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CLASSIFICATION:

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. PAAD Number: 615-0240 Grant Number 615-K-607	2. Country: KENYA
3. Category: Commodity Import Program (CIP)	4. Date: January 10, 1986
5. To: AA/AFR, Mark L. Edelman	6. OYB Change Number: N/A
7. From: AID/AFR/PD, Carol Peasley (Acting) C. Peasley	8. OYB Increase: None. To be taken from:
9. Approval Requested for Commitment of $14,355,000	10. Appropriation Budget Plan Code: ESF - GESA-86-31615-KG32 (637-61-615-00-59-61)
11. Type Funding: ☐ Loan ☒ Grant	12. Local Currency Arrangement: ☐ Informal ☒ Formal ☐ None
13. Estimated Delivery Period: 01 Oct 86--31 Dec 89	14. Transaction Eligibility Date:

15. Commodities Financed

$14,355,000 - Manufactured Fertilizers

16. Permitted Source		17. Estimated Source	
U.S. only	$14,355,000	U.S.	$14,355,000
Limited F.W.		Industrialized Countries	
Free World		Local	
Cash		Other	

18. Summary Description

The purpose of this Structural Adjustment Assistance Program (615-0240) is to provide the Republic of Kenya with balance of payments and technical assistance support while the Government of Kenya implements the policy changes necessary to accelerate the structural adjustment of the economy. Balance of payments assistance will be provided entirely through the private agricultural, industrial and commercial sectors. Counterpart Shilling generations will be used for mutually agreed development purposes in the public sector, and for establishment of a trust fund to support private sector development activities and to cover operating expenses of the A.I.D. Mission to Kenya.

This Program Assistance Approval Document outlines a three-year, $74 million program consisting of three parts: a $40 million Fertilizer Market Development Program; a $28 million Commodity Import Program; and a $6 million Technical Assistance Program. The proposed Grant will be made from Economic Support Fund resources, and would be authorized in three tranches: $25 million in FY 1986; $22 million in FY 1987; and $27 million in FY 1988. This facesheet approves $14.355 million for fertilizer for FY 1986. The PAAD also contains full justification for an FY 1986 program of an additional $5.645 million for fertilizer (first priority) and a $ 3 million private sector commodity import program (third priority). Should $2 million become available in FY 1986 for technical assistance (second priority), additional justification will be provided. These additional amounts will be approved by amendment to the PAAD if funds become available. The FY 1987 and 1988 programs will be approved by amendment based upon this PAAD and updated supplements.

All commodities will be of U.S. source/origin except as AID may otherwise agree in writing, with all counterpart generations directly deposited or guaranteed by participating commercial banks. Technical assistance services required to accelerate structural adjustment processes will be procured from U.S. or Kenyan sources.

19. Clearances		Date
AFR/PD	CPeasley	4/16/86
AFR/EA	[signature]	4/16/86
AFR/DP	[signature]	4/17/86
GC/AFR	MAK	4/15/86
DAA/AFR	[signature]	4/18/86
M/FM/PAD	[signature]	4/15/86
SER/AAM	[signature]	4/16/86

20. Action

☒ APPROVED ☐ DISAPPROVED

Authorized Signature: Mark L. Edelman

Date: 4/23/86

Title: Mark L. Edelman, AA/AFR

CLASSIFICATION:

SUMMARY DESCRIPTION (Continued)

The FY 1986 program is subject to the following:

CONDITIONS PRECEDENT AND COVENANTS

1. Conditions Precedent

A. <u>First Disbursement</u>

Prior to first disbursement of assistance under the Grant, or to the issuance by A.I.D. of documentation pursuant to which disbursement may be made, the Grantee will, except as the Parties may otherwise agree in writing, submit to A.I.D., in form and substance satisfactory to A.I.D.:

Evidence that a separate, numbered Special Account has been established in the Paymaster General into which the local currency proceeds from the sale of Eligible Items under this Agreement will be deposited in accordance with Section 5.4.

B. <u>Additional Disbursement.</u> Prior to the disbursement of funds under the Grant for the second and any subsequent procurements of fertilizer under this Agreement, or to the issuance by A.I.D. of documentation pursuant to which disbursement will be made with respect thereto, the Grantee will, except as the Parties may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D.:

(1) A full report on and accounting for all local currency proceeds generated under the FY 1984 Structural Adjustment Program Agreement, the FY 1984 Agricultural Development Program and the FY 1985 Structural Adjustment Program Agreement Amendment; and

(2) A detailed proposal for the use of the local currency proceeds generated or to be generated under the agreements listed in (1) above. In preparing this proposal, the Cooperating Country will take into consideration and specifically respond to a proposed local currency programming plan which will be provided by A.I.D. to the Cooperating Country.

2. <u>FY 1986 Covenants</u>

The Grantee shall covenant that, except as A.I.D. may otherwise agree in writing:

a. It will take all necessary steps to assure that all local currencies generated by this program are promptly deposited into the Special

Account; ensure that bank guarantees are strictly enforced and limited to 180 days; and that fertilizers will be sold only to legitimate distributors.

b. To further ensure effective fertilizer supply and distribution, it will:

(1) allow all major fertilizer distributors who import more than 2000 tons per year to receive import allocations up to their proven requirements;

(2) provide approved distributors with assured access to at least as much fertilizer as they imported the previous year;

(3) award import allocations in a timely fashion, twice a year, up to the end of February for the short rains, and up to the end of August for the next year's long rains;

(4) announce fertilizer prices in a timely fashion, twice a year, January for the long rains, and August for the short rains;

(5) establish retail ceiling prices to provide a gross margin sufficient to encourage retail marketing organizations to provide extension services and to distribute fertilizer in rural areas;

(6) establish a Fertilizer Unit within the Ministry of Agriculture and Livestock Development to monitor the Kenyan and world fertilizer situations and to develop a fertilizer information system covering national fertilizer needs, prices, imports, sales, stocks, importers performance, and research information on fertilizer response trials and cost/benefit studies. The information collected by this unit will be used for decision-making and to develop an import plan;

(7) implement a fertilizer pricing system which establishes wholesale and retail prices based on a Benchmark International C&F Price (BIP); and

(8) increase total fertilizer supply, consisting of commercial imports, donor aid, and carryforward stocks, in each annual fertilizer import plan consistent with estimated demand.

C. Exports. In order to expand exports and foreign exchange earnings, it will review its plans to implement manufacturing in bond. These plans shall be announced at the same time as the Government's new budget year and shall be announced and implemented by July 1987, except as the Parties may otherwise agree in writing.

D. Policy Dialogue. In order to expand, improve, and regularize the U.S.-Kenyan policy dialogue on structural adjustment matters, it will:

(1) schedule annual U.S.-Kenyan bilateral meetings to review policy aspects of the Government of Kenya's development strategy; and
(2) schedule monthly bilateral meetings to review policy implementation aspects of the Government of Kenya's development strategy.

E. Use of Local Currency.
(1) It will establish a separate Special Account in the Paymaster General and deposit therein currency of the Government of Kenya in amounts equal to proceeds accruing to the Cooperating Country or any authorized agency thereof as a result of the sale or importation of the Eligible Items. Funds in the Special Account may be used for such economic development purposes as are mutually agreed upon by A.I.D. and the Cooperating Country, provided that the first KShs 21,000,000 shall be entrusted to A.I.D. for deposit to the Trust Account to meet the requirements of the United States.

(2) It will promptly, fully and regularly report on and account for all local currencies generated from sale of Eligible Items under this Agreement in accordance with procedures to be mutually agreed upon by the Parties. In the event that the Cooperating Country fails, within 21 days of the date of a specific request from A.I.D., to report on or account satisfactorily to A.I.D. for funds which are required to be deposited in the Special Account established pursuant to Section (e)(1) above, A.I.D. may, at its option, suspend all disbursements under or terminate this Agreement by written notice to the Cooperating Country.

Economic Support Fund (ESF)
Program Assistance Approval Document (PAAD

Structural Adjustment Assistance Program
(615-0240)

for
FY 1986-88

Facesheet
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Abbreviations

ADP	Agricultural Development Program
CBK	Central Bank of Kenya
CIP	Commodity Import Program
CPI	Consumer Price Index (Nairobi)
CSFC	Cereals and Sugar Finance Corporation
CY	Calendar Year
DA	Development Assistance
DAP	Diammonium Phosphate
ESF	Economic Support Fund
FM	Office of Financial Management
FM/PAFD	Program Accounting and Finance Division
FMDP	Fertilizer Marketing Development Program
FSN	Foreign Service National
FY	Fiscal Year
GDP	Gross Domestic Product
GOK	Government of Kenya
IBRD	International Bank for Reconstruction & Development
IMF	International Monetary Fund
KEDRES	Kenya External Debt Reporting System
KFA	Kenya Farmers Association
KGGCU	Kenya Grain Growers Cooperative Union
KSh	Kenya Shilling
MEA	MEA Limited
MOALD	Ministry of Agriculture and Livestock Development
MT	Metric Tons
OSDBU	Office of Small & Disadvantaged Business Utilization
PAAD	Program Assistance Approval Document
PL 480	Public Law 480
PTA	Preferential Trade Agreement
PVO	Private Voluntary Organization
RVP	Rift Valley Province
SDR	Special Drawing Right
SER/AAM	Directorate for Program & Management Services/ Office of Acquisition Assistance Management
SGS	Societe General de Surveillance
SITC	Standard Industrial Trade Classification
TSP	Triple Super Phosphate
USAID	United States Agency for International Developmen
USIS	United States Information Service

I. Summary

This Program Assistance Approval Document (615-0240) presents and justifies a three-year, $74 million Structural Adjustment Assistance Program to provide the Republic of Kenya with balance of payments and technical assistance support while the Government of Kenya implements the changes necessary to accelerate the structural adjustment of the economy. Balance of payments assistance will be provided entirely through the private agricultural, industrial, and commercial sectors. Counterpart Shilling generations will be used for mutually agreed development purposes in the public sector, and for establishment of a trust fund to support private sector development activities and to cover the operating expenses of the A.I.D. Mission to Kenya. Technical assistance services and policy measures associated with the Grant will address basic development problems described in the body of this Program Assistance Approval Document.

