 = 100

b/ Weights: 0.778 High; 0.189 Medium; 0.033 Low.

c/ Consumer Price Inflation = 100* (((Xt)/(Xt-))-1), where Xt is the value of the CPI weighted average index in year t.

Source: Economic Survey, Annual, 1977-1985.

1b

3. Structural Adjustment

The drought of 1984 has slowed, but not halted, progress on policy change and policy implementation relevant to continued structural adjustment in Kenya. Despite the effects of the drought, improvements in macroeconomic management have continued since the early 1980's. As such improvements persist, they inevitably have positive effects on achievement of structural adjustment goals as well. Since the signing of the original Structural Adjustment Agreement in June 1983, Government budget deficits have continued to be controlled (Tables 4 and 5); increases in the supply of money have moderated (Table 6); and increases in the consumer price index have fallen from a peak of 20 percent in 1981 to 8.2 percent in 1984 (Table 9). Realignment of other prices has continued providing appropriate signals for continued structural adjustment, including appropriate changes in energy pricing, agricultural pricing, the exchange rate, real wage rates, and real interest rates.

Structural adjustment in Kenya, however, will require more than improved macroeconomic management and "getting prices right" although both are important and necessary. Difficult institutional changes will also be necessary in such areas as: improved management, budgeting, and financial control systems; improved donor coordination and budgeting of donor projects; reorganization of the role of parastatal bodies, including divestiture; more aggressive use of the exchange rate; increased export promotion; enhanced private investment; and liberalization of pricing and marketing controls. The current situation is summarized below.

a. Balance Between the Public and Private Sectors

Improved balance in resource use between the public and private sectors is a key element of structural adjustment in Kenya, and one where improvement has been marked as the Government share of GDP has fallen by nearly a fifth over the past five years. Budgetary control processes have improved substantially, and the meeting of IMF budget and credit targets has become nearly routine. Improvements in the Kenya External Debt Reporting System (KEDRES), and the start-up of the Kenya Internal Debt Reporting System (including parastatal debt reporting and billing), can be regarded as important steps forward. Microcomputerization of high-priority financial and management functions is beginning to contribute to on-going GOK programs to improve management systems in the Ministry of Finance and Planning.

Still required, however, are major improvements in setting project priorities, and in the integration of Development Plan objectives with the realities of the forward budgeting process. Linkages between the forward budgeting process and the formation of actual Budget Estimates must also be substantially tightened. Improvements in the formulation and implementation of the Development Estimates cannot be substantially effected without better coordination with external donors. Taken together, improvements in budgeting, management, and financial control can have structural adjustment affects by limiting the overall demand by Government on Kenya's limited available resources. At a more complex level, improvements in the rate of return on Government expenditure can substantially improve Kenya's overall development prospects. Given the extremely limited return on parastatal investments to date, parastatal reorganization and parastatal divestiture remain as prime candidates for GOK structural adjustment actions. To date efforts at divestiture have been limited to the drafting of studies and reports. Recently there has been somewhat more interest in improving parastatal financial management, strengthening GOK financial oversight, and limiting the rate of financial flows to parastatals whose prospects for producing financial returns are limited.

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 79.4 percent between late December 1981 and early July 1985 has been supplemented by a strong depreciation in the exchange rate between the SDR and the U.S. dollar. Attempts to maintain the real trade-weighted value of the Kenya Shilling through a more flexible exchange rate policy, however, have been insufficient to prevent a substantial decline in the volume of exports, or to supply the increased volume of imports required to increase output and competition in the economy as a whole. Steps taken to date to alter the exchange rate (and the exchange rate mechanism) have been significant, and represent moves in the right direction. The same may be said regarding the liberalization of quantitative import controls, and improvements in the uniformity and equity of tariff protection. Implementation of quantitative import controls in Kenya is too often still a case of "the rule of men," rather than "the rule of law." Moreover despite changes, the tariff regime provides far from uniform nominal rates of protection and contains even wider disparities in effective rates of protection. Nonetheless patterns of exchange rate adjustment, import liberalization, and tariff adjustment are by now well established in Kenya. These changes can be expected to continue (and perhaps to accelerate as effective trade protection studies are completed and reviewed).

These measures to improve the balance of payments on a structural adjustment basis have been supplemented by realistic energy pricing (which has reduced overall demand for petroleum products), and by a return to real positive interest rates (which has the potential to improve the capital account of the balance of payments as well). During CY 1985, Kenya has computerized and simplified its Export Compensation Scheme, and the first payments under the revised Scheme have now been made. Finally, Government of Kenya efforts to settle the disposition of the assets of the former East African Community have now been successful, and Kenya's accession to the Preferential Trade Agreement (PTA) has been completed. These two actions open at least the possibility that regional trade and regional cooperation can be widened among the states of Eastern and Southern Africa, with positive implications for eventual improvements in the volume of Kenyan exports and in the utilization of Kenyan industrial capacity.

c. Productive Employment

Structural adjustment policies are slowly improving on matters that would encourage productive employment of Kenya's rapidly growing labor force through a more rapid and efficient pattern of industrial and agricultural growth. The population problem itself has been strongly addressed during the past year at the most senior levels of Government. Over the past two years the staffing and functioning of the National Council on Population and Development has improved. Nevertheless, significantly more attention must be given now to reordering GOK budgetary priorities in order to make available the human and financial resources necessary to make nationwide delivery of high quality family planning services a reality.

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. This policy has resulted in a 1984 average real wage that is only slightly more than 80 percent of the average of a decade ago. The 1.1 percent increase in real wages which was permitted in 1984 followed a series of real wage declines in 1981, 1982, and 1983. (See Table 10.)

Real interest rates are an additional component of realigned factor prices. Rising nominal interest rates combined with lower growth in the Consumer Price Index have produced positive real interest rates for 1983 and 1984, and the trend is expected to continue for 1985. (See Table 11.)

Table 10
Kenya: Average Annual Wage Earnings, and Real Wage Growth, 1975-84

Year	Current Average Annual Wage[a]	Average Wage Index[b]	Nairobi CPI Weighted Index[c]	Real Wage Index[d]	Growth in Real Wages[e]
1975	381.3	99.2	108.5	91.5	-1.7%
1976	442.7	115.2	117.2	98.3	7.4%
1977	448.8	116.8	134.2	87.0	-11.5%
1978	529.8	137.9	144.9	95.2	9.4%
1979	579.6	150.9	162.6	92.8	-2.5%
1980	660.3	171.9	183.6	93.6	0.9%
1981	770.0	200.4	220.3	91.0	-2.8%
1982	822.4	214.1	258.8	82.7	-9.1%
1983	876.5	228.1	285.3	80.0	-3.3%
1984	959.6	249.8	308.8	80.9	1.1%

Notes:

a/ In Kenya Pounds (1 Pound = 20 KSh.)

b/ June 1975 = 100.

c/ January-June 1975 = 100.

d/ Real wage index = Average wage index / CPI weighted index.

e/ Growth in Real Wages = 100* (((at)/(at-))-1), where at is the value of the real wage index in year t.

Source: Economic Survey, Annual, 1977-1985.

Table 11
Kenya: Trends in Selected Interest Rates, 1980-84

	Year	Nominal Interest a/	Consumer Price Index b/	Real Interest Rate c/
Commercial Banks 1 Year Time Deposit d/	1980	5.63	12.9	-6.4
	1981	6.35	20.0	-11.4
	1982	12.25	17.5	-4.5
	1983	13.79	10.2	3.3
	1984	13.00	8.2	4.4
Commercial Bank Savings Deposits	1980	5.00	12.9	-7.0
	1981	6.00	20.0	-11.7
	1982	10.00	17.5	-6.4
	1983	12.50	10.2	2.1
	1984	12.50	8.2	4.0
Commercial Bank Loans and Advances d/	1980	10.00	12.9	-2.6
	1981	11.00	20.0	-7.5
	1982	14.00	17.5	-3.0
	1983	16.00	10.2	5.3
	1984	15.00	8.2	6.3
Hire Purchase and Merchant Bank Deposits d/	1980	8.75	12.9	-3.7
	1981	11.00	20.0	-7.5
	1982	14.75	17.5	-2.3
	1983	16.25	10.2	5.5
	1984	16.50	8.2	7.7
Hire Purchase and Merchant Bank Loans d/	1980	12.00	12.9	-0.8
	1981	14.00	20.0	-5.0
	1982	14.00	17.5	-3.0
	1983	16.00	10.2	5.3
	1984	20.00	8.2	10.9

Notes:
a/ Beginning of Calendar Year.
b/ Percentage increase in Nairobi CPI for all indicators, December over December, based on a weighted average of High (77.8%), Medium (18.9%), and Low (3.3%) income groups
c/ 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 CPI for Nairobi.
d/ Maximum.

Sources: Central Bank of Kenya: Economic and Financial Review, October-December, 1984.

Although growth in the monetary aggregates has slowed, and credit policies have been tight, Government has attempted to allocate an increasing proportion of domestic credit to the private sector. As discussed above, the private sector share of credit has increased to 62 percent in 1984 from the low point reached in the early 1980's. Nevertheless, the recovery has not permitted the private sector to achieve a share in overall credit commensurate with its share in the economy as a whole. Despite past efforts, overall wage employment in Kenya continues to grow more slowly than the labor force as a whole. Moreover, Government has accounted for a disproportionate share in the overall increase in employment over the last decade (although this trend has apparently slowed over the past three years).

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 13 percent during 1980-84. 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 again raised internal producer prices for maize and wheat, the major food grains. 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 ESF Grant, Government has placed most agricultural inputs on the "free" list of scheduled imports, and continues to broaden the role of the private sector in the importation 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. Of course lack of payment and late payment for major food grains have not been major problems during the recent drought. To the extent that some of these negative 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.

PART ONE: THE FY 1985 COMMODITY IMPORT PROGRAM (CIP)

III. Background: The ESF Program 1983-84

A. Implementation of the ESF Program 1983-84

1. Balance of Payments Assistance

Balance of Payments assistance to the Government of Kenya was provided in the form of a $28 million cash transfer under the FY 1983 ESF Agreement, and in the less fungible form of a $15 million Commodity Import Program (CIP) under the FY 1984 ESF Agreement.

Once Conditions Precedent had been met under the FY 1983 Agreement, the Ministry of Finance requested disbursement of the grant into the Government of Kenya's account at the Federal Reserve Bank of New York. Subsequently, the Federal Reserve Bank transferred these funds telegraphically to the GOK Account at the Central Bank of Kenya. The Central Bank of Kenya then credited the GOK Paymaster General Account with the equivalent Shillings for use in meeting budget ceilings for June 30, 1983. Dollar funds were provided for general purposes (excluding the finance of military, guerrilla or paramilitary requirements of any kind).

The FY 1984 ESF Agreement was signed on September 25, 1984. Implementation of the CIP portion of the program was slow in starting, however, as the GOK focused on meeting the Conditions Precedent related to policy reform, before starting to meet the Conditions and Covenants that were associated with implementation of the CIP. In the interim, the Mission established a CIP office within the Office of Projects, but located separately with easier access to the public. A Secretary (FSN 6) and a Program Procurement Specialist (FSN 11) were hired on a contract basis to staff the office under the supervision of an Assistant Project Development Officer with extensive experience with other CIPs. The CIP office reviews all applications for commodity eligibility, and for evidence of competition or for evidence of a special supplier/importer relationship. In addition, the CIP office explains the program to prospective importers; helps Kenyan importers to locate U.S. suppliers; and supervises the work of Price Waterhouse Associates. Price Waterhouse has been hired to provide arrival accounting and end-use auditing for the CIP. In addition Price Waterhouse will verify the accuracy of counterpart deposits for the CIP, as well as for fertilizer imports which are being financed under the Agricultural Development Program (615-0230). In August 1985 a list of Kenyan importers was sent to AID/W by the CIP office for publication in order to meet the advertising requirements of AID Regulation 1. The importer list was found to be too large to be economically reproduced and the list is being revised to include only the most active Kenyan importers. It is anticipated that the revised list will be published in September 1985.

By late April 1985 the GOK had invited local banks to participate in the CIP. On May 16 seven local banks were chosen as cooperating banks in which letters of credit could be opened. It was not until late June, however, that Financing Requests were received from the GOK confirming its choice of banks, and requesting that Letters of Commitment be opened with confirming banks in the U.S. The seven Letters of Commitment requested by the GOK ($1 million each) were issued by FM/PAFD an August 6, 1985.

By early August, twenty-five applications with a value of $1.2 million were being held by the CIP office, pending receipt of the Financing Requests. These applications were subsequently submitted to the GOK for license approval (a process which was covenanted to take no more than three weeks). Eight of the twenty-five applications have now been approved, although the approval process took longer than the stipulated three weeks. Six applications were provisionally rejected because they were said to be for goods produced locally (although only three were on Kenya's restrictive Import Schedule, IIB). These six rejected requests are now being reevaluated. The remaining eleven requests are still being processed.

The initially slow GOK processing of CIP applications can be explained in part by teething difficulties, e.g. the Central Bank does not usually process applications with less than a 1% application fee. The CIP has a fee only half as large as normal since inspection by the Societe General de Surveillance (SGS) is not required under the CIP. It is expected that future applications can be processed within the covenanted three weeks once GOK initial start-up difficulties have been overcome. However, we can expect some applications to continue to be rejected to protect local manufacturers.

The cooperating local banks have expressed an interest in giving more publicity to the CIP now that Letters of Commitment have actually been opened. As the banks see the first letters of credit being opened, it is reasonable to assume that significantly more applications will be received. A few larger transactions are presently being negotiated or are under active consideration, including equipment for a $1.6 million caustic soda plant, a $1 million vegetable oil procurement, and a $350,000 commercial explosives procurement.

2. Technical Assistance

The $8 million of technical assistance funding provided under the FY 1983 and FY 1984 ESF Agreements has served as a successful basis for both policy dialogue and policy implementation. With regard to technical assistance, the overall Structural Adjustment Program has adopted a "demand driven" approach responding to specific GOK requests for assistance within broadly defined categories of improved analysis, planning, management, and budgeting in the Ministry of Finance and Planning, the Central Bank, the Ministry of Agricultural and Livestock Development, and the Ministry of Commerce and Industry. To date technical assistance requests related to structural adjustment have included funding for short and long-term policy consultants, short and long-term technical training, microcomputer hardware and software, and policy studies. Close cooperation in the development of technical assistance requests has provided significant opportunities to undertake substantive dialogue on specific policy issues, while also providing insights into GOK structural adjustment priorities and implementation difficulties.

The overall amount of technical assistance has been increased from the $6 million level foreseen in the original FY 1983 PAAD submission, to $8 million ($2 million provided under the FY 1983 Agreement; $6 million provided under the FY 1984 Agreement). No additional funding for technical assistance is required or requested under the proposed FY 1985 Agreement. As indicated in Table 12 below, programming of technical assistance funds is on track with $5.8 million of the $8.0 million total reserved by implementation letter as of July 31, 1985. Commitments are expected to rise rapidly from $2.3 million at the end of July to $5.8 million at the end of December as major contracts already planned are signed for technical assistance, training, and computer hardware and software for the Ministry of Finance and Planning. Disbursements to date have not been large, but future disbursements will be tied to existing or planned contracts with largely predictable expenditures for consultant salaries, training expenses, and microcomputer hardware and software.

The Studies component of the ESF technical assistance has lagged to date, and will be given additional attention in early FY 1986 to conclude on-going discussions regarding the financing of studies in the areas of industrial efficiency and effective trade protection, parastatal management and accountability, and tourism promotion, among others. Following the July 1985 appointment of a full-time computer systems manager in the Central Bank of Kenya, it should now also be possible to complete programming of the Microcomputer component of the ESF technical assistance in order to permit disbursements under all components of the project to be completed by the PACD date of July 30, 1988. Disbursements to date under the Evaluation component have closely paralleled project paper estimates, as have CIP monitoring expenses, and no excess funding is foreseen to remain in either component by project's end in July 1988.