The proposed Grant consists of three parts: a $40 million private sector Fertilizer Market Development Program tied to procurement of manufactured fertilizers from U.S. sources; a $28 million private sector Commodity Import Program tied to procurement of A.I.D. Eligible Commodities from U.S. sources; and a $6 million Technical Assistance Program tied to procurement from U.S. or Kenyan sources. The proposed Grant would be made from Economic Support Fund resources, and would be authorized in three tranches: $25 million in FY 1986; $22 million in FY 1987, and $27 million in 1988. In FY 1986, funding priority will be given to the Fertilizer Market Development Program (first $20 million of available funding) the Technical Assistance Program (next $2 million), and the private sector Commodity Import Program (next $3 million). FY 1987 and FY 1988 programs would be based upon available funding and upon a review of the operations of the first year of the three-year program. Annual authorizations would follow Washington review of Program Assistance Approval Document updates, including review of all proposed conditions precedent and covenants. Shilling payments due from importers under the Fertilizer Market Development Program shall be paid directly into a special account, or shall be guaranteed by participating commercial banks with a delay not to exceed 180 days. Shilling payments from importers under the Commodity Import Program shall be directly paid into the special account by participating commercial banks, also with a delay not to exceed 180 days. The special account will be established in the Central Bank of Kenya as a uniquely identifiable element of the Treasury's Paymaster General Account. Withdrawals of approximately $1.3 million equivalent to cover the operating expenses of the A.I.D. Mission in Kenya shall have first priority access to the resources of the special account. Withdrawals of approximately $3.7 million equivalent to support private sector development activities in Kenya shall have second priority access to the resources of the special account. Remaining resources of the special account shall be programmed for high-priority, mutually agreeable development purposes during the Kenyan budget year FY 1987/88 and subsequent years.

To accelerate the analysis, planning, and implementation of structural adjustment measures, an overall level of $6 million dollars of technical assistance is proposed. This level is consistent with successful commitment of some $5.9 of technical assistance during the first two and a half years of Program 615-0213, and is designed to maintain the quality and quantity of U.S. support for policy-related studies, consultancies, training, and microcomputer hardware and software required to accelerate structural adjustment over the next three years. Planned technical assistance addresses improved policy formulation and policy implementation affecting private sector investment; improved balance of payments adjustment mechanisms, including export promotion; improved management, budgeting, and financial control in the Ministry of Finance and in the Ministry of Planning and National Development; parastatal rationalization including divestiture; and improved pricing and private sector marketing of agricultural inputs and outputs. Portions of the technical assistance resources will also be required to fund monitoring and implementation of commodity and fertilizer import programs, and to fund the planned mid-term and final program evaluations.

The conditions precedent to disbursement and covenants for the first year of Program 615-0240 are contained in Part IV.C. of this Program Assistance Approval Document, together with a description of priority areas of policy dialogue and conditionality for the Program as a whole. The FY 1986 conditionality addresses an improved mechanism for U.S.-Kenyan policy dialogue; improved export promotion; establishment of an operating expense and private sector development trust fund; and necessary policy reforms required to expand overall levels of fertilizer use in Kenya, to increase private sector participation in fertilizer marketing, to increase the overall level of fertilizer price and non-price competition, and to improve private sector outreach to fertilizer users in general and to smallholders in particular. Policy dialogue and policy conditionality in FY 1987 and 1988 will continue to emphasize Mission priority concerns related to: increased support for family planning; improved private sector investment climate; continued balance of payments adjustment; budgetary reform; and improved pricing and private sector marketing of agricultural inputs and outputs.

The proposed three-year, $74 million Structural Adjustment Assistance Program for FY 1986-88 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. Kenya's budget deficit is expected to fall from 5.0 percent of Gross Domestic Product (GDP) in the drought year 1984/85, to 4.3 percent or less in 1985/86, and to less than 4 percent under future likely International Monetary Fund (IMF) programs. Achievement of such targets with appropriate donor support will permit continued reduction of budget financing demands on the commercial banking system, and will permit further progress toward increasing the share of the private sector in overall domestic credit.

With regard to the external sector, the current account deficit is expected to fall from 5.5 percent of GDP in 1986 to 3.1 percent of GDP in 1989. Despite such projected improvements, Kenya must now begin to make major net repayments to the IMF, and to build up reserves drawn down during the recent drought. As a result, additional financing of some $152 million must still be arranged over the next few years, amounting to an estimated $52 million in 1987; $61 million in 1988; and $39 million in 1989. The proposed Structural Adjustment Assistance Program would provide $68 million of balance of payments support over the period 1987-89, covering approximately 55 percent of the estimated financing which must still be arranged. The proposed three-year, $40 million Fertilizer Market Development Program represents the minimum amount required to maintain the current U.S. presence in overall Kenyan fertilizer markets during a key period of policy reform and improved policy implementation. The existing private sector Commodity Import Program will require a minimum of $28 million over the next three years to maintain an average disbursement rate of $1.2 million per month, providing visible U.S. support for continued import liberalization.

As the Government of Kenya redirects its attention from drought recovery to the policy changes necessary to promote accelerated growth, there should be no reduction of U.S. support for structural adjustment or of balance of payments support provided through the private agricultural, industrial, and commercial sectors. Beyond the immediate impact on growth, a multidonor program of non-project assistance can contribute to the analysis, planning, financing, and implementation of the additional structural adjustment measures which will be required to place the Kenyan economy on a competitive footing in the years ahead. It is expected, that continued Kenyan access to IMF financing will be arranged at reduced levels over the next few years, perhaps in the context of an Extended Fund Facility. Similarly, additional World Bank program assistance, with suitable conditionality, may be agreed upon in the form of one of more sector loans. Bilateral program assistance in substantial amounts will also be required, with the U.S. continuing as the major bilateral donor providing program assistance in support of a more active program of policy change and accelerated structural adjustment.

II. Statement of the Problem, and Government of Kenya Response

A. Overview

Despite a major stabilization effort and initial structural adjustment measures, Kenyan growth rates in the 1980's have been insufficient to provide access to the jobs, incomes, and basic social services required to meet the rising expectations of Kenya's rapidly growing population. Changes in the structure of the economy have so far been inadequate to eliminate excess demand for foreign exchange and for government budgetary resources. Although significant decreases have been achieved in balance of payments and budget deficits, the associated reduction in government development expenditures in real terms and the compression of private sector imports have also contributed to slower growth.

Continuing a trend that began in the late 1970's, Kenya's real Gross Domestic Product 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 past 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.

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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 the Government of Kenya 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 improved 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.

Recovery from the 1984 drought will permit the Kenyan economy to grow by some 3.8 percent in 1985 (still less than population growth), and increased donor and other capital flows may permit a growth rate of perhaps 5 percent in 1986. Beyond 1986, however, the higher rates of growth required to fully employ Kenya's rapidly growing labor force and to provide sustained increases in per capita income cannot reasonably be achieved without substantial structural adjustment in addition to continued strong implementation of sound demand management policies.

B. Macroeconomic Analysis

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 27.9 percent of GDP in the drought year 1984/85 (thus sharply reversing an upward trend that had lasted for more than a decade). (See Table 3 below.) The Government has taken a substantial risk in reducing its relative share in the economy by more than 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. As indicated in Table 5B, overall government expenditures have declined by 10 percent in constant 1981 Shillings during the past five years, from 20.2 billion Shillings in 1980/81 to 18.1 billion Shillings in 1985/86. Moreover, development expenditures have declined by nearly 18 percent in constant terms, from 5.7 billion Shillings in 1980/81 to 4.7 billion Shillings in 1985/86.

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

1978/79	32.2%	1982/83	28.4%
1979/80	32.2%	1983/84	28.6%
1980/81	35.5%	1984/85	27.9% a/
1981/82	33.4%	1985/86	28.0% b/

Notes: a/ Provisional.
b/ Projected.

Source: Economic Survey, 1982-85.
Ministry of Finance and Planning, September 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 3.1 percent of GDP in 1982/83. The cutbacks in 1982/83 were more severe than had been planned, however, with the Government of Kenya 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 4.2 percent of GDP), but exceeded planned levels in the drought year 1984/85 (when the deficit rose to 5.0 percent of GDP). Drought implications for the budget, however, are estimated at some 1 percent of GDP so that the underlying deficit remained at or near the 4 percent level in 1984/85. As

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

1978/79	7.4%	1982/83	3.1% a/
1979/80	5.7%	1983/84	4.2%
1980/81	9.5%	1984/85	5.0% b/
1981/82	6.7%	1985/86	4.3% c/

Notes: a/ IMF target was 4.7 percent.
b/ Provisional. Approximately 4% excluding drought expenditures.
c/ Projected. May fall to 4.1 percent.

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

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 September 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.) Beyond 1985/86, budget deficits below 4 percent of GDP can be expected under future likely IMF programs.

c. Financing the Budget Deficit

Table 5B provides a summary of Central Government revenues, expenditures, and deficits for FYs 1980/81-1985/86 in constant 1981 Shillings. Financing requirements in constant terms will fall by nearly one-half during the five year period from 5.4 billion Shillings in 1980/81 to 2.8 billion Shillings in 1985-86. Net foreign financing of the deficit in constant terms will continue its rapid decline from 2.8 billion Shillings in 1980/81 to 0.16 billion Shillings in 1985/86, as gross foreign drawings fall sharply in 1985/86, and as foreign repayments continue at relatively high levels.