Table 12
ESF Technical Assistance
Financial Summary
as of July 31, 1985
(Thousands of U.S. Dollars)

T.A. Component[a]	Budgeted	Reserved	Committed	Disbursed
a.	3,900	3,162	1,012	0
b.	1,750	1,750	644	354
c.	1,250	274	219	146
d.	650	386	155	0
e.	150	43	42	30
f.	300	222	222	6
Total[b]	8,000	5,838	2,295	536

NOTES: a/ T.A. Components
a. Sectoral Policy and Planning
b. Strengthening Policy Capacity of Central Ministries
c. Studies
d. Microcomputers
e. Evaluation
f. Commodity Import Program Monitoring Implementation

b/ Totals may not add due to rounding.

A review of technical assistance activities being funded under Project 615-0213 is presented below utilizing the funding categories contained in the Structural Adjustment Program Amendment for FY 1984.

a. Sectoral Policy and Planning $3,900,000

- Technical Assistance Pool (TAP) $1,637,612
- Resource Management for Rural Development (RMRD) $2,100,000
- Drought Management (RMRD) $50,000
- Counterpart Training (RMRD-related) $92,400
- MBA's for Development (RMRD-related) $19,988

Under the FY 1983 and FY 1984 ESF Agreements $3 9 million has been budgeted for technical assistance to improve policy formulation and policy implementation affecting agriculture and rural development in Kenya. Of the total, some $1.6 million has been budgeted to continue U.S. support for the multi-donor Technical Assistance Pool (TAP) managed by the Harvard Institute for International Development (HIID) on behalf of the Ministry of Agriculture and Livestock Development. The TAP, which was previously funded under AID's Rural Planning II Project (615-0189), has been evaluated by the Berg team as having brought to Kenya a large number of highly skilled and experienced consultants who have ensured a certain amount of donor coordination; prepared numerous policy papers of high technical competence; arranged for high quality advanced training for numerous Kenyans; made some innovative departures in budget reform; contributed timely assistance in the 1984/85 drought relief effort; and helped in spreading microcomputer technology. (Draft Evaluation, Part II, A, Improved Analysis..., pp. 11-12.) To date $900,000 of ESF technical assistance funds has been committed to extend U.S. participation in the TAP through June 1986. An additional extension of U.S. participation in the TAP through June 1987 would utilize the remainder of the available $1.6 million. Such an extension would depend upon a favorable USAID review of increased efforts by the TAP to institutionalize policy making and policy implementation by Kenyan staff, to gradually reduce expatriate staff, and to concentrate more explicitly on training, as recommended in the Draft Evaluation, Part II, pp. 12-14.

As summarized in the budget table above, an additional $2.26 million of ESF funds have been reserved for a series of technical assistance activities in support of the new GOK emphasis on District Focus. USAID expects to support District Focus primarily in ways which promote decentralization, local participation, improved planning and budgeting, and improved policy and regulatory environments for private investment. Of the $2.26 million total, some $92,000 has been committed to date to begin early training in planning and management at the Masters level for 4 Kenyan counterparts. An additional $20,000 has been committed to begin the introduction of microcomputer technology in test districts, utilizing low-cost technical assistance provided through a buy-in to the PRE-funded project entitled MBA's for Development. An RFP has now been published in the Commerce Business Daily advertising for bids on the main component of Resource Management for Rural Development ($2.1 million) and on its Drought Management component ($50,000). The same RFP advertises for a related Financial Management activity ($450,000) which is described in Section III.A.2.b below.

b. <u>Strengthening Policy Capacity of Central Ministries</u> — <u>$1,750,000</u>

- Financial and Pricing Policy, Ministry of Finance and Planning	$254,504
- Budgeting and Management, Ministry of Finance and Planning	$450,000
- Microcomputer TA, Ministry of Finance and Planning	$692,158
- Deposit Insurance, Central Bank of Kenya	[illegible]
- Bank Inspection and Management Central Bank of Kenya	$2[illegible]
- Improved Import Licensing, Ministry of Commerce and Industry	$120,500

Under the FY 1983 and FY 1984 ESF Agreements, $1.75 million has been budgeted to improve policy formation and policy implementation in the Ministry of Finance and Planning ($1.4 million), the Central Bank of Kenya ($233,000), and the Ministry of Commerce and Industry ($121,000). Improved analysis, planning, budgeting, and management in the Ministry of Finance and Planning is desirable in its own right as Kenya seeks to meet its large development needs from limited domestic and foreign resources. In addition, improved control of expenditure and revenue by the Ministry of Finance and Planning can contribute to more limited public sector demands on available domestic financing, reducing the crowding out of private sector borrowing which has characterized Kenyan financial markets in the past few years. ESF-funded technical assistance to the Central Bank of Kenya is designed to improve the quality as well as the quantity of financing available to the private sector. Similarly a limited amount of technical assistance has been provided to the Import/Export Division of the Ministry of Commerce and Industry to reduce administrative bottlenecks in the issuance of import licenses, a primary impediment in the past to expanded private sector production and employment in Kenya.

Of the $1.4 million total budgeted for the Ministry of Finance and Planning under this component, some $255,000 has been committed to provide the services of a Senior Financial Advisor (Dr. Clive Gray) over a period of three years, together with related training for Kenyan staff. During the first two years of the consultancy to date, Dr. Gray has contributed substantially to the design and installation of a major new financial reporting mechanism (the Kenya Internal

Debt Reporting System or KIDRES), to the modification and expansion of the Kenya External Debt Reporting System (KEDRES), and to policy studies regarding elimination of anti-competitive business practices. During GOK FY 1985/86, Dr. Gray will continue to assist the Debt Management Section as parastatal organizations begin to respond to the new invoices issued by KIDRES. In addition, Dr. Gray will assist the Government Investment Division to analyze cash flow and forward budget data submitted by parastatals; assist the Treasury Budget Rationalization Task Force to analyze and to prioritize proposed expenditures; and assist the Debt Management Section to incorporate KEDRES data into analyses and projections of Kenya's external debt service ratio.

Up to $450,000 has been reserved for consultants to assist the Ministry of Finance and Planning over the next two years to improve implementation and integration of the planning and budgeting processes. (This consultancy has been included in the RFP for Resource Management for Rural Development, cf. Section III.A.2.a above.) The budgetary consultants will work closely with microcomputer consultants supplied by the firm of Thunder and Associates, who have completed nearly half of a two-year technical assistance effort to be funded at a total level of $848,000 ($692,000 from this component; $156,000 from the Microcomputer component below).

To date a mixture of 16 IBM PC and XT computers, and associated hardware and software, have been purchased and installed, initial training has been undertaken, and 11 of 30 applications identified by the Ministry as high priority have been programmed. Applications completed as of July 1985 include: the FY 1985/86 Development Budget; the FY 1985/86 Recurrent Budget; the 1984 Compendium of Donor Assistance Projects; the Budget Outturn (MOFP basis); the Budget Outturn (IMF basis); the Budget Trial Balance; the Exchequer Returns; the IMF Program Review; the National Cereals and Produce Board Cash Flow Forecast; the National Cereals and Produce Board Shipments Payment Schedule; and the Imprest Recovery System. Major emphasis was placed during the first year of technical assistance on production of the FY 1985/86 Budget (believed to be the first such national budget in Africa to be produced entirely on the microcomputer).

The second year of technical assistance will concentrate on expanded training, on the purchase and installation of a second tranche of hardware and software, and on the completion of remaining high priority applications identified by the Ministry, with emphasis on microcomputerization of the Forward Budgeting Process and of the Appropriation Accounts (i.e., the Budget Audit). As the Berg evaluation correctly points out, microcomputer usage achieved in the first year of technical assistance is mainly "operational" rather than "managerial" or "analytical" (Draft Evaluation, Part II, A, Improved Analysis..., p. 15.) However, enthusiasm among Kenyan counterpart staff has been high, implementation of high priority applications has proceeded rapidly, and support among senior managers in the Ministry of Finance and Planning has been excellent.

Similar effective utilization of ESF-funded technical assistance has been evidenced in the Central Bank of Kenya, where a short-term Deposit Insurance Advisor ($25,000) and a long-term Senior Management Advisor ($207,000) have contributed to strengthening the banking and financial system, one of Kenya's key development assets. Following TDY's in April and September 1984, Deposit Insurance Advisor Stanley Silverberg (seconded from the U.S. Federal Deposit Insurance Corporation -FDIC) completed a draft proposal for a Deposit Insurance System for Kenya which was submitted to the Central Bank in early October 1984. After Government of Kenya review and revision, the Deposit Protection Scheme was announced in the Budget Speech in June 1985, and legislation was introduced into Parliament shortly thereafter, with good prospects for passage before the end of this calendar year. The two-year consultancy of Senior Management Advisor Bernard McKeon (also from FDIC) commenced in September 1984, and is effectively strengthening the institutional capacity of the Central Bank of Kenya to carry out systematic inspection of Kenya's rapidly expanding system of banks and non-bank financial intermediaries

The remaining $120,000 of ESF funding in this component was utilized to support a nine-month TDY of Bureau of Census Management Consultant, Patricia Anderson. The Anderson TDY commenced in November 1983 and was completed in August 1984. The consultancy was successful in assisting to reorganize the records and filing system of the Import/Export Division of the Ministry of Commerce and Industry, and to substantially reduce administrative bottlenecks in the processing of individual import license requests. Installation of a well-documented manual system for processing import licenses was considered to be a pre-requisite for possible microcomputer assistance to the Import/Export Division in the future (although additional review of the theory and functioning of the overall system of Import License Schedules will have to be made before any decision regarding future assistance in this area is taken).

c. Studies $1,250,000

- Study of Effective Trade Protection and Industrial Efficiency, Phase I	$274,000
- Individual Industry Studies Phase II	$400,000
- Investment Advisory and Promotion Center	$55,000
- Tourism Promotion	$300,000
- Parastatal Management and Accountability	$221,000

The FY 1983-84 ESF Agreements provide $1.25 million to finance studies on mutually agreed topics relevant to future structural adjustment policy decisions in Kenya. As of July 31, 1985, some $274,000 of the total amount available had been committed to fund an initial study on Effective Trade Protection and Industrial Efficiency in Kenya, and on related training of Kenyan counterpart staff. Two economic consultants (Dr. Doris Jansen; Mr. Michael Selhorst) will have provided twenty-person months of consultancy services by October 30, 1985. Progress on interviews, data collection, and data analysis has been satisfactory to date, although counterpart support has been less than optimal. Following the Phase I study of broad industrial sectors, a series of follow-on studies of individual industries may be requested. However, the scope and methods of the Phase II Studies will depend in part on the final results obtained from Phase I activities. An additional $55,000 has been reserved to study the investment climate in Kenya and to investigate the future role of the Investment Advisory and Promotion Center in promoting required changes. Discussions on the programming of the remaining funds under the Studies component are continuing with emphasis on foreign exchange earning activities (perhaps tourism) and on parastatals (perhaps management and accounting, or divestiture).

• Microcomputers $650,000

- Ministry of Finance and Planning, Phase I	$154,386
- Ministry of Finance and Planning, Phase II (incl. TA of $155,614)	$230,614
- Central Bank of Kenya	$265,000

In connection with the technical assistance provided to the Ministry of Finance and Planning by Thunder and

Associates to date during CY 1985, some $154,000 of microcomputer hardware and software is being procured including:

- Microcomputer Systems	$130,717
- Software	$9,294
- Computer Furniture	$5,429
- Computer Supplies	$8,946
Total	$154,386.

Follow-on equipment requests ($75,000) and some additional technical assistance ($155,614) will be provided during the second phase of the Thunder and Associates consultancy beginning in mid-September, 1985.

e. Evaluation	$150,000
- Berg Evaluation	$ 43,176
- Final Evaluation	$106,824

An independent, outside evaluation team was formed, consisting of Dr. Elliott Berg (Elliott Berg Associates), Dr. Walter Hecox (Colorado College), and Dr. James Mudge (AID/PPC). The team did preparatory work in Washington in March 1985; and field work in Kenya in April; and submitted the draft Evaluation in May for Mission review. Results of this evaluation have been taken into consideration in the preparation of this FY 1985 Structural Adjustment Program Amendment.

Commodity Import Program, Implementation and Monitoring	$300,000
- Price Waterhouse Associates	$180,000
- Thunder and Associates	$42,000
- CIP Evaluation	$75,000
- Contingency	$3,000

Annex E to the FY 1984 PAAD contains a budget totalling $300,000 to implement and monitor the CIP. As of July 31, 1985, PIO/T 615-0213-3-40023 had obligated $42,000 for the services of the firm of Thunder and Associates to purchase and install two microcomputer systems, and to design a commodity tracking system. One of the two microcomputer systems is located at the firm of Price Waterhouse Associates who were hired at a cost of $180,000 under PIO/T 615-0213-3-40024 to provide arrival accounting, end-use monitoring, and counterpart deposit verifications for both the CIP portion of the Structural Adjustment Program and the fertilizer purchased under the Agriculture Development Program (615-0230). The $75,000 which has been budgeted to evaluate the implementation of the CIP is currently planned for use in February 1986.

3. GOK Compliance with Conditions Precedent and Covenants

Conditionality under the FY 1983-84 ESF Agreements has been complex, reflecting nearly the full range of policy dialogue considerations outlined in the original 1983 PAAD (p.35). GOK compliance has been uneven, reflecting the number and complexity of U.S. conditions and covenants; the complexity of other donor conditionality, including that of the IMF and the World Bank; rapidly changing economic conditions; administrative difficulties in key implementing ministries; and lack of concensus within the Kenyan Government regarding the necessity, desirability, and timing of various structural adjustment measures. The FY 1983 Program Grant Agreement contained seven Conditions Precedent related to policy reform, and seven policy-related Covenants. The FY 1984 Program Grant Agreement also contained seven Conditions Precedent related to policy reform, in addition to four policy-related Covenants. In many cases, Conditions Precedent and Covenants in the FY 1984 Agreement were designed to reinforce various aspects of conditionality contained in the earlier Agreement. A review of conditionality to date under Project 615-0213 is presented below utilizing the conceptual categories defined in the statement of work for the Berg evaluation.

a. <u>Improved Analysis, Planning, Budgeting, and Financial Management in the Ministry of Finance and Planning (Including Donor Projects)</u>

The Government of Kenya met all IMF and AID budget and credit targets for June 30, 1983 and for June 30, 1984 in keeping with Conditions Precedent to the FY 1983 ESF Agreement. The GOK also met the AID budget deficit target of 5 percent of GDP set for June 30, 1985 as covenanted in the 1984 ESF Agreement. The 5 percent deficit target for June 1985 was established by AID in the face of the extraordinary call on Government resources occasioned by the recent drought, and given the possibility that overall agreement might not be reached on a renewed IMF Stand-By Arrangement. Agreement on such an Arrangement was reached in February 1985, however, and the GOK has subsequently met all IMF budget and credit targets set for June 1985. It appears that similar targets set for September 1985 will also be met.

Regarding institutional reform of budgeting practices, the Government of Kenya formally met AID's FY 1983 Condition Precedent to review new projects in accordance with an investment plan and an external borrowing plan. This Condition Precedent was designed to indicate U.S. support for continued cooperation between Kenyan and World Bank personnel working together on the <u>1984-1988 Development Plan</u> (which was successfully produced in December 1983) and on the <u>Forward Budget and Public Investment Programme</u> (which was completed and published in January 1984). Additional Covenants to continue

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with refinement of the budgeting process were included in AID's FY 1983 and FY 1984 ESF Agreements. The Berg evaluation agrees that "better budgeting and more effective and efficient use of public sector resources is certainly a priority objective. Dispersion of resources on new projects while old ones limp along, and continuation of clearly low priority programs are certainly major impediments to faster, higher-quality economic growth and unless the economic decision-making institutions of government are strengthened now, resources will be squandered on ill-considered projects later, when present economic constraints ease." (Draft Evaluation, Part II, A, Improved Analysis..., p.3.)