The decline in net foreign financing in 1985/86 will be partially 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 in particular 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. Reduction of the deficit below 4 percent of GDP in 1986/87 and beyond would be of additional

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Table 5A
Kenya: Central Government Finance, 1980/81 - 1985/86
(Millions of CURRENT 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 b/
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 b/
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 b/
Financing	5,366	4,289	2,243	3,433	4,696	4,629 b/
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 b/
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
Non-bank 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% b/

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 grants 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: Government of Kenya, Ministry of Finance and Planning, July 4, 1985.

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Table 5B

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

(Millions of CONSTANT (1981) 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	15,016	14,643	14,499	14,717	15,281
Recurrent Revenue	14,338	14,216	13,722	13,760	13,666	14,074
Foreign Grants	451	800	921	740	1,051	1,207 b/
Total Expenditure	20,155	18,891	16,479	17,046	17,856	18,093
Recurrent	13,984	13,578	13,221	12,708	12,791	13,369 b/
Development	5,733	5,736	3,705	4,618	4,443	4,724
Adjustment c/	438	-424	-448	-280	622	0
Overall Deficit	-5,366	-3,874	-1,836	-2,547	-3,139	-2,812 b/
Financing	5,366	3,874	1,836	2,547	3,139	2,812 b/
Foreign Financing (net)	2,764	1,001	1,011	530	628	163
Drawings (gross)	3,498	2,022	2,224	1,400	2,115	1,456 b/
Repayments	-734	-1,021	-1,213	-869	-1,487	-1,293
Domestic Financing (net)	2,602	2,874	824	2,016	2,511	2,649
Non-bank Domestic	1,028	1,343	922	1,528	1,865	1,434
Bank and CSFC	1,574	1,530	-98	488	646	1,215
Memorandum Item:						
Overall Deficit to GDP at Market Prices d/	-9.5%	-6.7%	-3.1%	-4.2%	-5.0%	-4.3% b/

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

b/ Printed Budget Estimate. Deficit may fall to 2812m. KSh. or 4.1% of GDP if foreign grants rise to 1207m. KSh. and recurrent expenditures are reduced to 13369m. KSh. (in constant terms).

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: Government of Kenya, Ministry of Finance and Planning, July 4, 1985.

Table 6
Kenya: Monetary Indicators, 1980-85
(Millions of Kenya Shillings)

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
June 1985	24,718	133	27,591	10,019	17,705	64.2%	19.4

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

Source: Central Bank of Kenya. Economic and Financial Review, Vol. XVII, No. IV, April - June, 1985.

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benefit. 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 64 percent of total credit by June 1985. Nevertheless, this was still 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.)

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 several years, slower growth in the monetary aggregates has contributed to the process as well. In addition, there were devaluations of 5.1 percent in February 1981, 17.7 percent in September 1981, and two devaluations totaling 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 6 additional devaluations: 2.5 percent in July 1983; 2.6 percent in May 1974; 7.5 percent in March 1985; 0.5 percent in April 1985; 1.1 percent in June 1985; and 3.7 percent in August 1985. By the end of August 1985, the real effective exchange rate was once again at the IMF target set in December 1982.

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. The Government of Kenya 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 $2.6 billion during 1980-85. 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 30 percent in 1985. This level is expected to decline to 24 percent by 1989 as amortization of certain high-cost external loans is completed, despite the fact that two additional large scale borrowings at commercial rates have been negotiated for 1986 and 1987.

b. Merchandise Trade

The volume of Kenyan merchandise exports during the period 1980-84 has fallen by nearly 13 percent, and the overall terms of trade have fallen by 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. Long-term trends in import volumes are as clear, and as negative, as those for export volumes. The volume of Kenyan imports in 1984 was some 23 percent <u>lower</u> 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.

Despite such negative factors, Kenya'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). (See Table 7.) The trade deficit is expected to rise slowly from its 1983 low point to $622 million in 1986 (9.1 percent of GDP) and to a peak of $642 million in 1987 (8.6 percent of GDP). Kenya's import bill will be increased in 1986 by the purchase of two aircraft at a cost of some $135 million, and again in 1987 by the purchase of naval patrol boats at a cost of some $100 million. Thereafter, the merchandise trade deficit is expected to fall to $609 million in 1988 (7.2 percent of GDP) and to $623 million in 1989 (6.8 percent of GDP). Achievement of such targets will require avoidance of further extraordinary government imports of the types expected in CY 1986-87, and export growth averaging 5 percent in volume terms and 10 percent in value terms between 1985 and 1990. Recent data provide some early evidence of improvement in the competitiveness of Kenyan exports. Export volume in 1985 is estimated to have expanded by some 6 percent, with non-traditional exports expanding by some 16 percent in SDR terms (following a 12 percent increase in SDR terms for non-traditional exports in 1984 as well).

Table 7
Kenya: Current Account and Trade Balances, 1980-89

	Trade Balance		Current Account Balance	
	m. U.S. $	% of GDP	m. U.S. $	% of GDP
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	-565	-9.3%	-273	-4.5%
1986	-622	-9.1%	-376	-5.5%
1987	-642	-8.6%	-367	-4.9%
1988	-609	-7.2%	-311	-3.7%
1989	-623	-6.8%	-284	-3.1%

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

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 in 1.8 percent of GDP).

In response to the recent drought, however, 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 $273 million in 1985. The small surplus of $46 million in the basic balance of payments in 1984 was eliminated, and an overall basic balance of payments deficit of $99 million is expected in 1985. With the drought behind it, the Government of Kenya is now seeking to produce basic balance of payments surpluses throughout the period 1986-89. Such surpluses, however, will be offset by the need to begin substantial net repayments to the IMF, 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 1987-89 amounts to an estimated $152 million. (See Table 8.) The proposed $83 million of ESF Agreement would provide Kenya with balance of payments support equivalent to one-half of the required additional financing which must be found for CY 1987-89, providing substantial U.S. support for continued

Table 8
Kenya: Balance of Payments Projections, 1984-89
(Millions of U.S. Dollars a/, b/)

	1984	1985	1986	1987	1988	1989
Exports, f.o.b.	1,034	966	1,080	1,168	1,279	1,410
Imports, c.i.f.	-1,549	-1,532	-1,702 c/	-1,810 d/	-1,888	-2,033
Trade Balance	-515	-565	-622	-642	-609	-623
Services (net)	189	165	162	185	199	230
Private Transfers	4	4	4	4	5	5
Official Transfers	144	124	80	86	94	104
Current Account	-178	-273	-376	-367	-311	-284
Long-Term Private (net)	91	119	125	130	142	150
Long-Term Official (net)	163	38	217 e/	234 f/	154	174
Short-Term (net)	-30	17	59	50	50	50
Capital Account	224	174	401	414	346	374
Overall Balance	46	-99	25	47	35	90
Financing	-46	99	-25	-47	-35	-90
Increase in Reserves (-)	-38	57	15	-15	-24	-35
IMF (net)	-11	42	-90	-84	-72	-94
Other Assets (net)	3	-1	-	-	-	-
Required Financing	-	-	50	52	61	39
Memorandum Items:						
Gross Reserves (end of period)	426	353	343	358	385	420
Gross Reserves (months of imports)	3.3	2.8	2.6	2.5	2.4	2.5
Current Account Deficit (percent of GDP)	3.0%	4.5%	5.5%	4.9%	3.7%	3.1%

Notes: a/ Totals may not add due to rounding and exchange conversion.
b/ Exchange rate in SDRs per U.S. dollar: 1984 = .97560; 1985 = 1.01518 (first seven months only); 1986-89 = 1.0000 (assumed).
c/ Includes imports of two aircraft valued at some $135 million.
d/ Includes imports of naval patrol boats valued at some $100 million.
e/ Includes a loan of some $105 million to finance two aircraft.
f/ Includes a loan of some $85 million to finance naval patrol boats.

Source: Balance of Payments data. IMF, Staff Report for the 1985 Article IV Consultation, September 13, 1985.
Exchange rate data. IMF, International Financial Statistics, September, 1985.

Table 9
Nairobi: Consumer Price Index, All Goods, 1976-85

Year	Income Group High	Med	Low	CPI Weighted Average a/b/	Consumer Price Inflation c/
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%
1985 d/	341.0	347.0	366.7	343.0	11.1%

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)-1), where Xt is the value of the CPI weighted average index in year t.
d/ Estimate based on proportional change in CPI for first 6 months of 1985.

Source: Economic Survey, Annual, 1977-1985.
Central Bank of Kenya, Economic and Financial Review, April - June, 1985.

improvements in macroeconomic management and further structural adjustment in Kenya.

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 11.1 percent in 1985 (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.

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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 a number of areas as outlined below.

Balance Between Public and Private Sectors:

- maintenance of limitations on the overall share of Government in GDP;
- maintenance of limitations on the government budget deficit to eliminate crowding out of the private sector in domestic credit markets;
- increased user-financing of basic social services;
- improved project ranking and reduction of project proliferation;
- improved donor coordination and budgeting of donor projects;
- improved deposit, monitoring, programming, budgeting, and tracking of counterpart generations;
- improved integration of development planning, the forward budget, the budget estimates, the revised budget, and the appropriations accounts (budget audit);
- reduced role of parastatals in directly productive activities, including additional divestiture;
- reduced transfers of budgetary resources to parastatals;
- improved monitoring of public enterprises, including monitoring of parastatal debt repayment to the Treasury.