Pages 4-11 of this same section of the Draft Evaluation describe the present Kenyan budgetary process, including its many faults. Nonetheless, the Draft Evaluation concludes on page 21 of this same section that the "area of institutional or administrative reform is not well-suited for conditionality. It is rarely possible, first of all, to find good indicators that allow measurement of progress, and hence allow monitoring of proposed reforms." Moreover to quote the Draft Evaluation (p.25 same section), "governments hesitate to introduce these kinds of reforms, or do it poorly, not primarily because lack of will, but because of lack of capacity, and the latter is more related to the condition of underdevelopment than to political/bureaucratic resistance or related obstacles." USAID/Kenya is in basic agreement that conditionality in these areas of institutional change is difficult to measure or monitor. USAID has shifted its approach in the area of improved analysis, planning, budgeting, and financial management to the provision of more, and more appropriate, technical assistance. (See Section III.A.2 above.) Given the unsettled financial and economic conditions prevailing in Kenya during the early 1980's, close cooperation and cross-conditionality among policy-oriented donors in Kenya were appropriate, and remain so today, although the modalities for such cooperation will continue to evolve.

b. <u>Improved Functioning of Financial Markets (and Mobilization of Domestic Resources)</u>

No ESF conditionality was proposed. Progress in establishing a Deposit Insurance System, and in improving management and bank inspection by the Central Bank of Kenya, were addressed through technical assistance from the U.S. Federal Deposit Insurance Cooperation (FDIC). (See Section III.A.2 above.)

c. <u>Improved Functioning of External Markets</u>

Under the FY 1983 and FY 1984 ESF Agreements, AID conditionality related to the reform of external markets has centered on import liberalization, export promotion, and improved exchange rate flexibility. The Draft Evaluation (Part II. B., p. 20) concludes that "some of the conditions were modest and at best required Government expressions of intention to move or to implement intended policies rather than actual implementation. Lack of adequate performance on such conditions is difficult to attribute to anything but a lack of attention and priority for structural adjustment-based support efforts by donors. What can be termed superficial response to some other ESF conditions is discouraging for what it says about the seriousness with which Government takes ESF support. In other instances as discussed above Government lacked the basic political commitment to take on hard reform issues according to the previously agreed to time schedules."

Over the past two years, AID Conditionality has consistently promoted various aspects of import liberalization. Two Conditions Precedent to the FY 1983 Agreement sought evidence that Kenya's Import Schedule I would be sub-divided to establish a list of high priority items (including agricultural inputs) for which import licenses would be freely available. Government met these Conditions Precedent by presenting to AID the draft of the new Import Schedules IA and IB prior to June 30, 1983, and subsequently publishing the final version of the Schedules. In addition to these actions. Government covenanted in the FY 1983 Agreement to make approval of licenses on Schedule IA automatic. This Covenant was converted to a Condition Precedent under the FY 1984 Agreement. The FY 1984 Agreement also contained a related Condition Precedent requiring the GOK to establish an implementation schedule for foreign exchange allocations for imports on Schedule I.B.

The Draft Evaluation (Part II., B, p.23) concludes that "Kenya should receive high marks for making progress towards rationalizing the regime of import administration. Despite disappointments at certain parts of the system, it is clear that there is a much improved administrative system, that information is now more readily available to the public, and that license requests are processed and decisions announced on a more regular basis." With regard to Schedule IA, the Draft Evaluation estimates that the proportion by value of licenses approved in early 1985 appears to be 95 percent for raw materials, drugs, hospital equipment, agricultural inputs, and agricultural implements; 85 percent for machinery; 70 percent for industrial spare parts; 70 percent for books; but only 50 percent for motor-vehicle spare parts.

With regard to Schedule IB, the GOK in its letter to AID of February 22, 1985 confirmed that by the end of June 1985, a schedule for implementing Schedule IB would be established and announced, but additional evidence to date has been limited to verbal assurances. The GOK has moved ahead with additional liberalization of the import licensing system, however, and both the 1984 and 1985 June Budget Speeches have moved several hundred additional items each to the less restrictive Schedule IA from lower import schedules.

AID conditionality regarding import liberalization has extended beyond the system of import license schedules to include changes in the import tariff regime. The FY 1983 ESF Agreement includes language covenanting a move toward more uniform tariffs. The Draft Evaluation (Part II, B, p.22) notes that Kenya's June 1983 Budget Speech reduced most tariffs above 30 percent by an average of 15 percent, and that the June 1984 Budget Speech reduced most tariffs over 25 percent by an average of 14 percent. Subsequently, the June 1985 Budget Speech has reduced most tariffs above 25 percent by an additional 12 percent.

AID conditionality on the tariff regime has been designed to maintain GOK progress toward more uniform tariffs, a policy reform which was initiated under the first World Bank Structural Adjustment Loan (SAL I). Industrial efficiency and trade protection studies which could not be implemented under the SAL are currently being carried out using ESF grant funds. (See Section III.A.2 above.)

On the export side, both the FY 1983 and the FY 1984 ESF Agreements contain some conditionality. The FY 1983 Agreement contained a Condition Precedent requiring submission of evidence to AID regarding export promotion and the simplification of export documentation. The GOK met the AID requirement prior to June 30, 1983 submitting to AID copies of the May 1983 Exporters Guide, and citing (minor) increases in the overseas business travel allowance, as well as citing simplification of import and export licensing procedures.

FY 1983 and FY 1984 Covenants specify that the GOK will encourage exports within a flexible exchange rate system, improve the administration of exports and export incentives, and expedite studies of export promotion. No major export promotion studies have been carried out to date. However, export promotion has been encouraged by four devaluations of the Kenya Shilling against the SDR since the FY 1983 Agreement was signed: 2.5 percent in July 1983; 2.6 percent in May 1984; 7.5 percent in March 1985; and a minimum of 9.3 percent in July 1985. Since July 1983, the Central Bank of Kenya has adopted the practice of setting a central rate for the Kenya Shilling against the SDR within a band of plus or minus 2.25 percent. Under this more flexible system the Shilling fluctuates against major currencies on a daily basis. The Central Bank no longer makes official announcements of changes in the central rate, somewhat defusing the exchange rate as an issue for public debate. The Central Bank now monitors the real trade-weighted exchange rate of the Kenya Shilling against the currencies of all major trading partners to estimate the need for periodic adjustments.

In addition to increased exchange rate flexibility, the GOK has microcomputerized the processing of payments under its Export Compensation Scheme (utilizing IBRD-funded technical assistance supplied by the U.S. Bureau of Census). The first payments under the revised Scheme were made to exporters in the second quarter of CY 1985. With regard to the "Green Channel" Condition Precedent to the FY 1984 Agreement, USAID received assurance in the GOK's letter of February 22, 1985 that the Government would take steps by the end of June 1985 to improve the procedures for obtaining export documentation. Additional evidence to date, however, has been limited to verbal assurance that the issue is still alive.

d. Improved Functioning cf Agricultural Input Markets

As discussed above, AID has sought to improve the functioning of agricultural input markets by encouraging the GOK to include most agricultural inputs on the less restrictive Import Schedule IA. In addition, AID has sought to promote the expansion and privatization of fertilizer marketing in Kenya through DA-funded, private sector import programs, as well as through the use of ESF conditionality. In response to a Condition Precedent to the FY 1983 Agreement, the Government of Kenya established a fertilizer advisory committee with private sector members in September 1983. In keeping with an FY 1983 Condition Precedent, imports of donor-supplied fertilizer were made available for sale to any licensed fertilizer dealer, and the exclusive marketing agreement with the Kenya Farmers Association (KFA) was abrogated in November 1983. This abrogation opened the way for expanded private sector marketing activities, including the private sector marketing of DA-funded fertilizers under a system of commercial bank guarantees. As discussed in Section III.A.4. above, efficiencies have resulted in the deposit and programming of local currency generations, with favorable reactions by both the Kenyan Treasury and by other donors (including the World Bank, which has adopted a similar approach in its own fertilizer program in Kenya).

e. Improved Functioning of Agricultural Output Markets

A Condition Precedent to the FY 1985 ESF Agreement required evidence that the Government of Kenya was taking steps to develop an integrated food security policy, reduce the drain on public finance by the National Cereals and Produce Board, and study the management and organization of grain marketing. The Government of Kenya formally met the Condition, citing the production and subsequent GOK review of the large scale Bookers Study on grain marketing, (which included a review of the role of the National Cereals and Produce Board). However, little action of any sort to liberalize grain marketing has resulted to date from Government review of the Bookers Study.

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A related Condition Precedent in the FY 1984 ESF Agreement would permit private buyers and cooperatives to purchase up to 1 million bags of maize from producers when there has been a return to normality following the 1984 drought. The GOK response contained in its letter to AID of February 22, 1985 indicated Government's belief that neither rainfall nor quantities of maize available for marketing adequately capture the concept of normality, and that stock levels must first be rehabilitated to their pre-drought levels. By Government's definition, private sector marketing would be delayed until after the long-rains harvest this fall. Government's letter of February 22nd concludes that it is unlikely that sufficient surpluses will be forthcoming in 1985. A similarly brief response has been made to the FY 1984 Condition Precedent requiring evidence that a report will be submitted to AID by February 1, 1985 specifying that the problem of timely cash payments by parastatals and cooperatives to producers for principal food crops is resolved. The GOK letter of February 22, 1985 states that the problem of cash payments to producers of the principal food crops has been solved and that there are no arrears to farmers. The GOK letter states that these problems have been solved by the Government by releasing more money to the National Cereals and Produce Board, and permitting it to borrow with Government guarantee from banking institutions. Statements of account for the two principal grain marketing bodies which were to have been provided by the Ministry of Agriculture and Livestock before July, 1985 have not materialized as proposed in the GOK letter. More evidence of GOK performance, however, is available regarding the third Condition Precedent related to grain in the FY 1984 Agreement. Changes in controlled purchase prices for grain were announced on January 31, 1985, and reported to AID in the GOK Letter of February 22, 1985. These price changes have been subsequently Gazetted, and copies of the Gazette notices have been supplied to USAID.

f. Improved Analysis, Planning, Budgeting, and Financial Management in the Ministry of Agriculture and Livestock Development

No ESF conditionality was proposed. Progress on policy analysis, planning, project formulation, budgeting, and management are being underwritten through support to the multi-donor Technical Assistance Pool in Agriculture ($1.6 million; see Section III.A.2 above). Additional such assistance, with emphasis on implementing Government's plans for District Focus, will fund Resource Management For Rural Development activities ($2.26 million; see Section III.A.2 above).

g. Improved Implementation of Family Planning Policies and Programs

Under a Condition Precedent to the FY 1984 Agreement, the Government committed itself to waive all import duties and eliminate all taxes on commodities used for family planning services in Kenya. The required changes were Gazetted on November 14, 1984, and copies of the announcement have been supplied to USAID.

h. Reduced Government Participation in Parastatal Organizations

The Government of Kenya covenanted in the FY 1983 ESF Agreement that it would prepare strategies and mechanisms for divestiture of Government interests in public enterprises. A high level Parastatal Divestiture Committee was established. At the time of the Berg evaluation nearly a dozen separate studies and reports had in fact been prepared. No visible action has been taken to implement such studies or reports to date.

Under the FY 1984 ESF Agreement, Government covenanted to include the development budgets for all 25 major parastatal bodies "parallel with" the Budget Estimates for 1985/86. Government was able to complete a review of the financial plans for 5 or 6 of the major parastatals by June 1985, but formal integration of the results with the overall GOK budgeting process for FY 1985/86 was incomplete.

i. Increased Reliance on the Private Sector to Achieve Development Objectives

Government covenanted under the FY 1983 ESF Agreement to establish a Monopolies and Prices Commission to review and combat anti-competitive business practices. With ESF-funded technical assistance supplied by Dr. Clive Gray, a report and draft legislation to establish such a Commission were prepared. Strong opposition from some business quarters, and second thoughts by the concerned Ministries, have delayed implementation, perhaps indefinitely.

As a Condition Precedent to the FY 1984 ESF Agreement, the GOK has agreed to utilize $5 million equivalent of counterpart Shillings derived from the FY 1984 Commodity Import Program for mutually agreed Kenyan private sector activities such as agricultural, housing or export credit. However, no Shillings have as yet been deposited in the Special Account under the FY 1984 CIP due to initial GOK implementation delays.

4. Local Currency Deposit and Programming

The deposit and programming of Shillings generated from the sale of AID-financed commodities in Kenya takes place within the context of a strengthened system of accountability for PL 480 Title I, for U.S. fertilizer imports, and for general U.S. commodity imports. Starting in FY 1984, USAID negotiated specific local currency programming provisions

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with the Government of Kenya that are also gradually being accepted by Government as provisions to govern other donor-generated counterpart as well. GOK acceptance of the accountability procedures described in this section is a significant accomplishment of this three-year ESF program because it ensures the timely, full-value deposit of large scale donor program resources to the Exchequer.

Under the FY 1983 ESF Program, dollar and Shilling support helped to meet a severe financial crisis facing the Government. To ensure that the GOK satisfied the provisions of an emergency IMF Stand-By, the USG provided $30 million in ESF in late June of 1983. The $28 cash grant portion of this program generated 369 million Kenyan Shillings that were attributed to the GOK's FY 1982/83 Development Budget.

In the FY 1983 PAAD, the Mission had proposed that the local currency generated by the proposed three-year program be applied to three purposes: the financing of costs of policy reforms; support for jointly agreed, high priority projects; and funding of major foreign exchange saving or foreign exchange earning private enterprise investments. Because of the severe budget constraint at the end of the GOK's 1982/83 fiscal year, and the importance of not exceeding the IMF's domestic borrowing limits, the ESF-generated currency was directed entirely to the development budget.

Priority uses for these Shillings included rural development and agricultural production, economic planning and development, rural health and water, and rural roads, as agreed to in the GOK's letter of August 3, 1983. The Ministry of Finance letter itemized the Shillings released to six ministries for twenty-one program activities. These counterpart funds represented 35% of the Shilling budgets for these programs. Without the prospect of such an allocation, these programs would have been further under-financed and more seriously impaired during the last quarter of GOK FY 1982/83. On the whole, U.S. budget support for the GOK in FY 1983 was successful; the IMF targets were met; and the IMF stabilization program was continued to a successful conclusion.

The Regional Inspector General for Audit reviewed the FY 1983 ESF Program in a report dated February 15, 1985. With respect to local currency, the report concluded on the basis of a limited sampling that some funds were not spent on some projects in the amounts agreed to. USAID noted in its reply to the audit that the emergency cash grant mechanism of FY 1982 had been replaced with a private sector Commodity Import Program under a system of commercial bank guarantees which would generate local currency for programming in a more deliberate and predictable manner, and that the repository for local currency had been changed from the understaffed Cereals and Sugar Finance Corporation to the Government's Paymaster General Account in the Central Bank. USAID noted that the audit recommendation for strengthening "control" over these funds did not state how to do it or to what degree. However, USAID believes the procedures which were set in motion before the audit, and which are being implemented in FY 1985 and FY 1986, fully satisfy AID policy directives.

For the FY 1984 ESF Program, major changes were introduced in local currency procedures. Conditions 8, 9, and 10 of the FY 1984 ESF Amendment specify that the GOK will establish a uniquely identified account, and that a private sector bank guarantee mechanism will be utilized to ensure timely, full-value deposits of Shilling generations. For perhaps the first time, the GOK will receive full-value on a timely basis from the program aid of an external donor. In the past, deposits to Government via intermediate parastatal institutions were very uncertain.