External Balance:

- more aggressive use of the exchange rate to expand exports and reduce the need for administrative control of imports;
- reduced and more uniform tariff rates;
- elimination of export licensing;
- implementation of export insurance and manufacturing in bond;
- implementation of plans for improved regional trade.

Family Planning:

- increased budget support;
- improved organization at national levels;
- improved and expanded organization at district and local levels;
- increased role for PVO's and the private sector.

Private Sector:

- reduction of administrative controls on investment;
- reduction of price controls and encouragement of competition;
- review of taxation and financial incentives;
- stabilization and development of financial institutions and markets;
- development of sources for equity capital and term-credit;
- maintenance of real positive interest rates and development of a more competitive system for setting interest rates.

Agricultural Marketing:

- reduced price controls and liberalized marketing for agricultural outputs, including maize;
- reduced price controls and liberalized marketing of agricultural inputs, including fertilizer;
- consolidation and strengthening of agricultural research;
- improved management of agricultural extension.

The current status of policy change and structural adjustment 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 more than 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 government programs to improve management systems in the Ministry of Finance and in the Ministry of Planning and National Development.

Still required, however, are major improvements in setting project priorities, and in the integration of Development Plan objectives with the realities of the Forward Budget process. Linkages between the Forward Budget 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 overall government demands on Kenya's limited available resources. Increased user-financing of a variety of social services can also contribute to this goal. 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 government structural adjustment actions. To date transfers of budget resources have been reduced, monitoring of public enterprises has been somewhat improved, and the Government Task Force on Divestiture has completed the initial stage of its work. In recent months, the first of the divestitures recommended by the Task Force (the Kenya Fisheries) has taken place, with government agreement on divestiture of a second (the Kenya National Transport Company). More recently the Government of Kenya has also established a new Office of Auditor General for Parastatals.

b. External Balance

An important determinant of balance in the external accounts has been the adoption by the Government of Kenya of a more active exchange rate policy. Devaluation of the Shilling against the SDR by 73.4 percent between February 1981 and August 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 two years 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 also improved. Nevertheless, significantly more attention must be given now to reordering government 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

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.

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. Following several devaluations in 1985, consumer price increases have accelerated so that rates to some savers have turned marginally negative in 1985, although rates to borrowers remain positive in all cases.

Table 11
Kenya: Trends in Selected Interest Rates, 1981-85

	Year	Nominal Interest a/	Consumer Price Index b/	Real Interest Rate c/
Commercial Banks 1 Year Time Deposit d/	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
	1985 e/	12.00	11.1	0.8
Commercial Bank Savings Deposits d/	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
	1985 e/	11.00	11.1	-0.1
Commercial Bank Loans and Advances d/	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
	1985 e/	14.00	11.1	2.6
Hire Purchase and Merchant Bank Deposits d/	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
	1985 e/	14.50	11.1	3.1
Hire Purchase and Merchant Bank Loans d/	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
	1985 e/	19.00	11.1	7.1

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 based on proportional change in CPI for first 6 months of 1985.
e/ Estimate.

Sources: Central Bank of Kenya: Economic and Financial Review, April - June, 1984.

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Although growth in the monetary aggregates has slowed, and credit policies have been tight, the Government of Kenya 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 64 percent in June 1985 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, the Government of Kenya 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 and recently submitted to the Cabinet 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, the Government of Kenya 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 by the Technical Assistance Pool, the Government of Kenya has again raised internal producer prices for maize and wheat, the major food grains. The affects on rural welfare of price increases for outputs have been more than offset by increases in the prices of purchased inputs and consumer goods, 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 the Government of Kenya has committed itself, would be an important first step toward improving returns to employment in agriculture. With the drought behind it, the Government of Kenya is slowly beginning to turn its attention to ways of introducing increased private sector participation in grain marketing. As one example, USAID was successful in obtaining government concurrence in limited private sector marketing of PL 480 wheat in FY 1985, and expects to negotiate expanded private sector marketing of PL 480 wheat in FY 1986. 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 important to the rural incentive structure, to the successful utilization of agricultural research, and to the expansion of private investment in input delivery, in processing, and in trade.

III. Previous U.S. Program Assistance

A. Balance of Payments Assistance

1. Cash Grant and Private Sector Commodity Import Program (615-0213).

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 Commodity Import Program (CIP) under the FY 1984 ESF Agreement ($15 million) and under the FY 1985 ESF Agreement ($13 million).

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 government account at the Central Bank of Kenya. The Central Bank of Kenya then credited the government 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 Government of Kenya 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 a 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) and under the 1985 ESF Agreement. In September 1985 a list of Kenyan importers was sent to A.I.D. Washington by the CIP office for publication in order to meet the advertising requirements of A.I.D. Regulation 1. It is anticipated that the revised list will be published soon.

By late April 1985 the Government of Kenya 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 Government of Kenya 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 Government ($1 million each) were issued by FM/PAFD on August 6, 1985.

By the end of CY 1985, thirty-eight applications with a value of more than $1.75 million had been received and approved by the CIP office. All of these applications had been returned to the importers concerned with a letter of no objection, and with instructions to submit the applications to the Central Bank of Kenya. Almost all have now been submitted to the Central Bank, and have been returned to the CIP office with the applications approved. However, thirteen are still waiting for Import License Application approval.

Most of the applications were processed within the covenanted three weeks. Only one of the applications was rejected, and that was because the desired product was produced locally. We can expect some applications to continue to be rejected to protect local manufacturers.

The initially slow government 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.

The first letter of credit was opened in November 1985, and the first shipment was made in December. The first arrival in Kenya of CIP goods was frozen bull semen which arrived by air in December. The United States Information Service (USIS) has prepared a press release on this first arrival which should spark additional interest in the program. Also, the cooperating local banks have expressed an interest in giving more publicity to the CIP now that Letters of Commitment and letters of credit have actually been opened. A few larger transactions are presently being negotiated or are under active consideration, including equipment for a $1.6 million caustic soda plant, a $250,000 tallow procurement every other month, and a $350,000 commercial explosives procurement.

With a working CIP system in place, letters were sent in early January 1986 to each of the 1,200 importers who have expressed an interest in importing goods from the U.S. It is expected that this publicity will result in applications reaching the desired $1.5 million per month level. However, if that is not the case by March, the ninety-day interest-free period before the counterpart funds are required to be deposited will be increased which should result in the expected level of applications.

The $13 million of FY 1985 CIP funds cannot yet be utilized because the conditions precedent have not yet been met.

2. Agricultural Development Program (615-0228, 615-0230, and 615-0213).

The Agricultural Development Program, has for the past two years, been implementing a system to expand private sector fertilizer distribution in Kenya. The privatization effort began with the FY 1982 Agricultural Sector Grant (615-0228). Some 7,000 tons of the 14,000 tons of fertilizer imported under the program were sold directly to the private sector. In the two years that have elapsed since this effort began, USAID/Kenya has made a significant impact on improving fertilizer distribution in Kenya and on expanding donor coordination in this key area. (See Annex C for details.)

Prior to 1983, the fertilizer sector was in disarray, characterized by insufficient amounts of fertilizers arriving too late due to poor planning, and limited fertilizer distribution controlled by three major firms, the largest being the government controlled Kenya Farmers Association (now the Kenya Grain Growers Cooperative Union). The other two were private importers which sold fertilizer mainly to large estates or other distributors. USAID, through the Agricultural Development Program, has improved the operation of the sector by requiring the Government of Kenya to produce a fertilizer import plan, announce timely retail prices, focus on the deficiencies of the current pricing system, expand distribution through a number of private sector firms, and require payment under bank guarantees. Payment under bank guarantees assures the Government of Kenya that Shilling generations are available for use within 180 days of fertilizer sale to the private sector.

USAID/Kenya is pleased with the progress made by the Government of Kenya in expanding the opportunities for private sector fertilizer importers and distributors in Kenya. A total of 16 private sector firms participated in the distribution of the 21,000 tons of A.I.D.-financed diammonium phosphate (DAP) imported in March/April 1985 under project 615-0230. The balance available under this project, some 28,000 tons of DAP, was imported during November and December,

1985. Forty private firms requested allocations totaling 245,000 tons against the 28,500 tons which were available--an indication of the current level of private sector interest and effective demand. Table 12 indicates the source, amount, import period, and tonnage by types of fertilizer financed by USAID in Kenya since 1983.

Table 12
Kenya: Value of A.I.D.-Financed Fertilizer Imports, 1983-86

Program	$ Amount	Import Period	Tons Imported	Fertilizer Type
DA Grant (615-0228)	$4.4 million	Dec'83	14,000	DAP 9,000 MAP 5,000
DA Loan (615-0230)	$13 million	Mar-Apr'85 Nov-Dec'85	21,000 28,500	DAP 49,500
ESF Grant (615-0213)	$12 million	Mar-Dec'86	45,000	DAP 45,000

Although, increased participation of the private sector in fertilizer importation and distribution is recognized as a necessary first step it is also recognized that privatization alone will not achieve the larger objectives of increased fertilizer availability and use by small farmers. The current market situation is one in which the demand for inorganic fertilizers greatly exceeds availability. In this context, the larger farmer who generally has better technical and market information, transportation to the major market centers, and has a better liquidity position has a comparative advantage with regard to the purchase of fertilizer inputs. Given these market conditions the distribution system needs to be better integrated and more highly disciplined, and requires more fertilizer in order to increase the availability and use by small farmers. Steps to implement this strategy were incorporated in the FY 1985 Structural Adjustment Program Amendment (615-0213) which provided an additional $12 million that will cover the cost and shipping of approximately 45,000 MT of DAP for importation during the period March-December, 1986.

B. Technical Assistance

The technical assistance support provided under Program 615-0213 enhanced the Government of Kenya's ability to analyze and implement development policy. The analyses provided by numerous long and short-term consultants gave life

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to the Mission's policy dialogue generally, to the innumerable steps required of a national structural adjustment process, and to the specific requirements of the conditions and convenants of each of the annual grants under program 615-0213. The consultancy portion of the ESF assistance package came at a time, in the mid 1980s, when a broader group of Government of Kenya policy makers began to realize that macroeconomic stability had to be translated into economic reforms to rekindle a high rate of economic growth. Although the individual steps in this broad process may appear small, and delays and retreats are inevitable, overall progress is evident for reasons cited below.

The total budget for consultancies was $8 million, reflecting commitments of $2 million under the FY 1983 grant and $6 million under the FY 1984 grant. No additional funds were needed or requested under the FY 1985 grant. As of the end of CY 1985, $5.9 million of the $8 million total have been committed.

The technical assistance budget was broken down into the following basic purposes (by amount): agricultural policy and planning ($3,900,000); macroeconomic policy and planning ($1,750,000); studies ($1,250,000); microcomputers ($650,000); evaluation ($150,000); and CIP monitoring ($300,000).

During the FY 1983-85 period the Mission sought, it believes successfully, to ensure that policy dialogue would become an integral part of A.I.D.'s business--across the broad spectrum of its program-project portfolio. Technical assistance under ESF has supported Government of Kenya and A.I.D. policy initiatives, and served as a model for dialogue and policy implementation in related areas such as agricultural and private sector policy, and for fertilizer and grain import privatization.

The ultimate goal of all of these parallel and coordinated "discussions" with the Government of Kenya has been greater government efficiency and enhanced private sector growth. A.I.D. did not close the door during this period to any public or private sector process that promised to contribute to structural adjustment. New areas that proved to be fruitful, in retrospect, included financial market strengthening and development, investment promotion, and the wide use of microcomputers. It is also evident that policy dialogue is a mid to long-term process, made up of innumerable conversations, consultancies and negotiations, and that "progress" often rears its lonely head when least expected.

The bulk of the funds utilized during these first years supported three relatively large policy-oriented efforts with the Ministry of Finance and Planning, and with the Ministry of Agriculture and Livestock Development. Policy advice and associated training and institutional strengthening were offered through a Technical Assistance Pool to the Ministry of Agriculture and Livestock; through a new Resource Management for Rural Development unit, and through technical implementation of improved import administration. In addition A.I.D. reached agreement on assistance to the Central Bank and strengthened support for budgetary and donor coordination within the Ministry of Finance.

The Government of Kenya's import licensing procedures have been greatly improved with U.S. Bureau of Census advisers. This assistance, admittedly coupled with an improved foreign exchange reserve position, has speeded processing, and furthered some degree of decontrol of the import regime itself.

Other areas of progress, albeit belated, have been parastatal divestiture and price decontrol. The extent to which the ESF consultancies and training contributed to the actual decision process is not known. Nonetheless by mid-1985, two years after initial discussions, the Government of Kenya has started the divestiture process, and President Moi recently announced governmental commitment to some price decontrol.

A.I.D.'s priority on the private sector has been given an early and sustained boost under ESF, which is lending a strong policy orientation to the FY 1987 project, Private Enterprise Development. Contributing studies included investment and export promotion, effective rates of protection, and price decontrol. The very tentative conclusion of the effective rates of protection study, invaluable in its own right as a guide to industrial policy, is that the overall level of protection (and therefore degree of major industrial inefficiency) is less than had been expected--another sign that Government may not have as far to go as previously thought to rationalize national investment priorities.

Another area where an early investment in a consultancy has contributed to a demonstrated pay off is support for the Central Bank. Two areas are noteworthy: a strengthening of the Bank's ability to ensure financial discipline among the private sector banking community, and the establishment in December 1985 of a deposit insurance scheme. Both steps are important underpinnings to a strong private sector.

Microcomputer usage has been the primary technological revolution of the ESF grant. The speed of their introduction; the enthusiasm of support staff; and the extensive utilization for budgets of all kinds (leading to the meeting of deadlines for the first time) have all been gratifying. None of the microcomputers have been supplied on an equipment basis alone, but have been financed as problem solving packages with consultants and training, thereby explaining the apparent large allocation of $650,000 for this one activity. It remains for A.I.D. to continue to press the Government of Kenya to use its micros, as well as its consultants, to move from procedural improvements to analyses and other steps underpinning the reform process.

During 1985 A.I.D. financed a major evaluation of its ESF program by an outside team headed by Dr. Elliott Berg. The team's report focused on the ESF-supported policy dialogue and related conditions and covenants, and offered recommendations in several areas, but only made passing reference to the Mission's use of consultancies. Ironically, an earlier audit of 615-0213 did not cover these consultancies either. Accordingly, the Mission has scheduled an evaluation of this facet of ESF for early CY 1987.

C. Conditions and Covenants

Conditionality under the FY 1983-85 ESF Agreements has been complex, reflecting nearly the full range of policy dialogue considerations outlined in the 1983 PAAD (p. 35). Kenyan 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 1983-85 Program Grant Agreements contained eighteen conditions precedent related to policy reform, and fifteen policy-related covenants. 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.

1. Improved Analysis, Planning, Budgeting, and Financial Management in the Ministry of Finance and Planning (Including Donor Projects)

The Government of Kenya has successfully met all IMF and A.I.D. budget and credit targets for 1983, 1984, and 1985. The nearly routine manner with which such targets are now met suggests that substantial institutionalization of

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improved budgeting processes has already occurred. In particular, the Government of Kenya formally met A.I.D.'s FY 1983 condition precedent to review new projects in accordance with an investment plan and an external borrowing plan. Additional covenants to continue with refinement of the budgeting process were included in A.I.D.'s FY 1983 and FY 1984 ESF Agreements, and significant progress has been made, particularly with regard to computerization of major budget, debt reporting, and donor coordination functions. The FY 1985 Agreement included two additional convenants designed to encourage formal budget review of all donor projects, and development of a new system for deposit and use of local currencies generated from donor program assistance. Both are scheduled for implementation during the first quarter of CY 1986. The Berg Evaluation of Project 615-0213 concluded that the area of institutional or administrative reform is not basically well-suited for conditionality. 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. 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.

2. Improved Functioning of External Markets

Under the FY 1983-85 ESF Agreements, A.I.D. conditionality related to the reform of external markets centered on import liberalization, tariff reform, export promotion, and improved exchange rate flexibility.

The Berg Evaluation (p. 76) 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 Government of Kenya in its letter to A.I.D. 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 Government of Kenya 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. The Government of Kenya has committed itself under the FY 1985 Agreement to transfer additional such items in June 1986.

A.I.D. 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 Berg Evaluation (p. 75) 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.

On the export side, both the FY 1983 and the FY 1984 ESF Agreements contained some conditionality. The FY 1983 Agreement contained a condition precedent requiring submission of evidence to A.I.D. regarding export promotion and the simplification of export documentation. The Government of Kenya met the A.I.D. requirement prior to June 30, 1983 submitting to A.I.D. 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 Government of Kenya 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 six devaluations of the Kenya Shilling against the SDR since the FY 1983 Agreement was signed. 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 Government of Kenya has computerized 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, but it is unclear whether sufficient financial and administrative resources can be devoted to the Scheme to make a real difference in export volume.

3. Improved Functioning of Agricultural Input Markets

A.I.D. has sought to improve the functioning of agricultural input markets by encouraging the Government of Kenya to include most agricultural inputs on the less restrictive Import Schedule IA. In addition, A.I.D. 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 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. Efficiencies have resulted in the deposit 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). Expanded private sector marketing, improved pricing, and reduced government control are proceeding rapidly under additional FY 1984 and FY 1985 conditionality.

4. Improved Functioning of Agricultural Output Markets

A condition precedent to the FY 1983 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 government review of the large scale Bookers Study on grain marketing, (which included a review of the role of the National Cereals and Produce Board). With the drought behind it, the Government of Kenya is beginning to move toward implementation of increased private sector marketing, including initial private sector marketing of FY 1985 PL 480 wheat.

5. Improved Implementation of Family Planning Policies and Programs

Under a condition precedent to the FY 1984 Agreement, the Government of Kenya 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. More recently under the FY 1985 Agreement, the Government of Kenya has covenanted to earmark $5 million of ESF counterpart funds in support of family planning activities.

6. 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, and has completed its initial work. The first of the divestitures recommended by the Task Force (the Kenya Fishing Industries), has now been carried out, and agreement on a second divestiture (the Kenya National Transport Company) has been reached.

Under the FY 1984 ESF Agreement, the Government of Kenya covenanted to include the development budgets for all 25 major parastatal bodies "parallel with" the Budget Estimates for 1985/86. The Government of Kenya was able to complete a review of the financial plans for 5 or 6 of the major parastatals by June 1985. More recently under the FY 1985 Agreement, Government has agreed to establish and staff an Office of the Auditor General for parastatals by March 30, 1986 in order to improve financial accountability of major parastatals.

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

The Government of Kenya 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, and these have now been submitted to the Cabinet for approval.

As a condition precedent to the FY 1984 and 1985 ESF Agreements, the Government of Kenya has agreed to utilize $10 million equivalent of counterpart Shillings derived from the FY 1984-85 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 CIP due to initial government implementation delays.

D. Local Currency Deposit, Programming, and Use

Previous U.S. program assistance agreements for FY 1983-85 call for deposits of Shilling counterpart generations into special accounts, generally with the Treasury's Paymaster General Account in the Central Bank of Kenya. In one case, the 1984 Agricultural Development Program (615-0230), the agreement calls for equivalent deposits of $13 million to be made to an interest bearing commercial bank account. In all cases, the Government of Kenya was expected to automatically deposit these funds and to periodically report on the status of the funds.