A portion of the Shilling generations under the FY 1985 Agreement will support programs covered by the Kenyan budgets for FY 1986/87 and FY 1987/88. These allocations will be made to the Vote, Sub-Vote and Head level in the Development Estimates. More significantly, based on the GOK policy of limiting the Government's share of GDP, and on the U.S. strategy of supporting private sector development, the FY 1985 ESF Agreement will also allocate $5 million equivalent to private sector activities such as agricultural, export, and housing promotion.

B. The Berg Evaluation

The planned mid-term evaluation of the three-year Structural Adjustment Program (615-0213) was carried out in March and April 1985 by an independent three-man team consisting of Dr. Elliott Berg, Dr. Walter Hecox, and Dr. James Mudge. The Draft Evaluation was submitted to USAID/Kenya in May 1985, permitting the Mission to utilize results during the development of the FY 1985 Structural Adjustment Program Amendment. Evaluation results will be more fully utilized in the development, design, and implementation of a proposed follow-on ESF program starting in FY 1986.

The objective of the recent evaluation was to assess the significance of policy measures (program outputs) and the effectiveness and efficiency of policy targets (verifiable indicators) selected for inclusion in AID's Structural Adjustment Program. The assessment included recommendations to AID, and to Kenya's Ministry of Finance and Planning, regarding selection of new approaches to policy dialogue, high priority policy measures, and improved mechanisms for policy implementation over the next five years and beyond.

The evaluation indicated that the policy areas selected for inclusion in AID's Structural Adjustment Program were for the most part highly significant, but indicated that the number of policy areas selected was probably too large for the GOK to fully implement, or for AID to easily monitor or evaluate. (The nine policy areas of the Program are listed above in Section III.A.3 which contains a review of the GOK response to AID conditionality.) Program conditionality and technical assistance covered nearly the full range of policy dialogue issues outlined in the original PAAD submission. This broad coverage was intended to permit USAID to respond to the evolving policy situation, as well as to respond to specific GOK requests for technical assistance within well defined, highly significant policy areas. This "demand driven" approach was designed in part to improve implementation results by concentrating on policy changes formulated by the GOK itself in its major planning and budget documents.

As the evaluation made clear, the GOK response to AID and other donor conditionality was uneven. GOK interest, commitment, and ability to simultaneously implement policy changes in a number of key areas during a period of changing economic conditions were overestimated by the donors in general and by AID in particular. More specifically, conditionality aimed at fostering institutional change was found by the evaluation to be largely inappropriate given the difficulty of setting measurable targets, or of monitoring or evaluating progress toward such targets. The GOK willingness and ability to complete reports and provide evidence of progress were also limited, even in cases where considerable progress had been made. As a result the Draft Evaluation recommends avoidance of such difficult to measure "process" conditionality in the future, a recommendation that complements suggestions elsewhere in the Draft that the total number of Conditions and Covenants should also be limited. USAID is in basic agreement with such findings. This agreement is reflected in part by the type and number of Conditions and Covenants selected for inclusion in the FY 1985 Structural Adjustment Program Amendment. Steps to improve the quality of the dialogue along the lines suggested in the Draft Evaluation are also being investigated.

The Draft Evaluation reviewed AID's Structural Adjustment Program in the context of Kenya's overall efforts at macroeconomic management and structural adjustment, including the Kenyan response to donor conditionality as a whole. The Draft Evaluation in Part V, Section 1 concluded that the "future level of ESF funding of course depends on many factors other than GOK economic performance. But judged even by that standard alone it would be difficult to justify a program cut. As shown in the previous section, the GOK's overall economic policy performance has been good or better than good in many important areas. . . . Nevertheless, the GOK failure to address adequately its structural problem is a matter of real concern to the U.S. as a friend and partner of Kenya. The fact that it is first and principally a <u>Kenyan</u> problem does not diminish our concern. Unless new sources of economic growth can be found, future prospects are alarming--for Kenya's people and government, and for Kenya's outside friends." The mixture of commendations and concerns expressed in the Draft Evaluation is shared by the Kenya Mission. Recommendations contained in the Draft Evaluation to limit, change, and better define ESF conditionality, to improve the context of policy dialogue, and to redirect local currency programming are already being implemented in the FY 1985 ESF Amendment, and will form an important basis for development of the next ESF program.

IV. The FY 1985 Commodity Import Program ($13 million)

A. Description of the FY 1985 Commodity Import Program

1. The Commodity Component

The CIP Component of the FY 1985 Agreement will generally be handled in the same manner as the $15 million CIP component in FY 1984. However, the implementation path contained in Annex D of the FY 1984 PAAD showed that applications would be forwarded to the Ministry of Commerce by the prospective importers who would then send them to the Central Bank of Kenya (CBK). Instead applications are being submitted directly to the CBK by the importers, and the CBK is forwarding them to the Ministry of Commerce. The applications then travel back to the CBK, and are delivered to the USAID CIP office where the Import License number and Foreign Exchange Allocation License Numbers are entered into the computerized Commodity Tracking System.

The CIP evaluation mentioned in Section IV. D.2 of the FY 1984 PAAD has been delayed until early CY 1986 due to slow initial disbursements under the CIP.

The CIP Implementation Schedule included as Annex C of the FY 1984 PAAD has been updated as follows:

Activity	84 PAAD	Update
FY 1984 Grant Agreement signed	9/21/84	9/25/85*
Contractor hired to provide list of importers	6/13/84	6/13/84*
CP's satisfied	11/30/84	-
List of importers sent to AID/W to fulfill advertising requirement	11/30/84	8/16/85*
Bank L/Comms issued by AID	12/15/84	8/6/85*
Technical Assistance Contractor hired	1/1/85	3/22/85*
Initial L/C's opened	1/1/85	8/30/85
Importers List published by AID/W	N/A	9/15/85
First shipments from U.S.	3/1/85	10/1/85
Imports start arriving in Kenya	5/1/85	10/15/85
Initial counterpart deposits made into Special Account	6/1/85	1/1/86
Evaluation of CIP	Oct. 85	Feb. 86
Terminal Date for Requesting FR's	9/21/86	9/30/87
Final Shipment from U.S.	9/17/87	7/31/88
Grant CIP funds fully disbursed	10/31/87	9/30/88
Final deposits into special account	12/31/87	12/31/88
Final withdrawals made from special account	1/31/88	1/31/89

* Actual date

2. Conditions Precedent

Prior to first disbursement of assistance for the Commodity Import Program under the Grant, or to the issuance by AID of documentation pursuant to which disbursement may be made, the Grantee will, except as the Parties may otherwise agree in writing, submit to AID, in form and substance satisfactory to AID:

a. A statement of Grantee commitment to utilize, in its FY 1986/87 and FY 1987/88 budget years, five million dollars equivalent of the counterpart Shillings generated under the FY 1985 Structural Adjustment Program Amendment for mutually agreed family planning activities, and five million dollars equivalent of such counterpart Shillings for mutually agreed private sector activities, such as agricultural, housing and export promotion. The Grantee will notify AID of the Forward Budget commitments for FY 1986/87 by March 30, 1986;

b. Evidence that the Grantee has established and staffed by March 30, 1986 an Office of the Auditor and Controller-General for parastatal organizations; and

c. Evidence that the Grantee has established by March 30, 1986 a donor subcommittee for transportation.

3. Covenants

Local Currency Programming

a. The Grantee will devise a new system for the collection, deposit, management and utilization of local currencies generated from externally funded assistance programs, and introduce the proposed system for discussion at a donors meeting to be held in Nairobi by early 1986.

Donor Coordination

b. The Grantee will undertake a formal review of all its internally funded development projects by April 30, 1986 to determine how effectively current projects are being implemented, and to enable the Grantee to decide which projects to terminate and which project funds should be reprogrammed.

Private Sector

c. The Ministry of Finance will undertake by April 30, 1986 an assessment of new and existing legislation and regulations that attract private foreign investment.

d. The Grantee will continue to transfer items from more restrictive import schedules to less restrictive schedules in conjunction with the introduction of the FY 1986/87 budget in June 1986.

Special Accounts

e. Shillings generated under the Commodity Import Program portion of this Amendment will be deposited to the Paymaster General special account set up for the FY 1984 Commodity Import Program. Counterpart generated by the fertilizer imported under the Agricultural Development Program portion of this Amendment will be deposited to a special FY 1985 Agricultural Development Program Account in the Paymaster General.

4. Local Currency Deposit and Programming

The local currency deposit and programming procedures for the FY 1985 ESF Agreement reinforce the local currency conditions agreed to in FY 1984. (See Section III.A.4 above). The following further conditions apply for FY 1985.

The Government of Kenya's family planning program will receive $5 million of support under Condition Precedent No. 1 of this year's ESF Amendment. Funds made available will primarily cover the costs of administration, staff training, office equipment, and visual aids.

Allocations of up to $3 million equivalent will be made to the development budget for Egerton College to further its development and implementation of a management capacity that can (a) review, revise and develop new curricula on a regular basis; (b) develop and implement an active extension and research dimension; (c) operate and maintain the physical plant; (d) administer and manage a dynamic agricultural education program; (e) develop and attract quality faculty; and (f) make the Agricultural Resources Center an operational entity of the college.

As specified under Condition Precedent No. 1, USAID shall continue its private sector emphasis by providing an additional $5 million equivalent for private sector activities (out of the total of $25 million to be generated by the FY 1985 program). Proposals for Shilling use include support for the Senior Executive Service Corps, and for such private sector activities as agriculture, export and housing promotion programs. As USAID and the GOK gain experience with the use of counterpart funding to support AID dollar-funded projects, USAID will expand such funding to priority projects in areas other than family planning.

USAID's Agricultural Management Project (615-0221) may also be tested as a model for use of counterpart to support private sector activities. Partial support to private participants and to training institutions can be provided in order to prevent the immediate application of full cost pricing from discouraging private participation. If this use of Shillings is successful, similar procedures could be used to support USAID's proposed Training for Development Project (615-0234) in FY 1987. Shilling counterpart support to private sector housing projects would supplement dollars borrowed under the Housing Guaranty Program, and help to expand the portfolio of lower-cost private housing projects, while also assisting the development of a secondary mortgage market in Kenya.

Parallel with strengthening of USAID's internal counterpart procedures, there has been an increased level of attention by the GOK to its own accounting procedures applicable to other donor counterpart generations. It is to USAID's credit that the GOK is drawing on USAID's work in this area to strengthen GOK procedures governing the program assistance of other donors, thereby enhancing both fiscal discipline and revenue generation.

PART TWO: THE FY 1985 AGRICULTURAL DEVELOPMENT PROGRAM (FERTILIZER)

V. The FY 1984 Agricultural Development Program 1/

A. Introduction

1. Program Rationale

The purpose of the ongoing FY 1984 Agricultural Development Program (ADP) has been to implement a system to bring about increased private sector distribution of fertilizer in Kenya. The distribution system implemented by the ADP has applied only to donor financed fertilizer. However, the conditionality of the ADP was intended to promote the rationalization of the commercial import and allocation system as well. Through the improved distribution system implemented under the ADP, a framework is being established to ensure that fertilizer will be imported into Kenya at the right time, of the appropriate types, in sufficient amounts, and will be sold at competitive prices.

The 1984 Agricultural Development Program has addressed three of the major problems constraining the efficient distribution and increased use of fertilizer. These are: 1) the lack of a system to allow private importers/distributors to plan ahead, resulting in not enough fertilizer being imported or imported too late, 2) limited importation and distribution by only a few large distributors, restricting price competition and availability of fertilizer to smallholders, and 3) lack of increased use by smallholders resulting in low output per acre.

2. Program Objectives

Five major objectives of the 1984 Program are:

(a) to increase private sector fertilizer distribution.

(b) to reduce the Government of Kenya's role in fertilizer marketing.

1/ Background on this Program and the detailed analytical framework which supports the fertilizer component of the FY 85 Structural Adjustment Project can be found in the PAAD for the Agricultural Development Program (615-0230), dated September 14, 1984.

(c) to liberalize the pricing system.

(d) to promote wider and more efficient distribution, including the introduction of smaller packages, and

(e) to improve Government planning for fertilizer imports based on total requirements, current stocks and donor import intentions

3. Implementation Measures

The 1984 ADP included several implementation measures designed to help achieve the program objectives and to address problems which arose in previous fertilizer programs. A key feature of the ADP was the central role of the Fertilizer Coordinating Committee (FCC) in the planning, procurement and allocation of the fertilizer. Composed of officials from the Ministry of Agriculture and Livestock Development (MOALD), the Ministry of Finance and Planning (MF&P), and Office of the President (OP), this Committee was charged with assuring that the annual fertilizer import plan was prepared, and that timely decisions were made concerning the quantity and timing of imports and allocations of AID fertilizer among distributors. The FCC was also charged with assuring that fertilizer prices were determined and announced on schedule. The work of the Fertilizer Coordinating Committee is done in consultation with two other committees. The first is the Fertilizer Advisory Committee (FAC), a body established under the 1983 Structural Adjustment Program and composed of both public and private sector representatives. The second is the Commodity Aid-Allocation Monitoring Committee (CAMC), a Governmental committee charged with making decisions concerning donor financed commodities.

The fertilizer allocation process consists of the following three steps. First, the CAMC announces the quantities, types and arrival dates of aid fertilizer and solicits applications for allocations from interested private firms. The CAMC then reviews the applications and grants allocations. In order to receive an import allocation the applicant must in theory be registered with the MOALD as an established fertilizer distributor with a ready retailing network, or be able to demonstrate previous experience in the distribution of agricultural inputs. Third, each firm receiving an allocation is required to provide the Government with cash or a bank guarantee not exceeding 180 days for the value of the allocation. The guaranteeing bank pays the

Government the amount of the guarantee when payment is due, thus ensuring that the Government receives timely and full payment for the AID fertilizer. The Government deposits these funds in a special interest bearing account maintained by the Cereals and Sugar Finance Corporation.

B. Implementation of the FY 1984 Agricultural Development Program:

1. Status of The 1984 ADP Objectives

Achievement of the 1984 ADP objectives to date, as described below, has been satisfactory. Partial fulfillment of the objectives has resulted in an expanded private sector fertilizer distribution system in Kenya.

(a) Increase Private Sector Distribution

The 1984 ADP has successfully involved sixteen private sector firms in fertilizer distribution. This compares favorably with six firms active in distribution of donor fertilizer under the 1982 Agricultural Sector Grant (615-0228). Prior to 1983, when AID began discussions with the GOK to expand private sector distribution, only the Kenya Farmers Association (KFA), a government-controlled cooperative, had a legal monopoly on the distribution of all donor financed fertilizer.

The 20,800 tons of AID financed diammonium phosphate fertilizer (DAP) which arrived in March and April 1985, was allocated to private sector firms by the GOK through its Commodity Aid Allocation Monitoring Committee (CAMC). This Committee was established by the GOK in September 1984 to manage the procurement, importation and distribution of donor fertilizer. The CAMC executes some of the functions outlined in the 1984 Program as the duties of the Fertilizer Committee. Its mandate was accepted by AID as partial fulfillment of the Conditions Precedent to establish the Fertilizer Committee.

Twenty-nine firms requested allocations for the 20,800 tons imported in March/April 1985. In order to give new and smaller firms an opportunity to enter the fertilizer market, the CAMC granted an allocation to each firm. Of these, sixteen were able to secure the required bank guarantees and actually receive fertilizer for distribution.

As part of the AID fertilizer program efforts, the GOK is expanding opportunities for private sector fertilizer marketing. The Ministry of Agriculture and Livestock Development maintains a list of firms eligible to import and distribute fertilizer. There are presently 76 firms eligible to directly import fertilizer. Of the firms registered with the MOALD to distribute fertilizer, only a limited number are actually given allocations to import fertilizer directly. Selection of firms to receive import allocations is done by the Fertilizer Coordinating Committee. Final approval of the firms selected is given by a committee of Permanent Secretaries from the Office of the President, Ministry of Finance and Planning, and the Ministry of Agriculture and Livestock Development. In June 1985, the GOK announced that for the present crop year, 85/86, twenty-seven firms have been given allocations to commercially import a total of 101,000 tons of fertilizer. During the previous two crop years, 15 firms were given commercial import allocations.