The only programs which have thus far generated local currency have been the FY 1982 Agricultural Development Program (615-0228), the FY 1983 Cash Grant (615-0213) and the FY 1984 Agricultural Development Program (615-0230). All of the local currencies from the FY 1982 Agricultural Development Program, and all of the local currencies from the FY 1983 Cash Grant have been deposited and programmed. In addition, as of September 30, 1985, approximately $6.4 million equivalent Kenya Shillings have been generated under the FY 1984 Agricultural Development Loan, with the remainder to be generated early in CY 1986.

The first generations under the FY 1984 Commodity Import Program (615-0213) are expected in early CY 1986 based on issuances of import licenses to date. Deposits are due under this program 90 days following disbursements for commodities by A.I.D. Washington. Estimated generations under this program for CY 1986 are approximately $8 million equivalent Shillings.

All Shilling generations from the FY 1985 Agricultural Development Program (615-0213) are expected in CY 1986, while the FY 1985 Commodity Import Program (615-0213) is not expected to generate local currency until CY 1987.

In July 1985, USAID Kenya adopted a new uniform Accounting and Control System for Local Currency Counterpart Funds. Under this system, the USAID Controller makes specific requests for deposits to special accounts and regularly follows up to ensure timely deposits and accountability. This system also calls for copies of deposit slips to be forwarded to USAID in addition to regular reports and/or bank statements.

The mechanism for programming local currency counterpart generations has traditionally been through an exchange of letters by which uses have been attributed to government budget line items. This methodology was used for the 1983 cash grant, and $17.1 equivalent Shillings were programmed for rural development and $10.9 million for agricultural development.

Under the new system, programming of counterpart is accomplished via bilaterally approved commitment agreements, which describe the project activities to be funded including objectives, outputs, implementing agency, and fiscal data. Thus far, none of the $6.4 million generated under the Agriculture Development Loan has been "committed," although the Mission expects this to be done within the next few months based on recent meetings with the Ministry of Finance. See Table 13 for the agreed uses of counterpart generations under previous program assistance agreements.

Table 13
Kenya: Agreed Counterpart Uses; U.S. Program Assistance, FY 1983-85

Agreement No	Program Description	Uses	Amoun ($Millio
615-0228	82 Agricultural Dev. Prog.	Water Development	4.4
615-0213	83 Cash Grant	Rural Development	17.1
		Agricultural Development	10.9
		Subtotal	28.0
615-0213	84 Commodity Import Prog.	Non Governmental Organizations	5.0
		Mutually Agreed Developmental Purposes	10.0
		Subtotal	15.0
615-0230	84 Agricultural Dev. Prog.	Agriculture, Health, Nutrition, Family Planning, Education, Social Services, Water Development, Environmental and Natural Resources	13.0
615-0213	85 Commodity Import Prog.	Family Planning	5.0
		Private Sector: Agriculture, Housing Export Promotion	5.0
		Subtotal	10.0
615-0213	85 Agricultural Dev. Prog.	Mutually Agreed Purposes	15.0
		Total	85.4

Note: *Programming completed.

IV. The FY 1986-88 Structural Adjustment Assistance Program (615-0240)

A. Balance of Payments Support

1. Basic Market Analysis

The strength of the dollar in recent years has somewhat limited the demand for U.S. imports in Kenya. In addition, the desirability of maximizing the development impact of Commodity Import Programs in keeping with Section 801 of the International Security and Development Cooperation Act of 1985 suggests the need for a two-track approach to providing balance of payments assistance to Kenya during U.S. FY 1986-88. The proposed FY 1986-88 Structural Adjustment Assistance Program, therefore, includes both a $40 million Fertilizer Market Development Program and a $28 million private sector Commodity Import Program. (In addition a $6 million technical assistance component in support of structural adjustment is also proposed. See Section IV.B. below.) Based on current Kenyan requirements, up to $20 million of the proposed FY 1986 funding of $25 million will be reserved to finance imports of U.S. fertilizers, with $3 million reserved for general private sector commodity imports, and $2 million reserved for technical assistance. Success of the Fertilizer Market Development Program, and additional experience gained with the general Commodity Import Program in CY 1986, will be utilized to determine the relative shares of fertilizer and general commodity imports in overall U.S. balance of payments assistance each year during FY 1987 and FY 1988.

It should be noted that the volume of Kenyan commercial imports from all countries was compressed by 40 percent during the period 1980-84, with the overall value (expressed in U.S. dollars) falling by 42 percent from $2.6 billion in 1980 to $1.5 billion in 1984. (See Table 14.) Moreover, the U.S. share of Kenyan imports has fallen from 6.4 percent of the total in 1980 to 4.6 percent of the total in 1984. The total value of Kenyan imports from the U.S. has, therefore, fallen from $163 million in 1980 to $70.6 million in 1984. Such changes represent the compound effect of the dollar's appreciation versus most major currencies (making dollar-denominated goods appear relatively more expensive to Kenyan importers) and the continuing devaluation of the Shilling against the SDR.

In 1980 Kenya imported 33 different Standard Industrial Trade Classification (SITC) categories of U.S. goods each valued at more than one million U.S. dollars. By 1984, this list of major SITC categories had shrunk to twelve. Seven of the twelve major SITC import categories in 1984 were manufactures (including hydrocarbons, insecticides, fungicides, excavators, machine parts, large trucks, and lubricating oil). The remaining five categories were agricultural (including rice, wheat, non-fat dry milk, tallow, and soyabean oil). Most of the rice, wheat, and milk products are already being funded under existing concessional U.S. programs.

Table 14
Kenya: Value of Major Imports from the United States, 1980-84

Article SITC	Shortened Description	Value (U.S. $1,000,000) 1980	1981	1982	1983	1984
022 429	Non-Fat Milk	2.1	3.0	2.0	3.2	1.4
041 100	Durham Wheat	9.2	1.0	2.9	9.2	0.0
041 200	Other Wheat	2.7	0.0	10.4	4.1	3.4
042 210	Rice	0.6	2.7	2.6	4.4	7.9
044 000	Maize	18.5	10.7	4.4	0.0	0.0
045 990	Other Grains	0.0	2.3	1.7	1.1	0.2
334 211	Jet Fuel	1.9	0.0	0.0	0.0	0.0
334 302	Gas Oil	1.9	0.0	0.0	0.0	0.0
334 511	Lubricating Oil	2.1	0.0	2.3	3.2	0.0
411 321	Tallow	1.0	1.5	2.6	1.2	1.2
423 202	Soya Bean Oil	0.5	2.5	1.2	1.8	1.2
511 110	Ethylene	0.1	1.0	0.1	0.1	0.1
511 290	Other Cyclic H.C.	4.0	1.8	1.1	3.0	3.2
562 190	Other Fertilizer (N)	4.0	0.0	0.0	0.0	0.0
562 223	TSP	0.0	7.4*	0.0	0.0	0.0
562 290	Other Phosphates	0.0	1.4	0.0	1.8	0.0
562 920	Fertilizer (N+P)	0.0	1.9	2.0	0.7	0.0
562 991	Ammonium Phosphate	2.0	12.6*	0.0	4.4*	0.0
582 310	Alkyds/Polyesters	1.4	0.2	0.0	0.0	0.0
582 901	Other Polyesters	1.0	0.1	0.0	0.0	0.0
583 110	Polyestyrene	1.1	0.2	0.0	0.3	0.0
591 102	Insecticides	3.9	4.3	2.6	3.5	2.9
591 200	Fungicides	6.4	1.8	1.6	3.8	2.7
598 209	Other Oils	3.6	1.7	0.5	1.0	1.2
621 010	Rubber (Plates, Sheets)	1.1	1.0	0.5	0.3	0.2
653 140	Tire Cord (cont.)	0.0	1.2	0.0	0.0	0.0
653 540	Tire Cord (non-cont.)	1.5	2.5	1.9	0.3	0.2
674 700	Tinned Steel	1.0	0.6	0.0	0.0	0.0
713 110	Aircraft Engines	3.1	0.3	0.0	0.0	0.7
722 400	Wheeled Tractors	1.8	0.7	0.4	0.2	0.7
723 410	Bulldozers	2.0	0.9	0.0	0.1	0.7
723 420	Mech. Shovels, Excavators	1.9	0.2	0.0	0.0	2.5
723 900	Machine Parts	1.8	1.8	1.3	0.6	2.5
724 410	Textile Machinery	4.2	0.0	0.0	0.0	0.0
743 109	Indus. Pumps, Comps.	1.0	0.1	0.0	0.2	0.1
745 221	Indus. Machinery	1.1	0.0	0.0	0.0	0.0
749 200	Auto Parts	0.0	1.2	0.8	0.3	0.6
749 910	Parts (elec., tel.)	0.1	1.0	0.1	0.4	0.0
782 102	Trucks (3t. plus)	1.0	2.3	0.0	0.0	4.0
782 109	Other Vehicles	3.1	0.0	0.0	0.0	0.0
784 900	Auto Parts (spec.)	0.0	1.1	0.5	0.4	0.5
792 100	Helicopters	12.3	14.7	0.0	0.0	0.0
792 300	Aircraft (spec.)	0.1	2.0	0.2	0.3	0.2
792 901	Aircraft Parts	4.4	6.8	1.7	0.4	1.0
793 820	Floating Docks, Dredges, etc	0.0	0.0	18.0	0.0	0.0
Total Imports from U.S.		163.0	140.7	99.5	85.1	70.6
Total from All Countries		2584.9	2061.1	1648.6	1360.7	1519.0
Share from U.S.		6.3%	6.8%	6.0%	6.3%	4.6%

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Kenya: Value of Major Imports from the United States, 1980-84 (cont)

Notes: Major Imports defined as those exceeding 1 million U.S. dollars for a given 6-digit SITC category in any year 1980-84.

*Denotes current USAID/Kenya/AGR data which may differ from Government of Kenya statistics due to rounding, exchange rate difference, or misclassification at port.

Exchange rate: 1 U.S. dollar = KSh 7.4202 (1980); 9.0475 (1981); 10.922 (1982); 13.3115 (1983); 14.4139 (1984).

Source: Trade Data. Ministry of Finance, Customs and Excise Department. Special Exercises for USAID/Kenya, November 1982, May 1983, December 1985.

Exchange Rate Data. IMF, International Financial Statistics, Yearbook, 1985.

Kenyan fertilizer imports have averaged about 140,000 tons per year during 1980-84. The U.S. has been an important source of fertilizer, providing approximately one-fifth of fertilizer imported during this time. Of this total, USAID-financed fertilizers have accounted for about two-thirds of all U.S. source fertilizers. The USAID-financed component amounted to 11% of the volume and 14% of the value of total fertilizer imports for the first half of the decade.

Table 15
Kenya: Quantity and Value of Fertilizer Imports, 1980-1984

	1980	1981	1982	1983	1984
Total Quantity (metric tons)					
All Sources	129,672	206,667	129,608	150,677	74,336
U.S. Origin	15,200	69,564	14,209	19,819	0
Share U.S. Origin	11.7%	33.7%	11.0%	13.2%	-
USAID Financed	0	63,050	0	14,000	0
Share USAID Financed of U.S. Origin	-	90.6%	-	71.6%	-
Total Value (Millions of U.S. $)					
All Sources	40.8	53.2	28.6	37.7	19.2
U.S. Origin	6.1	21.5	2.0	6.6	0.0
Share U.S. Origin	15.0%	40.4%	7.0%	17.5%	-
USAID Financed	0.0	20.0	0.0	4.4	0.0
Share USAID Financed of U.S. Origin	-	93.0%	-	66.7%	-

Notes: Includes USAID, donor, and commercial fertilizer imports. Minor misclassifications of fertilizers may have occurred at port.

Sources: Ministry of Finance, Customs and Excise Department. Special exercises for USAID/Kenya, December 1985. USAID financed import information from AGR/USAID/Kenya.

The Kenyan capacity to import goods from abroad has been severely diminished over the past five years. It appears, therefore, that there will not be any difficulty in drawing down the amounts available under existing and proposed ESF programs if a two track approach is adopted incorporating both a Fertilizer Market Development Program and a private sector Commodity Import Program. Until major European and Asian currencies regain some additional strength versus the U.S. dollar, the Mission feels it is unwise to rely solely upon a Fertilizer Market Development Program, or solely upon a private sector Commodity Import Program to effectively disburse required levels of ESF assistance. Similarly, in the current circumstances, it appears equally unwise to utilize a narrow positive list of eligible items within the private sector Commodity Import Program, at least until greater experience is gained with disbursements under the FY 1984-85 CIP. The greatest development impact can be achieved by expanding Kenya's existing marketing channels for manufactured fertilizer, while providing the remainder of Kenya's private sector with improved broad access to imports of U.S. origin.

2. Private Sector Commodity Import Program (CIP)

Although U.S. exports to Kenya have declined in recent years due to a strengthened U.S. dollar, and due to Kenyan shortages of foreign exchange, $28 million worth of general commodities can reasonably be expected to be financed under the CIP over the next three years. The commodities to be imported would primarily consist of machinery, raw materials for manufacturing, spare parts, and inputs needed by the agricultural sector, including pumps and irrigation systems.

Overall responsibility for implementing the Kenyan side of the CIP rests with the Ministry of Finance. However, the success of the CIP depends greatly on the involvement of several Kenyan cooperating commercial banks which will open the letters of credit. The Kenyan cooperating banks will be provided with an incentive to participate, as they were under the CIP of the Structural Adjustment Program (615-0213). This incentive will remain an interest free period which will be between 90 and 180 days. Only after the interest free period is up will the cooperating banks be required to deposit the local currency into the special account. The Central Bank of Kenya's role is one that will differ little from its role in ordinary foreign exchange operations.

USAID/Kenya's role will generally be one of day to day program monitoring. A U.S. direct hire project officer with extensive CIP experience has been assigned responsibility for the CIP to assure attainment of the program's objectives and to safeguard A.I.D.'s interest and investment. The Mission will continue to review each import license application for commodity eligibility and evidence of competition, or evidence of a special supplier relationship. The review will be performed under the direct supervision of the A.I.D. direct hire project officer. The Mission has a personal services contract with a senior Kenyan procurement specialist who will continue to explain the CIP procedures to importers, and to assist in locating U.S. suppliers when possible. If the workload warrants it, another personal services contractor, either U.S. or Kenyan, will be engaged.

A U.S. firm will be hired on an hourly basis, utilizing the Program's technical assistance funds, in order to assist small Kenyan businesses to locate potential U.S. suppliers and to assist them in obtaining competitive quotations for their requirements. This is necessary because under the Structural Adjustment Program (615-0213) it was found that frequently U.S. suppliers would not respond to written or telexed inquiries from Kenyan businesses, and because it was frequently found to be difficult to locate several different U.S. suppliers to obtain competitive quotations. The required U.S. firm could be an 8A firm.

Price Waterhouse Associates, or a similar firm, will perform all arrival accounting and end-use accounting, and will verify deposits into the special account, as has been done under the Structural Adjustment Program (615-0213). The Mission will carefully review and take appropriate action on all reports submitted by the contract firm, i.e. reports on CIP-financed goods which have remained in the port for more than 60 and 90 days, reports on end-use accounting visits, and monthly reports on deposits into and withdrawals from the special account.

A.I.D. Washington's involvement will include issuance by FM of Letters of Commitment to the U.S. correspondent banks. SER/AAM will be involved in approving Form 11 applications and in reviewing payment documents for compliance with A.I.D. Regulation One. SER/AAM/CST will be responsible for performing post-payment audit of prices (including review of Form 282 and follow up with suppliers concerning claims for over-pricing, as required). SER/AAM/TRANS will monitor compliance with cargo preference and grant ad hoc transportation source waivers as needed. A.I.D.'s certifying office in New York will process disbursements to correspondent banks.

The CIP component of the proposed Program will generally be handled in the same manner as the CIP component of the Structural Adjustment Program (615-0213). 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. Instead, applications are being submitted directly to the Central Bank by the importers, and the CBK is forwarding them to the Ministry of Commerce. The applications then travel back to the Central Bank, and are delivered to the USAID CIP office where the Import License number and Foreign Exchange Allocation License numbers are entered into a computerized Commodity Tracking System.

To ensure timely implementation of the CIP, it will be necessary (as has been done under Program 615-0213) to delegate to the Mission Director authority to approve Commodity Procurement Instructions.

Further, as has been done for Program 615-0213, the following commodities which we expect to be imported will not be subject to prior review in A.I.D. Washington:

Schedule B. No.	Description
176.0320	Corn Oil
176.5220	Soybean Oil
177.5640	Inedible Tallow

The following commodities which are not normally eligible for A.I.D.-financing will be eligible for such financing under the CIP:

193.2500	Vegetable substances, crude, N.S.P.F.*
451.1500	Flavors and flavoring extracts, essences, esters and oils (A) Essential oil 911 SF (Fruit Blend) (B) Yellow essential oil (Fruit Blend) (C) Green essential oil (Peppermint Blend) (D) Pink essential oil (Spearmint Blend)

* Eligibility limited to Viscarin (Irish Moss).

Annex F to the FY 1984 Structural Adjustment Program (615-0213) PAAD provides a detailed explanation of government import licensing and controls, and of foreign exchange licensing and controls. That PAAD also provides (in Section IV.C.4) a detailed description of the customs and port entry records and accounts. These described organizations and systems differ little from those in place today.

There are approximately 4,000 registered importers in Kenya, although only about 1,500 are considered relatively active, and only 1,200 have evidenced a desire to import goods from the U.S. These numbers do not include government ministries and parastatals. In short there is a large, active, sophisticated import community in Kenya. Subsidiaries of several U.S. firms are active importers. About

250 U.S. exporters have local representatives. Asians of Indian or Pakistani origin play a significant part in most business activities in Kenya, including importing.

3. Fertilizer Market Development Program (FMDP)

a. Introduction and Program Rationale

Kenya's greatest development challenge is to increase agricultural production and agricultural exports with sufficient speed to meet the food security needs of its rapidly expanding population (4.1% per annum). During the 1960s, Kenya's agricultural growth rate averaged a substantial 4.6% per annum. Since 1972, however, annual agricultural growth has declined to 2%-3% per annum. The causes of this slowdown are many and complex. Factors which fueled agricultural growth in the 1960s, notably the expansion of cropped acreage, the introduction of hybrid maize, and the shift in smallholder production toward the higher value commodities of coffee, tea, and dairy products are no longer operative. At the same time, a more pervasive set of underlying causes for slower agricultural growth is rooted in the inability to develop an adequate framework of agricultural incentives, services, and institutions needed to encourage continuous investment and innovation.

The agricultural strategy which emerges is therefore two-fold. In the immediate to short-term the focus must be on both the development of an environment capable of providing the farm household with necessary inputs and incentives to intensify production per land unit. While in the longer term the focus must be on agricultural research and the development of productivity enhancing technologies.