(b) Reduce Government Role in Fertilizer Marketing and Pricing.

Three years ago AID has encouraged the GOK to break its monopoly agreement for the marketing of donor-supplied fertilizer with the Kenya Farmers Association (KFA), now re-named the Kenya Grain Growers Cooperative Union (KGGCU). This was achieved in the 1982 Agricultural Sector Grant in which the GOK agreed to distribute half of the 14,000 tons received that year through the KFA, and half through the private sector. The 1984 Agreement built upon these changes so that now the entire amount of AID fertilizer is offered to the private sector for distribution. This objective therefore has been fully achieved in respect to getting a Government agency out of the exclusive distribution of donor fertilizer. The KGGCU was allocated 38% of the 20,800 tons of AID DAP and paid for it using the bank guarantee scheme as do other private firms. The GOK still carries out a major role in fertilizer marketing through its allocation authority, setting of prices, and determining types and quantities to be imported. The FY 85 Agricultural Development Program and future AID fertilizer programs will address this issue of excessive GOK involvement.

(c) Price Liberalization

The 1984 Agreement contains a covenant that the GOK will conduct a review and revision, as appropriate, of the current system of pricing fertilizer. The GOK has just completed this review under funding provided by the Netherlands' Government. The study was conducted by Dr. Michael Schluter, an economist with extensive experience in conducting studies of Kenya's agricultural sector for the World Bank and the International Food Policy and Research Institute (IFPRI). The GOK is now studying the recommendations made by Dr. Schluter. It recognizes the need to rationalize the pricing system so that distributors are encouraged to implement downstream marketing systems.

(d) Wider and More Efficient Distribution

The objective of the 1984 Agreement to develop wider and more efficient distribution, including smaller packages, has so far achieved the following. To date, 18,000 tons of the 20,800 tons imported has been distributed. About 35 percent was sold directly to stockists, and cooperatives. The AID DAP was distributed to all of the major maize and wheat producing districts in Kenya. However, late arrival of the DAP due to the GOK's lateness in meeting the Condition Precedent, and the current constraints of the marketing system meant that the AID DAP was not distributed in all rural areas.

Efficiency in distribution is demonstrated, in part, through the range of fertilizer prices offered to various buyers. Due to the increased number of distributors, a significant degree of price competition was evident. The GOK established the base price of the AID fertilizer at Nakuru as KShs 4,907 per metric ton. This price was determined by adding 30% plus KShs 100 per ton to the C.I.F. price at Mombasa of $232 per ton. The ceiling retail price at Nakuru was set at KShs 5,773 per ton, yielding a maximum margin of 17% for distributors. Due to this adequate margin, distributors were able to charge various prices depending on the type of buyer (cooperatives, stockists, large end-users or individual smallholders).

As an example, in Eldoret the Kenya Grain Growers Cooperative Union (KGGCU) adopted the following price schedule:

- KShs. 283.05/bag to stockists buying more than 500 bags.
- KShs. 285.85/bag to stockists buying less than 500 bags.
- KShs. 288.60/bag to individual members of KGGCU.
- KShs. 292.65/bag (ceiling) to non-member farmers.

The objective of distribution of smaller bags has not yet been achieved. The GOK must announce a policy to authorize a somewhat higher price ceilings on fertilizer sold in packages of less than 50 kg. The analysis of a pricing formula for small bags is now being reviewed following the recently completed pricing study.

The lack of authorized differential prices for different sized fertilizer packages is the main constraint preventing distributors from selling fertilizer in smaller units. Increased costs are incurred by the distributors from extra handling and bagging materials.

Despite the lack of a GOK-authorized price differential, two Nakuru-based distributors did repackage 50 kg bags of DAP into 10 kg packages, selling at KSh 55.65, or 20% of the 50 kg bag price. The demand for DAP in the 10 kg packages was substantial. The two firms sold 400 tons of DAP in smaller packets; 200 tons were sold directly to end-users and the balance was sold to stockists. In both cases, purchasers of 10 kg bags of fertilizer were charged KShs 55.65. However, village stockists re-sold the 10 kg.bags to smallholders in their respective areas for KShs 61 per bag, receiving a margin of 10%. Farmers were receptive to buying at this price from village stockists, since it represented a savings over usual costs associated with travel to and from Nakuru.

(e) Improve Government Fertilizer Import Planning

Some progress has been made in the effort to improve Government planning for commercial as opposed to donor fertilizer imports based on total requirements, current stocks, and donor import intentions. On June 24, 1985 the GOK announced the approved list of commercial import allocations. This list included 27 firms which were allocated a total of 101,000 tons of various types of fertilizer for importation during the 85/86 crop year. This system will be further improved in the 1985 Agricultural Development Program by obtaining more accurate and timely data on total requirements, current stocks, and donor intentions. AID's ultimate goal is not to perfect Government fertilizer import planning, but to see it replaced by a well-functioning market system capable of forecasting fertilizer demand. Until the private market system is better established the Government will retain a role in import planning. The improvements initiated in this regard in the 1984 ADP and continued in the 1985 ADP are seen as necessary interim measures.

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2. Summary of FY 84 Fertilizer Procurement, Bagging, and Allocation

Following fulfillment of the 1984 Conditions Precedent in December 1984, the GOK requested 20,000 metric tons of DAP for the long rain planting season which was expected to begin in March, 1985. Bids were requested for both bagged and bulk fertilizer, with the first 10,000 metric tons to be delivered to a U.S. port by January 31 and the balance for delivery by February 15.

On the day of awarding bids, the GOK announced its desire to change the importation plan by bringing in bulk DAP with bagging to be done at the MEA Ltd. facility in Nakuru. Although this procedure would delay the distribution of the fertilizer by at least two weeks and thereby jeopardize timely delivery, an essential element of the Agricultural Development Program, AID reluctantly agreed to the GOK plan in order to prevent further delays through protracted negotiations. Awards were eventually made for the supply of 20,000 metric tons of bulk DAP, plus bags at $185.17 per ton with the first shipment on a U.S. carrier at $125.00 per ton and the second on a foreign carrier at $47.30 per ton. The need to expand the role of the private sector and redefine the role of the Government is demonstrated by the delays encountered in the FY 1984 Program.

The fertilizer was delivered on March 7 (10,500 metric tons) and April 8 (10,328 metric tons). Two-thirds of the first consignment was temporarily warehoused at Mombasa due to a shortage of rail cars and engines. The total loss of fertilizer due to spillage, dust and other circumstances is estimated to be approximately 365 tons or 1.65%, well below the industry standard of 2% loss for bulk fertilizer transfer.

Coinciding with the arrival of the first fertilizer shipment the GOK advertised the availability of AID DAP and solicited applications for allocations. Sixteen firms were able to produce the necessary 120-day bank guarantee and thereby receive DAP allocations.1/ Although it was intended that the AID fertilizer be allocated among the applicants based on each firm's past experience with fertilizer distribution and the extent of its distribution network and facilities, some firms without retail networks received fertilizer. The names of the sixteen firms, and the tonnages allocated to each, are listed below:

1/The Program specified that the bank guarantees could not exceed 180 days. The Government chose to require 120 day guarantees.

FIRMS WITH DISTRIBUTION NETWORK	
KGGCU	8000
MEA	1000
FAGS	300
Agrico	1000
Supplies & Services	1200
Orbit Chemicals	1000
Nova Chemicals	300
Safina	1000
Farmchem	1000
Devji Meghji	500

FIRMS WITHOUT DISTRIBUTION NETWORK	
Abcon	1,000
Athi Greens	200
Musola	1,000
Tofas	800
Panorama	1,500
Nyali Chemicals	1,000

3. GOK Compliance with Conditions Precedent and Covenants

(a) Conditions Precedent

The 1984 Agricultural Development Program included four major Conditions Precedent to initial disbursement. This conditionality was intended to promote specific policy changes which would streamline the process of fertilizer demand assessment and importation.

The first and second conditions contained standard language regarding authorized signatures and legal review of the Agreement. The third condition (Article 3.1 (c) of the Loan Agreement) was the establishment of a Fertilizer Committee to "implement the private sector fertilizer distribution policy." This committee was to be composed of officials from the Ministry of Agriculture and Livestock Development, the Ministry of Finance and Planning, and the Office of the President. With the assistance and advice from the Fertilizer Advisory Committee, it would be responsible for implementing the private sector fertilizer distribution policy.

In September 1984 the Government of Kenya formed the Commodity and Allocation and Monitoring Committee (CAMC) to supervise the procurement, importation and allocation of aid commodities. The responsibilities of the CAMC are very similar to the Fertilizer Committee. The membership of the CAMC includes the officers proposed for the Fertilizer Committee. For these reasons, the Government requested that the CAMC be accepted to execute the functions of the proposed Fertilizer Committee. AID accepted this recommendation subject

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to the creation by the GOK of a Fertilizer Coordinating Committee responsible for seeing that the functions of the CAMC and the Fertilizer Advisory Committee were carried out. The Condition Precedent 3.1.(c) was then satisfied.

Two of the remaining conditions (3.1. (d) and (e)) dealt with assembling and publishing information on current fertilizer stocks, donor fertilizer financing intentions, and a compilation of commercial fertilizer import applications. The final condition (3.1. (f)) required the Government to develop an annual fertilizer import plan specifying types, quantities and timing of required fertilizer imports as well as anticipated donor financing.

The Government prepared and submitted to AID on December 17, a tabulation of fertilizer requirements, showing, by type, total requirements, stock levels, anticipated donor and commercial imports, and net balances. AID accepted this document as satisfying Conditions 3.1. (d), (e), and (f

(b) Covenants

The first set of Covenants in the FY 84 ADP Agreement dealt with private sector fertilizer distribution and generally reiterated the Conditions Precedent to first disbursement, requiring their annual satisfaction. The first Covenant requires the Government to announce wholesale and retail fertilizer price by November 1 of each year. This was not required as a condi ion during the first year because the November 1 deadline would have expired before the CPs could be met. Instead the GOK had to announce the price of AID DAP prior to its arrival in Mombasa. The Government did publish retail fertilizer prices on February 8, 1985. This action only partially satisfied the first Covenant (Section 6.1 (a) of the Agreement) because wholesale prices were not included in the announcement. During discussions between AID and the Ministry of Agriculture and Livestock Development, it was agreed that this Covenant would be satisfied if the GOK published retail prices only and made wholesale prices available to potential distributors prior to arrival of the AID financed fertilizer shipments.

The remaining Covenants required the Government to prepare an annual statement outlining donor fertilizer financing plans, commercial import expectations and a fertilizer import plan. This material is to be prepared annually on the following schedule; the donor intentions by June 1, the commercial import applications by July 15, and the overall fertilizer import plan by July 30. This Covenant was satisfied in full by the Government during the month of July 1985.

A second set of Covenants required the Government to review and revise, as necessary, the current fertilizer pricing structure. Such a review has just been completed with financing from the Dutch Government. Following a review of this study, the issue of fertilizer packaging can be addressed, satisfying another Covenant. It is anticipated that some portion of the fertilizer arriving in the next 1984 tranche (October 1) will be packaged in amounts of 25 kg. or less. At this time it is expected that the new packaging policy and price formulas will be operative within the November 1, 1985 time frame as specified in Project Implementation Letter No. 1.

A final set of Covenants concerned the deposit and utilization of program-generated local currency. The Government agreed to deposit all receipts from fertilizer sales to distributors in a separate interest-bearing account with the Cereals and Sugar Financing Corporation (CSFC).

Government action on this Covenant has not been prompt. Only at the beginning of August did the Government confirm that the account was open. The Loan Agreement specified that the CSFC should maintain the counterpart funds with a commercial bank. On August 7 the GOK notified AID that the CSFC had opened an account with a commercial bank where counterpart shilling deposits would earn interest at a rate of 12.5%.

4. Status of AID Program - Generated Local Currency Funds

The 1984 Agricultural Development Program included measures to improve the deposit and monitoring of the local currency funds generated from AID fertilizer sales. Each private distributor applying for DAP was required to provide a 180 day bank guarantee or pay cash for the fertilizer to be allocated. The guaranteeing bank pays the GOK the amount of the guarantee when payment is due, with the GOK depositing the funds into a special account. Although some applicants were

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unable to obtain a guarantee and hence obtained no DAP allocation, this system has insured that full and timely payment of shillings is made.

All bank guarantees, as called for in the FY 1984 Agreement for the first tranche of fertilizer delivery to Kenya, will have expired by September 23, 1985. At that date a total of KSh 102,065,600 will be in the CSFC account. The CSFC is required to provide AID with a quarterly report detailing the status of the special account. The first quarterly report will be made on September 30, 1985.

The 1984 Loan Agreement includes a Covenant that the counterpart funds will be used for mutually agreed upon development activities of the Government. It is expected that agreement will be reached concerning the development programming of the KSh 102 million, including acceptance of some of the recent evaluation's suggested uses for these funds which would reinforce the objectives of the Agricultural Development Program.

C. The Williams/Allgood Evaluation

During July 1985, a mid-term evaluation of the Agricultural Development Program was conducted by two fertilizer marketing specialists from the International Fertilizer Development Center. The evaluation focused on implementation of the 1984 Program to date. In addition, recommendations were made to improve implementation during the second year of the 1984 Agricultural Development Program, and to guide the Mission in the design of a long-term plan for improved fertilizer marketing in Kenya.

The primary evaluation findings regarding the first 10 months of Program implementation are as follows:

- private sector involvement in fertilizer distribution has improved;
- AID provided DAP is the most cost effective fertilizer available in Kenya;
- fertilizer (including AID DAP) is still not readily available to smallholders;
- criteria must be strengthened and enforced for firms to receive allocations of AID fertilizer and a system of rewards must be established to encourage firms to promote downstream marketing;

- educational programs directed to improving fertilizer marketing at the distributor and stockist level and use at the farmer level are needed;

- the current pricing system must be improved to correct the imbalance that heavily favors wholesalers and does not provide adequate margins to retailers;

- the distribution of fertilizer in small bags is justified but a marketing study is needed to determine the proper bag size and distribution area;

- A portion of local currency generations should be programmed to promote improved distribution and increased use of fertilizer

- GOK planning of fertilizer imports should be improved.

In addressing areas for needed improvement over the long run, the evaluation identified the following key constraints. First, Kenya lacks an integrated fertilizer marketing system featuring well managed, autonomous organizations able to make informed marketing decisions. At present, the Government decides product mix, quantities to be imported, prices, margins, and allocations to distributors. Second, although progress has been made in privatization, in the words of the evaluation, "the fertilizer industry in Kenya is drifting aimlessly" and is not yet capable of fostering the development of a viable, self-sustaining industry capable of serving and increasing use of fertilizer by both large and small farmers. Third, there is lack of sufficient product in Kenya, and uncertainties regarding the allocation of scarce fertilizer resources make it practically impossible for private sector firms to invest resources in a fully developed frtilizer marketing network. Implementation modifications in the FY 1985 ADP will partially address these shortcomings and the proposed FY 1986 multi-year AID Fertilizer Marketing project will take dead aim at this issue.

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VI. The FY 1985 Agricultural Development Program

A. Introduction

1. The Importance of Fertilizer in Kenya

The ability of Kenya to meet its domestic food requirements is precariously balanced. On one hand, domestic production of maize and wheat, the nation's grain staples, during periods of favorable weather is approximately 2.3 million tons per year. On the other hand, Kenya's population of 20 million annually consumes about 2.6 million tons of grain. With a population growth rate of 4 percent, increases in domestic food production have barely kept pace with the food needs. In periods of drought such as 1984, Kenya faced a food deficit which had to be filled by importing 862,000 tons grain valued at $111 million. Ironically, Kenya's main exports which produce the foreign exchange needed to purchase food imports are also agricultural products whose output is affected by the same climatic variances as maize and wheat.

Kenya's greatest challenge in the coming years therefore, is to maintain sufficient increases in domestic food production and foreign exchange earnings through agricultural exports to provide the food needs of its rapidly expanding population. There are only two ways of doing this. First, additional land can be brought into production. The 1985 World Bank Study, "Kenya Agricultural Inputs Review, Volume II", forecasts that for the period 1983-1990 new land will be brought into crop production at the rate of approximately 2.7% per year and will reach a total area of 1.95 million ha. by 1990. Approximately 7% of Kenya's land area is classified as high potential and has good productive soils and reliable rainfall. Another 11% of the total area is of medium quality. Most of this land is presently under cultivation and the opportunity for horizontal expansion is limited. The principal area for expansion lies in the semi-arid regions that have marginal crop production capability. For the short run and until the crop production infrastructure can be developed, increased production in this area is also limited.

The second way to increase crop production is vertical expansion or increased production per unit of land. According to recent studies, this offers the best opportunity for increasing food production by 4% per year which is required to maintain pace with Kenya's population requirements.

If agricultural production is to be increased in Kenya, essential crop production inputs and an infrastructure for delivering them must be made available. The importance of making fertilizer available to the farmer, particularly the small farmer in Kenya, and its role in increasing food production has been well documented. Section III, and Annexes E and F of the FY 1984 Agricultural Development Program PAAD provide substantial analysis to justify the need for fertilizer imports in Kenya. Other studies demonstrate that fertilizer use is profitable to the farmer. Currently, marginal returns for each Shilling of fertilizer used are highest for coffee and tea at about KSh 10-14, and approximately KSh 3 for maize and wheat. Fertilizing sugarcane returns about KSh 1.2 for each KSh invested in fertilizer. FAO fertilizer trials on potatoes from 1968-1974 indicate a return to fertilizer use of between KSh 6.7-10.0 for each Shilling of fertilizer used. Now that fertilizer prices are falling, and with stable to increasing crop prices, the returns to fertilizer use in Kenya should increase substantially.

The smallholder has an important role to play in increasing food production in Kenya through fertilizer use. The need to make fertilizer available to the small farmer is critical. The Integrated Rural Survey (IRS) II, 1978 indicates that 50% of all farms average 2 ha. in size and account for 3.5 million ha. of the total crop area. The study further shows that 90% of all farms are under 5 ha. Since the study, fragmentation of land holdings into smaller units has continued. The World Bank's Country Study entitled Kenya, Growth and Structural Change, Volume I shows that agricultural production can increase with a reduction in holding size. The report shows that with every 10% reduction in holding size, output per ha. increased by 8%. Other experiments in Central, Eastern and Rift Valley Provinces have produced similar results.

For the period July 1, 1982 to June 30, 1983, it is estimated that smallholders, cultivating up to 10 ha. of land, consumed 43% of the fertilizer used in Kenya. In three coffee producing districts where smallholders prevail, Muranga, Nyeri, and Kirinyaga, cooperative unions accounted for 72.5% of sales. Coffee farmer cooperative unions are well established in these areas with effective retail distribution networks. In all of the major food crop producing areas, however, smallholders are not served by effective cooperatives or retail outlets. Thus, the importance of making sufficient amounts of fertilizer available to the smallholder through a network of rural retailers/stockists supplied by an efficient integrated fertilizer marketing system cannot be over emphasized.

2. Program Rationale

During the second year of the Agricultural Development Program, AID will develop a more extensive and responsive fertilizer marketing and pricing system rooted in the private sector. The 1985 Agricultural Development Program will implement short-term recommendations from the 1984 Program evaluation. The recommendations will assist AID and the GOK to build on the progress to date, and to develop a follow-on program of improved fertilizer marketing. The follow-on program (FY 86 and beyond) will promote the establishment of an integrated fertilizer marketing system which leads to increased use of fertilizer by the smallholder, reduces the Government's role to monitoring and quality control, and creates a non-regulated system where prices of fertilizer, and quantities and types to be imported, are determined primarily by the market. The main rationale for the 1985 Program, therefore, is to link the improved and expanded private sector fertilizer distribution system set up with the 1984 Program, with an integrated fertilizer marketing system which follows market signals, and which will be able to import sufficient product to truly meet demand by farmers in all areas of the country, particularly among smallholders.

3. Program Objectives

The basic objectives of the 1984 Agricultural Development Program will remain unchanged under the 1985 Program. These objectives are: 1) to expand and strengthen private sector fertilizer distribution, 2) to reduce the Government's role in fertilizer marketing, and 3) to improve the system of fertilizer pricing, allocation and planning.

These objectives will be addressed through the use of $ 12 million to finance the importation of approximately 45,000 tons of bulk DAP between January 1, 1986 and September 14, 1986. Approximately $8 million of the $12 million total will be used to finance fertilizer from the US. The balance, $4 million, will be used to finance the associated shipping costs. As in the 1984 Program, the Government of Kenya will allocate this fertilizer to private sector firms for countrywide distribution. The GOK will be asked to implement certain modifications from the original design of the 1984 Program as described in Section B. 2. below.

The 1984 implementation modifications carried out in the 1985 Agricultural Development Program will lead to improved fertilizer marketing in Kenya characterized by:

a. Increased price liberalization, i.e. moving away from a system of administered prices to a market-based pricing system.

b. Increased fertilizer availability to and purchase by smallholders.

c. Elimination of a need for Government involvement in the allocation of donor and commercial fertilizer.

d. The development of an integrated marketing system characterized by a number of marketing organizations which would in the long run perform the following functions:-

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- Determine the products required based on research data and keep an adequate supply for timely availability to the farmers;

- Determine the price of products based on market costs and a reasonable profit;

- Determine when the products are required in specific markets and arrange transportation to the appropriate markets;

- Forecast demand by product at the farm level in each market and determine quantities required to satisfy demand; and,

- Determine promotional activities and time periods for educating retailers and farmers on product use

B. Description of the FY 1985 Agricultural Development Program

1. Evaluation Conclusions and Recommendations

Two major issues were identified in the evaluation.

a. AID and the GOK need to develop a long term strategy for developing an integrated fertilizer marketing system in Kenya, and

b. Although the FY 84 Agricultural Development Program has been successful in developing widespread distribution of fertilizer through the private sector, changes are necessary to make an impact on increasing the use of fertilizer by smallholders and their knowledge of how, when, and what types of fertilizer to apply.

The 1985 Program will concentrate on developing an integrated marketing system. Such a marketing system must include an information program developed and implemented by private distributors on how to use fertilizer, associated services such as soil testing, and a network of widely distributed village stockists organized by major distributors - also instructed on how to advise smallholders on the use of fertilizer.

2. Implementation Modifications

Procurement, allocation, distribution, and monitoring procedures of the 1985 ADP will be the same as those carried out in the 1984 ADP with the following exceptions.

a. Consolidation of Government Fertilizer Committees

Presently, three committees are involved with the planning and allocation of donor and commercial fertilizer imports: the Fertilizer Advisory Committee (FAC), the Commodity Aid-Allocation Monitoring Committee (CAMC), and the Fertilizer Coordinating Committee (FCC).

The FAC was established in 1983 as a Covenant to the FY 1983 Structural Adjustment Program (615-0213) to include government and private sector representatives to advise the Ministry of Agriculture and Livestock Development on the types, quantities, and timing of fertilizer imports to Kenya, and the private sector firms eligible to distribute the fertilizer. The Committee has not been functional during the past year due to the GOK perception that the private sector members were not capable of representing the fertilizer industry as a whole. The government members of the Committee, however, are continuing to perform the function of advising on types, quantities, and timing of imports, and allocations to commercial importers, without the essential input of the private sector.

The CAMC was established in September 1984 to implement the GOK procedures for the procurement, importation, and distribution of donor fertilizer. This Committee is functioning effectively and the evaluation recommended its continuation.

The FCC (more commonly referred to as the Fertilizer Committee) was established in December 1984 as partial fulfillment of a Condition Precedent in the FY 1984 Agricultural Development Program. Its function is to assure that allocations are made on a timely basis, prices are received and announced on a timely basis, and a fertilizer import plan is developed. This Committee has performed well and its continuation is recommended.

In practice, the members of all these Committees are the same persons, consisting of one person from the MOALD, two from the Ministry of Finance and Planning, and one from the office of the President. The CAMC includes representation from the Ministry of Commerce and Industry and the Cereal and Sugar Finance Corporation (CSFC) on an ad hoc basis. In order to rationalize the structure of currently functioning Committees, the FY 1985 ADP will require the GOK to maintain the Fertilizer Committee as a functioning body, recognized by AID as being responsible to assure that the activities of the Agricultural Development Program are implemented. The Fertilizer Committee will be responsible to assure that:

(1) donor and commercial fertilizers are allocated to eligible distributors on a timely basis;

(2) the Ministry of Finance and Planning is advised on the quantities and types of fertilizer to be requested from donor countries;

(3) a list of approved fertilizer importers and distributors is continually updated, and expanded; and

(4) a fertilizer import plan is developed annually.

The CAMC will continue to function as a government Committee, but the FAC will be eliminated. The members of the Fertilizer Committee have performed the functions of all three committees quite well. The consolidation of Committees will streamline decision making and greatly simplify implementation of the Agricultural Development Program.

b. Promotion of a Kenya National Fertilizer Association

The elimination of the Fertilizer Advisory Committee leaves one important input out of the process of developing an improved fertilizer distribution and marketing system in Kenya, i.e. an established channel for the private sector to convey its requirements and concerns to the Government. This void can be filled by the recently established Kenya National Fertilizer Association (KNFA). The KNFA was established at the request of the GOK in May 1985 by five of the major private sector fertilizer importers/distributors in Kenya as a means to convey to the Government, the concerns of the private sector. Two meetings have been held to date, and membership is being extended to all registered fertilizer importers/distributors. AID will require the Government of Kenya to recognize the KNFA as a valid organization, and to include a representative to attend its meetings on an ad hoc basis. This requirement is being addressed as a Covenant in the 1985 Program. AID anticipates the continued development of the KNFA as a focal point of the Kenyan fertilizer industry and as a participant in the generation on an integrated marketing system. Beginning this amendment period, the GOK should make every effort to support the formation and strengthening of the KNFA.

c. Improved Fertilizer Import Plan

A major improvement in implementation of the Agricultural Development Program, and a contribution to an improved fertilizer marketing system, can be made by improving forward planning to ensure timely availability of fertilizer.

Currently, the GOK is required by AID to develop an annual fertilizer import plan which includes current stock levels, total requirements by type, and donor and commercial import intentions. The development of such a plan has made a tremendous improvement in planning for fertilizer imports. But weaknesses are still evident.

The major weakness is the uncertainty, due to lack of forward planning, which still prevails among private firms and the GOK as to when imported fertilizer will arrive in Kenya. Private firms need to know when the Government is bringing in donor fertilizer so that they can time their own imports to coincide with supply and demand. The Government of Kenya must submit its request to the donors so that fertilizer will arrive in Mombasa in a timely fashion. In the long rain planting season (January 85 - June 85) this year, fertilizer was not available at the right time due to lack of forward planning. Commercial firms were expecting the demand for DAP to be met by AID imports. Consequently, their own allocations were not used to import DAP early in the season. AID DAP was not imported by the GOK in time due to delay in meeting the Conditions Precedent in the 1984 Program. But also, the GOK has not yet fully taken into consideration AID's procurement guidelines and the time required for advertising and awarding tenders in the US. These problems and the resultant delays in arrival of fertilizer can be minimized through improved forward planning.

AID will therefore require the GOK as a Covenant in the 1985 Program, to submit a modified fertilizer import plan (see Annex A) annually beginning April 1, 1986.

In support of improved forward planning and timely availability of AID fertilizer, AID will require the GOK to submit its procurement requests for fertilizer financed under the 1985 Program no later than the following dates:

April 1 for August 1 delivery (for short rains)
August 1 for December 1 delivery (for long rains)

d. Criteria for Marketing Organization

In order to promote the availability of fertilizers to smallholders, and to increase its effective use by smallholders, an integrated marketing system must be developed. Such a system will be characterized by the existence of a number of strong private sector marketing organizations which perform the essential functions of marketing i.e., determines effective demand, distributes the product, and promotes its use. Such marketing organizations exist in Kenya but their potential has not been utilized.

A free market system of fertilizer imports would be the optimum activator to promote an integrated marketing system. Until conditions allow such a system, the present GOK allocation system, which does allow private sector distribution, will prevail. To promote further growth of an integrated marketing system, certain improvements in the present system are to be incorporated in the 1985 Program. These improvements will help to promote the establishment of marketing organizations and will reward those firms which promote the use of fertilizer by smallholders.

The problem of AID fertilizer being channeled to pass through traders rather than complete marketing organizations was considered in the design of the 1984 PAAD as follows:

"Only those private sector firms which have demonstrated knowledge and experience in the local retail fertilizer market will be given an allocation......"

As was described in the evaluation, this criterion was not adequately met with the first two allocations under the 1984 Program. The 1985 Program therefore includes new provisions to ensure more effective fertilizer distribution.

AID will require that its fertilizer be allocated to only those firms which are dedicated to developing a long term commitment to fertilizer marketing and can meet a set of criteria designed to test this commitment. A number of firms distributing AID DAP have made such a commitment, and have already met the criteria. The criteria established for firms to distribute AID fertilizer is purposely not excessively stringent so as not to preclude any new distributors from entering the fertilizer marketing system. However as the fertilizer program progresses, the criteria should be reviewed and modified as necessary.

Beginning with the 1985 Program, the following criteria will be established for distributors to receive AID fertilizer:

* Distributors will have in place or will develop during the present period, a distribution network;
* Distributors will demonstrate access to storage capacity for fertilizer allocated by the CAMC;
* Distributors will be capable of securing the necessary bank guarantees;
* Distributors will agree to distribute education leaflets on how to apply fertilizer. Leaflets will be developed and provided by the GOK;

Distributors of AID fertilizer will not be preventec from receiving allocations for commercial imports. Likewise, commercial importers will not be barred from receiving allocations of AID fertilizer.

It is also stipulated that upon receiving an allocation of AID fertilizer, resale to other distributors is prohibited unless approved in advance by the CAMC.

AID will periodically evaluate the performances of each distributor that receives AID funded fertilizer. Failure to comply with the established criteria will result in the subject distributor being disallowed by the CAMC to receive future supplies of AID fertilizer.

e. Marketing of Fertilizer in Small Bags

The 1984 Program included a provision for marketing fertilizer in bags smaller than 50 kg with an appropriate price differential. The recently concluded evaluation confirms that the introduction of a 10 kg. bag is justified. Although a market for the small bag is apparent, size and specific location of the market has not been adequately researched. The evaluation recommends that a portion of the AID funded DAP arriving in October to December, 1985 be packaged in 10 kg bags and test-marketed through selected distributors. The 10 kg bags should be allocated to those distributors requesting small bags based on their perception of the local market. Beginning with the October 1985 arrival of 9,750 tons of DAP, if a firm intends to distribute AID DAP in small bags, it must request a specific tonnage to be allocated in small bags; e.g. 10 kg or 25 kg bags. Allocations in tons, for the full amount of AID-financed DAP to arrive before December 1985 will be made concurrently with allocation for the first shipment in late September.

In order to receive the DAP in small bags each distributor will agree to establish at least three test market areas for distribution of the product. The distributors should monitor the sales and report to the MOALD and AID on the effectiveness of the small bag. This information is necessary to better estimate the market for small bags.

AID will propose that local currency generated by DAP sales be used to finance a market research study on the small bag. The major focus of such a study would be to (1) determine the most appropriate bag size (i.e. 5 kg, 10 kg or 25 kg; (2) determine the most appropriate bagging material (i.e. polypropylene or paper etc.); (3) determine the primary target market for which the small bag is most appropriate; (4) determine distributor and retailer margins on the small bags, and (5) determine the effective demand for the small bag.

At the conclusion of the current fertilizer pricing analysis AID will work with the MOALD to establish a price differential for the 10 and 25 kg bags. The differential should be adequate to compensate for the increased cost of bags and the additional handling involved with the 10 kg bags. It is estimated by the evaluation team that these costs will amount to about KSh 305 per ton for the bagging cost and KSh 15 per ton for additional handling. The price of 10 kg bags must be announced before the arrival of the October 1 shipment so that distributors can plan their procurements and marketing strategies.

3. Long-Term Fertilizer Strategy

The Agricultural Development Program evaluation conducted in July 1985 identified the key deficiencies in Kenya's present fertilizer distribution system and offered both short and long-term recommendations for its improvement. The basic deficiencies are two: the absence of an integrated marketing system that encourages, rationalizes and rewards retail marketing of fertilizer to all consumers, and the absence of a strategy for guiding the development of a viable fertilizer industry. The evaluation determined the most significant deterrent to private sector participation (investment) in fertilizer marketing in Kenya today is the extreme uncertainly of fertilizer supply availability and of fertilizer prices. Eight of the major fertilizer distributors in Kenya interviewed by the evaluation team indicated that they would be interested in developing an integrated fertilizer marketing system if guaranteed the quantities and types of fertilizers required and a reasonable margin. Without the security of being able to secure fertilizers when needed, none of the distributors were willing to invest in promotional activities, retail operations and other factors critical to increasing fertilizer consumption. The AID Agricultural Development Program is designed to assist in alleviating some of this market uncertainty.

The 1985 ADP incorporates most of the evaluation's short-term recommendations and is intended to support the gradual emergence of a private sector fertilizer marketing system. But a comprehensive, long-term strategy is also required. As the evaluation points out, "the industry and particularly the all-important marketing components are not being developed with a purpose." To rectify this situation a long-term plan of action is proposed. Components of this plan over the short run (1-2 years) would include a 2 year effective demand forecast, announced fertilizer prices well in advance of the planting seasons, development and dissemination of educational literature, expansion of products available through AID, promotion of an effective national fertilizer association, and technical assistance on fertilizer marketing.

Over the long run (3-5 years) the GOK should establish a fertilizer pricing margin that will encourage sales through retailers, allocate fertilizer only to qualified distributors over a three year period, and promote a strategy to implement an integrated fertilizer marketing system driven by the private sector and which establishes the role of the Government as one of regulation and quality control. The ultimate goal is for the Government to remove import restrictions on fertilizer so that sufficient quantities will be imported to generate price competition and guarantee an availability of fertilizer to rural areas. Prices and quantities to be imported will therefore be determined by the market place.

AID is in the position to take a leadership role in promoting a market-oriented fertilizer distribution system for Kenya. Movement toward such a system can be assisted by AID through a 5-6 year program of sustained annual fertilizer imports supported by technical assistance and training, along with the proper policy interventions instituted in a phased approach. A multi-year AID financed Fertilizer Marketing Project is being developed by USAID/Kenya for initiation in FY 1986.

4. Conditions Precedent

The 1985 ADP contains only one Condition Precedent . In order not to delay the distribution of AID financed DAP arriving in Kenya by October 1, 1985, AID will require the GOK to do the following:

No later than October 1, 1985, the Government of Kenya will announce the wholesale and retail prices of AID financed Diammonium Phosphate (DAP) sold in 50, 25, and 10 kg bags.

Evidence to satisfy this Condition Precedent will be the following:

a. A copy of the CAMC's instructions to interested distributors of AID DAP which outlines the procedures to be followed in submitting applications for allocations, and also includes the wholesale prices of DAP in various sized bags.

b. A copy of the Government's announcement of retail fertilizer prices of DAP in various sized bags.

5. Covenants

The 1985 ADP contains seven covenants. Covenants a-c are carried over from the 1984 ADP, and are modified slightly as described below. Covenant d-g are new and reflect the implementation modifications described in Section VI. B.2.

In order to reflect the revised timing and improved format of the fertilizer import plan:

a. The Government of Kenya will develop and make available as public information, a fertilizer import plan which includes current stock levels; requirements by type, area, and seasonality of use; donor financing intentions, and commercial import intentions. This plan will be developed annually by April 1.

In order to improve the pricing structure of fertilizer:

b. The Government of Kenya will carry out a review of the current pricing structure for fertilizer in order to provide adequate margins at the wholesale and retail level, and to promote wide distribution of fertilizer. The Government of Kenya will implement the recommendations as appropriate.

In order to assure that shilling generations will be deposited into the Treasury in a timely fashion:

c. The Government of Kenya agrees that all fertilizer purchases from Government by private distributors will be paid for in cash in advance or via a bank guarantee not to exceed 180 days.

In order to assure that AID financed fertilizer is delivered in Kenya with sufficient time to allow distribution to farms:

d. The Government of Kenya will submit its request to AID to finance the procurement of fertilizer each year no later than April 1 for fertilizer to be used during the short rains, and no later than August 1 for fertilizer to be used during the long rains.

In order to fill the private sector void left by the elimination of the Fertilizer Advisory Committee:

e. (1) The Government will promote the formation of the Kenya National Fertilizer Association (KNFA) by assisting with its expeditious registration as an Association with the Office of the Attorney General, and the development of its Constitution.

(2) The Government will inform the Kenya National Fertilizer Association (KNFA) when and where Fertilizer Committee meetings are to be held, provide an agenda for the meeting, and request the KNFA to be represented and to submit written recommendations at each meeting.

In order to better inform the smallholder on how, when, and what types of fertilizer to apply:

f. The Government will develop and provide educational leaflets on fertilizer use to distributors of AID fertilizer by December 1, 1985.

In order to promote the development of a number of integrated fertilizer marketing organizations capable of serving the smallholder in rural areas:

g. The Government will enforce the following criteria for distributors to receive AID financed fertilizer, and to remove those firms from the list of eligible distributors who do not conform:

(1) Distributors will have in place or be willing to develop during the present period, a distribution network;

(2) Distributors will demonstrate access to storage capacity for fertilizer allocated by the Commodity Aid-Allocation Monitoring Committee (CAMC);

(3) Distributors will be capable of securing the necessary bank guarantees;

(4) Distributors will agree to distribute education leaflets on how to apply fertilizer. Leaflets will be developed and provided by the Grantee;

(5) Distributors of AID financed fertilizer will not be prevented from receiving allocations for commercial imports. Likewise, commercial importers will not be barred from receiving allocations of AID fertilizer.

6. Local Currency Deposit and Programming

The 1985 Agricultural Development Program will result in the additional generation of approximately KSh 270 million in counterpart funds. The issues associated with the generation, programming, monitoring and release of Kenya Government-owned counterpart shillings are the subject of a detailed technical analysis prepared in July 1985. Recommendations from this study have led to a formalized system in AID of accounting for counterpart fund deposits. In the case of shillings generated by fertilizer sales, the new accounting system would integrate the monitoring reports prepared under contract by Price Waterhouse. This system will enable AID to better track the timing and amounts of counterpart shilling deposits. The programming and ultimate expenditure of these funds as planned will remain the task of the AID Project Manager, in close cooperation with GOK counterparts. Project Implementation Letter No. 7 of the FY 1984 ADP, dated March 5, 1985, detailed procedures to be followed by the Government in implementing and reporting on the Special Account for fertilizer proceeds.

The recent fertilizer evaluation listed several potential uses of counterpart funds which would bolster the Program's efforts at market development. AID will work with the Government of Kenya to develop proposals for counterpart funding in the following areas:

- establish a market research study to determine the most suitable small bag size.

- assist with conducting fertilizer research to determine the most appropriate types and generations of fertilizers to apply, and to develop crop response curves.

- develop fertilizer marketing courses for distributors and stockists to be held at the Egerton College, Agricultural Resource Center.

- in cooperation with MOALD and others, develop planting and fertilization instruction leaflets for maize, wheat, cowpeas, potatoes, cotton and vegetables.

ANNEXES

A. Fertilizer Import Plan

B. Implementation Schedule

C. Initial Environmental Examination

D. Statutory Checklist

E. Implementation Schedule for Commodity Import Program

F. Kenya Government Request for Grant Amendment

Annex A

Fertilizer Import Plan

Part 1 - Summary

Fertilizer Type	Current Stocks	Requirement for Oct-Dec	Requirement for Jan-June	Total Requirements for Crop Year	Donor Imports	Commercial Imports	Total Imports	Balance Shortfall

Part 2 - Short Rain Requirements

		Donor Supplied Fertilizer			Commercial Supplied Fertilizer		
Quantity required by Type per Province	Date Required by Type per Province Fertilizer Type	Request to Donors (Date/Amount)	Delivery to Mombasa (Date)	Distributed to Farmers (Date)	Allocation Given (Date/Amount)	Delivery to Mombasa (Date)	Distributed to Farmers (Date)

Part 3 - Long Rain Requirements

		Donor Supplied Fertilizer			Commercial Supplied Fertilizer		
Quantity required by Type per Province	Date Required by Type per Province Fertilizer Type	Request to Donors (Date/Amount)	Delivery to Mombasa (Date)	Distributed to Farmers (Date)	Allocation Given (Date/Amount)	Delivery to Mombasa (Date)	Distributed to Farmers (Date)

Action	Date	Action Agent
FY 1985 PAAD Amendment Authorized	9/15/85	AID/W
Amended Project Agreement Signed	9/30/85	USAID and GOK
Wholesale and retail prices of AID financed DAP in 10, 25, and 50 kg bags announced	10/1/85	GOK
Applications requested from private sector distributors for allocations of 28,500 tons DAP due to arrive between October and December 1985	10/1/85	GOK
9,750 tons bulk (FY 84) DAP arrives at Mombasa and railed to Nakuru for bagging	10/5/85	GOK
Retail prices of all types of fertilizer announced	11/1/85	GOK
4,500 tons bulk (FY 84) DAP arrives at Mombasa and railed to Nakuru for bagging	11/1/85	GOK
4,500 tons bulk (FY 84) DAP arrives at Mombasa and railed to Nakuru for bagging	11/10/85	GOK
Educational leaflets on fertilizer use developed and provided to distributors	12/1/85	GOK
9,750 tons bulk (FY 84) DAP arrives at Mombasa and railed to Nakuru for bagging	12/10/85	GOK
Agreement on use of FY 84 generated counterpart shillings	12/30/85	USAID and GOK
Kenya National Fertilizer Association (KNFA) registered and Articles of Association approved	4/1/86	GOK
Request for AID financed DAP during short rains	4/1/85	GOK
Fertilizer Import Plan for 86/87 crop year completed	4/1/86	GOK

IFB issued for short rain requirements	5/1/86	AID/W, Kenya Embassy
Bank guarantees expired and all shilling generations from FY 84 Agreement deposited in Special Account	6/30/85	GOK
Short rain import requirements shipped from US port	6/30/86	US Fertilizer supplier and freight agent
Request for AID financed DAP during long rains	8/1/86	GOK
Arrival of short rain fertilizer imports to Mombasa	8/1/86	Freight Agent
IFB issued for long rain requirement	8/15/86	AID/W and Kenyan Embassy
Long rain requirement shipped from US Port (NLT PACD)	9/30/86	US Fertilizer suppliers and freight agent
Arrival of long rain fertilizer imports to Mombasa	11/15/86	Freight Agent
Agreement on use of FY 85 generated counterpart shillings	11/30/86	USAID and GOK
Bank guarantees expired and all shilling generations from FY 85 program deposited in Special Account.	5/30/87	GOK

ANNEX C

INITIAL ENVIRONMENTAL EXAMINATION

OR

CATEGORICAL EXCLUSION

Country	Kenya
Program Title and Number	615-0213, Commodity Import Program of the Structural Adjustment Program
Funding:	FY 1985 ESF Grant, $25 million
IEE/CE Prepared by:	Stephen A. Klaus, Projects Division

Environmental Action Recommended:

Positive Determination ______________________

Negative Determination $12 Fertilizer Imports

or

Categorical Exclusion $13 Million C.I.P.

A negative threshold decision is recommended for the $12 million worth of fertilizer to be financed by A.I.D. under this PAAD since the fertilizer will not have a significant impact on the physical and natural environment (see attached justification).

A categorical exclusion is recommended for the $13 million worth of general commodities to be financed by A.I.D. under the C.I.P. portion as described in this PAAD. The C.I.P. portion meets the criteria for Categorical Exclusion in accordance with Section 216.2 of Regulation 16, and is therefore excluded from further review (see attached justification).

Action requested by: [signature] Date: 9-20-85

Charles L. GLadson
Mission Director

Concurrence: See State 286852 attached to this IEE, Date: ___________
African Bureau Environmental Officer

A. **Program Description:**

The purpose of the Agricultural Development Program and Commodity Import Program (CIP) portions of the Structural Adjustment Program is to provide critical balance of payments support while improving the agricultural input supply system and assisting the GOK to continue to promote the structural supply system and assisting the GOK to continue to promote the structural changes needed to address the underlying development problems facing the economy. This purpose will be achieved by providing $12 million for U.S. fertilizer and its associated transportation services cost for distribution through the private sector, and by effecting policy reform in the agricultural input supply system; and also by supplying $13 million for a CIP for the Kenyan private sector tied to U.S. procurement. Specific commodities to be imported under the CIP will not be identified until well into program implementation.

Continued external balance of payments support is required to help ensure that Kenya's prudent management of the external account does not adversely affect Kenya's prospects for short and long-term economic growth.

Food production in Kenya, particularly the hybrid maize which has been responsible for much of the increase in output over the past few years, relies heavily on imported fertilizer for its success. Currently approximately 41% of imported fertilizer is used on maize. In the short-term this program will help ensure availability of this key input through direct financing of its importation. In the longer term, implementation of the policy reforms linked to this project will help ensure effective private sector distribution of fertilizer and improved marketing to the small holder.

Twelve million dollars provided through this grant will be used to procure approximately 45,000 metric tons of Diamonium Phosphate (DAP). As with previous A.I.D.-financed fertilizer programs, the fertilizer will be procured by the Kenyan Embassy in Washington, D.C. with the assistance of A.I.D.'s Office of Commodity Management, or its successor. Then, the fertilizer will be sold directly to private sector distributors for sale to farmers.

The policy initiative linked to this program emphasizes the further development of agricultural input supply reforms initiated in previous Agreements. Specifically the Agricultural Development portion of this grant will be used to expand and strengthen private sector fertilizer distribution; to reduce the Government's role in fertilizer marketing; and to improve the system of fertilizer pricing, allocation, and planning.

The local currency generated by the sale of the fertilizer to private sector distributors will become available within 180 days of sale of fertilizer to private firms. The proceeds of fertilizer sales, and CIP imports, will be used to defray the costs of priority development activities included in the GOK 1986/87 and subsequent year development budgets, especially those supported by other A.I.D. programs and projects, specifically including family planning and private sector activities.

B. Identification and Evaluation of Environmental Impacts of the Fertilizer to be Imported under the Agriculture Development Program:

Funds provided by the proposed grant have partially been programmed to finance the import of fertilizer within the limits of quantities and types projected for Government licensing in 1986/87. The types of fertilizer normally imported into Kenya are as follows: sulphate of ammonia, urea, calcium ammonium nitrate, ammonium sulphate nitrate, calcium nitrate, single super phoshate, hyperphosphate, triple super phosphate, di-ammonium phosphate (DAP), mono-ammonium phosphate (MAP), muriate of potash, sulphate of potash and NPK (mixed fertilizer). The grant funds will be used to import DAP for which the United States is very competitive. To the extent that provision by AID of necessary foreign exchange will guarantee the delivery of required fertilizer inputs, overall fertilizer usage may be greater in 1986/87 than would otherwise have been the case. The environmental impact of any potential increase in fertilizer usage would be related primarily to changes in soil character, and in the chemical and possibly, biological state of water. In general, Kenya soils are normally deficient in nitrogen and phosphates while potassium is generally well supplied. The phosphate and nitrogen/phosphate formulation proposed for financing is of the specific type being recommended primarily for application to maize, wheat, barley and other food crops. When applied to crops, such a fertilizer is capable of causing changes which may be adverse, beneficial or of no significant consequence. Improper use by inexperienced handlers and farmers is a possibility for limited quantities of fertilizer. For most part, however, fertilizer will be obtained by established farmers who have used them previously, and farmers who have attended training courses at Farmer' Training Centers where fertilizer applications are normally taught and demonstrated. Also, in this Amendment, the Government will covenant that it will distribute leaflets to farmers explaining proper fertilizer application methods. In general, applications of fertilizer will increase yields per hectare which are very low. The use of fertilizer will thus have a significant beneficial effect on the land. Overuse of phosphate and nitrogen/phosphate complexes poses the possibility of negative effects on water quality. Th permissible criterion for nitrate (determined as nitrogen) in public drinking water is 10 milligrams per litre. Overuse of nitrates and phosphates can also contribute to over-growth of objectionable plant forms in lakes and other standing bodies of water. The GOK Ministry of Water Development has over 100 stations which monitor the quality of water. Chemical tests are regularly carried out, and no sources with unsafe quantity of nitrates and phosphates linked to fertilizer use have been identified. While conditions among developing countries vary widely, it is clear that Kenya falls nearer to the bottom than to the top of the list of developing countries in terms of comparative fertilizer use. Required fertilizer imports of specific types will be assured within the limits of the quantities and types projected for government licensing this year. Quantities beyond those already projected for licencing by government are not contemplated. The program will have its effects primarily throgh improvements in the balance of payments and through increases in development revenues available to government in agreed-upon areas. Such effects, though important in underwriting significant and ongoing structural adjustments in the Kenya economy, are generalized rather than specific and affect the overall environment in a manner that is primarily indirect.

C. Recommended Environmental Action:

1. In accordance with AID Regulation 16, it is recommended that a negative determination is appropriate for the fertilizer to be financed under the Program. The primary objective of the Program is to provide balance of payments and budgetary assistance while also financing the import of fertilizer. As noted above, the use of fertilizer financed by AID will not have significant impact on the physical and natural environment

2. In accordance with AID regulation 16, it is recommended that a categorical exclusion be granted pursuant to Section 216.2(c)(2)(ix), which provides an exclusion with respect to CIPs when, prior to approval, AID does not have knowledge of the specific commodities to be financed and when the objective in furnishing such assistance requires neither knowledge, at the time assistance is authorized, nor control during implementation, of the commodities or their use in the host country.

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DE RUEHC #6852 2611603 CN: 21697
ZNR UUUUU ZZH CHRG: AID
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FM SECSTATE WASHDC
TO AMEMBASSY NAIROBI IMMEDIATE 9875
BT
UNCLAS STATE 286852

AIDAC, NAIROBI FOR ~~REDSO/ESA~~

E.O. 12356: N/A
TAGS:
SUBJECT: STRUCTURAL ADJUSTMENT PROGRAM - (615-0213)

REFERENCES: STATE 283371

THE BUREAU ENVIRONMENTAL OFFICER (BEO) FOR AFRICA DELEGATES AUTHORITY FOR APPROVAL OF THE INITIAL ENVIRON-MENTAL EXAMINATION (IEE) FOR THE SUBJECT PROJECT TO THE MISSION DIRECTOR, WITH THE CONCURRENCE OF THE REGIONAL LEGAL ADVISOR, UNDER THE PROVISIONS OF REFTEL ABOVE. FORWARD COPIES OF SIGNED DOCUMENT AID/W. SHULTZ
BT
#6852

NNNN

ANNEX D

3A(2) - NONPROJECT ASSISTANCE CHECKLIST

CROSS-REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? YES. IDENTIFY. The Country Checklist was updated this FY and formed ANNEX B to the Health Planning and Information Project (615-0187) Project Paper Amendment No. 1.
HAS STANDARD ITEM CHECKLIST BEEN REVIEWED? Yes, and is attached hereto.

GENERAL CRITERIA FOR NONPROJECT ASSISTANC

1. FY 85 Continuing Resolution. Sec. 525 FAA Sec. 634A, Sec. 653(b).

a. Describe how Committees on Appropriations of Senate and House have been or will be notified concerning the non-project assistance;	The Committees were notified in the Congressional Presentation, also a Congressional Notification has been sent to the Committees
b. Is assistance within (Operational Year Budget) country or international organization allocation reported to the Congress (or not more than $1 million over that amount)?	Yes
c. If the proposed assistance is a new country program or will exceed or cause the total assistance level for the country to exceed amounts provided to such country in FY 85, has notification been provided to Congress?	N/A
d. If proposed assistance is from the $85 million in ESF funds transferred to A.I.D. under the second CR for FY 83, for "economic development assistance projects", has the notification required by Sec. 101(b)(1) of the Second CR for FY 83 been made?	N/A
2. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is the basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?	No further legislative action is required.

3. FAA Sec. 209. Is assistance more efficiently and effectively given through regional or multilateral organizations? If so why is assistance not so given? Information and conclusion whether assistance will encourage regional development programs.	No
4. FAA Sec. 601(a). Information and conclusions whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce, and (f) strengthen free labor unions.	a) Yes b) Yes c) No d) Yes e) Yes f) No
5. FAA Sec. 601(b). Information and conclusion on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).	The source of all goods is restricted to the U.S. The procurements will be widely advertised by AID. Subsidiaries and authorized distributors of U.S. firms in Kenya will be able to more easily obtain import licenses under the program than is now possible.
6. FAA Sec. 612(b), Sec. 636(h); FY 85. Continuing Resolution. Sec. 507. Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the United States are utilized to meet the cost of contractual and other services in lieu of dollars.	NA
7. FAA Sec. 612(d). Does the United States own excess foreign currency of the recipient country and, if so, what arrangements have been made for its release?	No

8. Faa Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? — Yes

9. FY 85 Continuing Resolution. Sec. 522. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative and is such assistance likely to cause substantial injury to U.S. producers of the same or similar competing commodity? — N/A

10. FAA 118(c) and (d). Does the program comply with the environmental procedures set forth in AID Regulation 16? — Yes

Does the program take into consideration the problem of the destruction of tropical rain forests? — No

11. FAA Sec. 128. Has an attempt been made to finance productive facilities, goods and services which will expeditiously and directly benefit those living in absolute poverty under the standards adopted by the World Bank? — N/A

12. FY 85 Continuing Resolution. Has full consideration been given at each stage of design to the involvement of small minority (including women-owned businesses) enterprises, historically black colleges and universities, and minority PVO's? — To the extent they wish to do so, as suppliers of goods, they may. Procurements will be widely advertised.

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Funds.

a. FAA Sec. 531(a). Will this assistance support and promote economic or political stability? To the extent possible, does it reflect the policy directions of FAA Section 102? — Yes, through provision of budget and balance of payments support during a period of economic slowdown.

b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities?	No
c. FAA Sec. 534. Will ESF funds be used to finance the construction or the operation of maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such use of funds is indispensable to nonproliferation objectives?	No

3A(3) - STANDARD ITEM CHECKLIST

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

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

A. PROCUREMENT

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

   This CIP Grant does not provide financing specifically for procurement of goods from small businesses. However, procurements under the program will be widely advertised and small businesses will have the opportunity to participate in supplying goods to the extent they care to do so. Procurement of services except for those incidental to commodity procurement is not anticipated.

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

   Yes

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

   Yes

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

   Yes

5.	FAA Sec. 604(d). If the cooperating country discriminates against U.S marine insurance companies, will agreement require that marine insurance be placed in the United States on commodities financed?	Kenya does not discriminate against U.S. marine insurance companies, however, goods purchased under this grant may, if the importer desires, be insured in the U.S. This is contrary to Kenya's usual practice of directing that all marine insurance for goods imported into Kenya be placed in Kenya.
6.	FAA Sec. 604(e) ISDCA of 1980 Sec. 705(a). If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity?	N/A
7.	FAA Sec. 604(f). Are there arrangements whereby a supplier will not receive payment under the commodity import program unless he/she has certified to such information as the Agency by regulation has prescribed?	Yes
8.	FAA Sec. 608(a). Will U.S. Government excess personal property be utilized wherever practicable in lieu of the procurement of new items?	It is not practicable for this private sector program.
9.	Merchant Marine Act of 1936, Sec. 901(b). Sec. 603, FAA. Compliance with requirement that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S.-flag commercial vessels to the extent that such vessels are available at fair and reasonable rates.	Yes

10. International Air Transport and Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will provision be made that U.S.-flag carriers will be utilized to the extent such service is available?

    Yes

11. FY 85 Continuing Resolution, Sec. 504. If the U.S. Government is a party to a contract for procurement, will the contract contain a provision authorizing termination of such contract for the convenience of the United States?.

    Yes

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

    No technical assistance will be financed under this Amendment, neither will facilities of other federal agencies be utilized.

B. OTHER RESTRICTIONS

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

    Yes

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

    Yes

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

    N/A

4 Will arrangements preclude use of financing:

a. FAA Sec. 114, 104(f), FY 85 Continuing Resolution Sec. 527. To pay for performance of abortions or involuntary sterilization or to motivate or coerce persons to practice abortions? to pay for performance of involuntary sterilizations as method of family planning or to coerce or provide any financial incentive to any person to practice sterilizations? or to lobby for abortions? Yes

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

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

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

e. FY 85 Continuing Resolution Sec. 503. to pay pensions, etc., for military personnel? Yes

f. FY 85 Continuing Resolution Sec. 505. to pay U.N. assessments? Yes

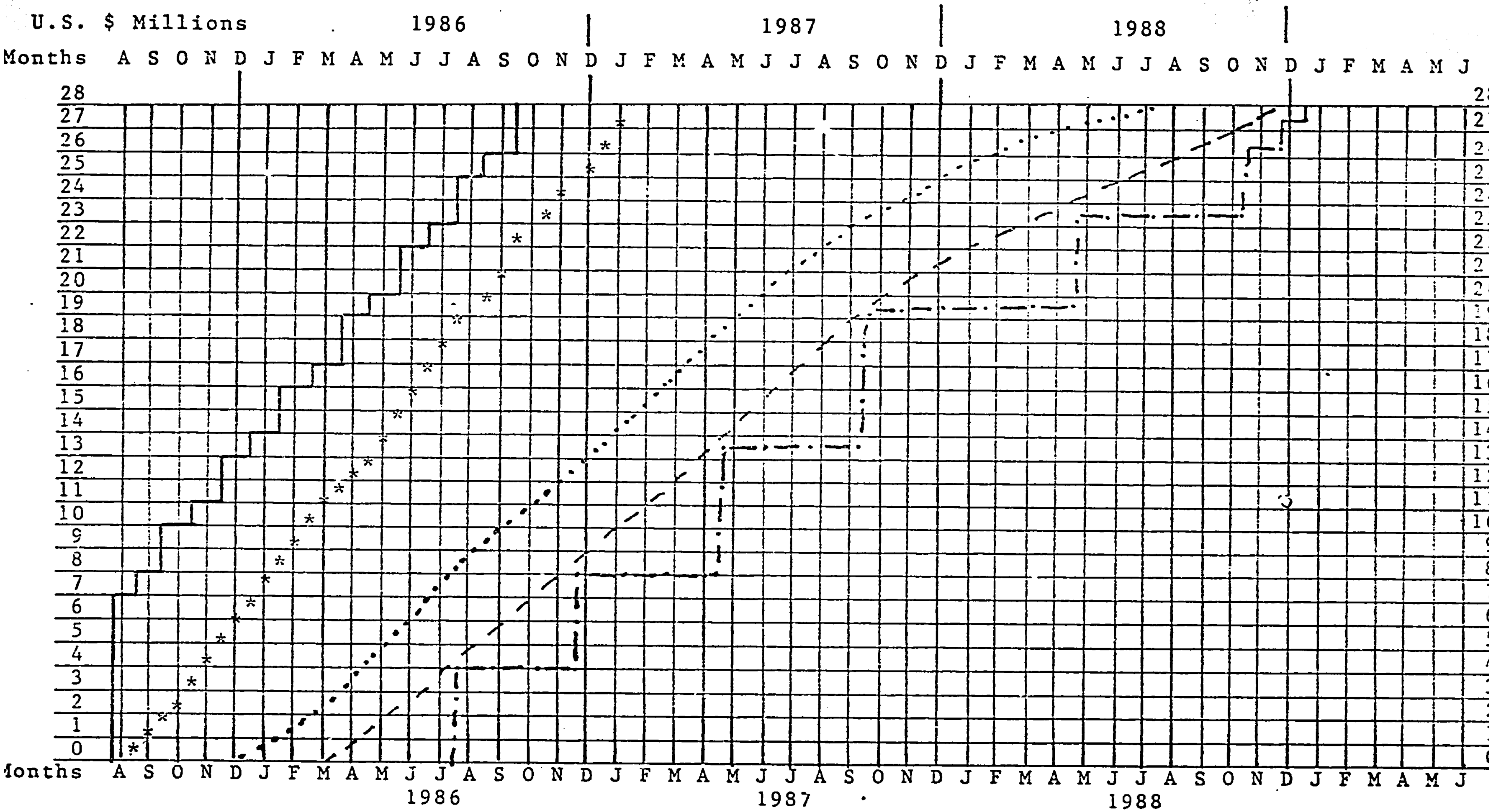
g. FY 85 Continuing Resolution Sec. 506. to carry out provisions of FAA Sections 209(d) and 251(h)? (transfer to multilateral organization for lending). Yes

h. FY 85 Continuing Resolution, Sec. 510. To finance the export of nuclear equipment, fuel, or technology or to train foreign nationals in nuclear fields? Yes

i. FY 85 Continuing Resolution Sec. 511. To aid the efforts of the government to express the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights? Yes

k. FY 85 Continuing Resolution. Sec. 516. To be used for publicity or propaganda purposes within U.S. not authorized by Congress? Yes

EXPECTED COMMITMENT, DISBURSEMENT, DEPOSIT AND WITHDRAWAL 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 equivalant of U.S.$
-.-.-. equals withdrawals from the Special Account

ANNEX E

t:2130 Hug.

ANNEX F

OFFICIAL FILE

Proj

REPUBLIC OF KENYA
MINISTRY OF FINANCE AND PLANNING

Telegraphic Address:
FINANCE-NAIROBI
Telephone: 338111
When replying please quote

Ref. No. EA/FA 9/05

THE TREASURY
P.O. Box 30007
NAIROBI
KENYA.

22nd August 1985

Mr Charles L Gladson
Director
USAID/Kenya
P O Box 30261
NAIROBI

DATE REC'D	
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REPLY DUE	
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ACTION TO	
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Dear Mr. Gladson,

FISCAL YEAR 1985 E.S.F. STRUCTURAL ADJUSTMENT PROGRAMME GRANT 615-0213 AMENDMENT

I response to our recent discussions in connection with the Structural Adjustment Programme Grant for Fiscal Year 1985, a formal request is hereby made to your Government for a $13 million Commodity Import (C.I.P.) and for a $12 million Agricultural Development Program.

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

Yours sincerely,

H M MULE
PERMANENT SECRETARY

ACTION COPY

Action taken: PAAD Amendment
No action necessary: X
SAK 9/3/85
(Initials) (Date)

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