Given the current state of agricultural technology in Kenya, increased utilization of fertilizers is considered to be one of, if not the, critical means to achieve increases in productivity. In 1982/83, the last year for which analysis is available, fertilizer use was estimated to be nearly 159,000 MT with 57% applied to large farms, and 43% applied to smallholder plots. (See Table 16.) Of the total nutrient use in 1982/83, 51% was nitrogen, 44% Phosphate, and 5% Potash. Major crops using nitrogen are coffee, tea, and sugar, while the cereals make up 60% of phosphate use.

A review of present versus optimal utilization rate shows that in 1982/83 nitrogen utilization was only 36% of the recommended levels. (See Table 17.) Similarly, phosphate utilization was only 35% of the recommended levels. (See Table 18.) It is especially noteworthy to review the figures for maize which show that, for

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areas other than Trans Nzoia and Uasin Gishu, utilization rates were consistently under 20% of the optimal recommendations. Such findings indicate that the potential benefits to increased fertilizer use are great. It is believed that Kenya's total fertilizer consumption is likely to increase to well over 300,000 MT by 1990/91. The expected annual cost to meet this demand is $88 million.

Table 16
Kenya: Estimates of Fertilizer Use by Crop and Farm Size for Financial Year July 1, 1982 - June 30, 1983

Crop	Estates	Large Farms	Smallholders	Total
Coffee	21,300	-	19,400	40,700
Maize	1,000	15,700	14,300	30,000
Tea	17,900	-	10,000	27,900
Sugar	12,700	-	13,800	26,500
Wheat	1,000	11,000	-	12,000
Barley	-	4.700	-	4,700
Other Horticultural Crops	[illegible],000	-	1,200	3,200
Tobacco	-	-	2,540	2,540
Potatoes	-	-	2,500	2,500
Rice	-	-	2,500	2,500
Sunflower & Rape	-	1,790	-	1,700
Pineapples	2,000	-	-	2,000
Irrigated Cotton	-	-	1,600	1,600
TOTAL	57,900	33,190	67,840	58,930
Percentage	36%	21%	43%	100%

Source: IBRD Kenya Agricultural Inputs Review (1985) Volume II, Table I, p. 19.

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Table 17
Kenya: The Gap between Present and Optimal Levels of Nitrogen Consumption for Maize, Coffee, and Tea, 1982/83

Crop	Estate/Smallholder District/Province	Estimated Levels of Use in 1982/83	Nutrient Rq'ment at Recommended Levels	Additional Nutrient Requirement	Present as % of Recommended
		(tons of nitrogen)			
Coffee	Estate	4,760	6,720	1,960	72
	Smallholder	4,660	13,390	8,730	35
	Subtotal	9,420	20,110	10,690	47
Maize	Trans Nzoia	1,520	3,660	2,140	42
	Uasin Gishu	1,270	3,360	2,090	38
	Kericho	120	3,480	3,360	3
	Nandi	300	2,640	2,340	11
	Other RVP (inc Meru)	620	2,490	1,540	25
	Bungoma	220	1,800	1,580	12
	Kakamega	320	2,680	2,360	12
	Kisii	20	3,440	3,420	1
	Other Nyanza	5	480	475	1
	Central Province (inc Embu)	850	3,340	2,20	26
	Subtotal	5,245	27,370	21,505	19
Tea	Estate	4,225	4,225	-	100
	Smallholder	2,500	7,000	5,100	33
	Subtotal	6,725	11,825	5,100	57
	TOTAL	21,390	59,305	37,295	36

Sources: IBRD: Kenya: Agricultural Inputs Review, (1985), Volume II, Table 7A. p. 40.

Table 18
Kenya: The Gap between Present and Optimal Levels of Phosphate Use for Maize, Coffee, and Tea, 1982/83

Crop	Estate/Smallholder District/Province	Estimated Levels of Use in 1982/83	Nutrient Rq'ment at Recommended Levels	Additional Nutrient Requirement	Present as % of Recommended %
		(tons	of	phosphate)	
Coffee	Estate	1,760	2,486	726	71
	Smallholder	1,460	4,944	3,484	30
	Subtotal	3,220	7,430	4,210	43
Maize	Tans Nzoia	2,560	3,660	1,100	70
	Uasin Gishu	2,144	3,360	1,216	64
	Kericho	200	3,480	3,280	6
	Nandi	506	2,640	2,134	19
	Other RVP (inc Meru)	1,152	2,880	1,728	40
	Bungoma	368	2,250	1,882	16
	Kakamega	544	3,350	2,806	16
	Kisii	30	3,350	2,806	16
	Other Nyanza	8	480	472	2
	Central Province (inc Embu)	2,328	3,320	1,992	40
	Subtotal	8,840	28,860	20,020	31
Tea	Estate	1,145	1,145	-	100
	Smallholder	500	1,520	1,020	33
	Subtotal	1,645	2,665	1,020	57
	TOTAL	13,705	38,955	25,250	35

Source: IBRD: Kenya: Agricultural Inputs Review (1985), Volume II, Table 7B, p. 41.

It is important to stress that the required increases in fertilizer uses will not be automatic. Rather, successful implementation will require a fundamental improvement in availability, incentives, and actions to promote complementary inputs and improved husbandry methods. As such the Fertilizer Marketing Development Program intends to address both the availability issue as well as the development of a fertilizer marketing system that will encourage sustained increases in utilization.

The FY 1986-88 multi-year Fertilizer Market Development Program will therefore promote the establishment of an integrated fertilizer marketing system. The system is expected to lead to increased use of fertilizer by the smallholder, to reduce government involvement to monitoring and quality control, and to create a non-regulated system where prices of fertilizer, and quantities and types to be imported, are determined primarily by the market. The system to be created will follow market signals and will be able to import sufficient product to truly meet demand by farmers in all areas of the country, including small holders. This program is a logical follow-on to the successful effort to privatize the fertilizer distribution system in Kenya.

b. The Current Situation

Calendar year data for 1985 based on Customs records are not yet available. However, projected data are available for the Ministry of Agriculture and Livestock Development's fertilizer year which extends from July 1, 1985 to June 30, 1986. The expected level of fertilizer imports in 1985/86 is some 247,000 metric tons with donors financing up to 108,000 metric tons or 44 percent of the total amount. The balance of 139,000 metric tons will be financed by private firms and cooperatives under commercial allocations provided by the Ministry of Agriculture and Livestock Development (MOALD). The trend toward liberalization in the last 3 years has permitted more private firms and independent cooperatives to commercially import fertilizer. Prior to 1983, approximately 6 organizations imported fertilizer commercially. In 1983/84 and 1984/85, 13 such organizations were allowed to commercially import fertilizer. During 1985/86, 27 organizations of various types are being given allocations to commercially import fertilizer.

Of the 139,000 tons of fertilizer to be commercially imported during the 1985/86 crop year, the Kenya Grain Growers Cooperative Union (KGGCU), a government controlled institution, will import approximately 45,000 tons or 32%. 14,000 tons or 10% will be imported by MEA Ltd., an African-owned private agricultural input distributor. A large, independent coffee growers cooperative union is importing 7,000 tons or 5% for its own use. The balance of the fertilizer to be imported into Kenya in 1985/86 will be purchased by smaller private firms and independent cooperatives, either for their own use or for onward distribution. The decision to permit up to 10 end-users (as opposed to distributors) to import directly from overseas suppliers is another important step toward liberalization taken by the Government of Kenya in 1985/86. These end-users include a number of private coffee and tea estates, as well as several coffee, tea and sugar cooperative unions. Four of the private sector firms importing fertilizers to Kenya currently operate their own network of retail distribution outlets in the major grain growing areas of the country. Other fertilizer importers currently distribute their fertilizer on consignment to privately owned shops selling general merchandise, or to direct end-users.

Currently fertilizer is listed on Kenya's Import Schedule II.A., where its importation is subject to overall ceilings with allocations to individual importers made by the Ministry of Agriculture and Livestock Development (MOALD). However, due in large measure to prior USAID programs, the Government of Kenya is considering proposals to move fertilizer imports to Schedule I.A., i.e. to eliminate allocation procedures and to allow unrestricted imports. The Government, through its allocation procedures, currently controls both the amounts and types of fertilizer imported, and determines which firms are eligible to import fertilizer. The Government also sets retail fertilizer price ceilings for all types of fertilizer based on a fixed percentage markup of C&F Mombasa prices. Government approval of import allocations is officially based on the firm's experience in the fertilizer business, financial soundness, and efficiency of its fertilizer distribution network, although there have been some anomalous allocations in the past. Once an allocation is given, firms importing fertilizer must apply through the Ministry of Commerce and Industry for a foreign exchange license which must also be approved by the Central Bank (both approvals are semi-automatic once MOALD approval has been obtained).

Firms commercially importing fertilizer arrange credit terms through overseas suppliers. Credit is often provided for up to 90 days. Private sector firms purchasing donor-supplied fertilizer through the Ministry of Finance are required to pay for the fertilizer under a system of bank guarantees not exceeding 180 days. Delays of deposits are needed to allow distributors sufficient time to sell their supplies and to offset the various negative features inherent in many donor programs. Fertilizer is used during two peak seasons, October to December for the short rains, and March to

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June for the long rains, and the Government of Kenya is beginning to recognize the need for reasonable working stocks in-country.

c. Logistics

During the first year of the FY 1986-88 Fertilizer Market Development Program, A.I.D. will finance the procurement and associated shipping costs of approximately 65,000 metric tons of diammonium phosphate (DAP) fertilizer. A Financing Request to initiate procurement of this fertilizer is expected from the Government of Kenya in April 1987 for imports beginning in October 1987 and ending in January 1988. As with the 1984 Agricultural Development Program (615-0230) and the 1985 Agricultural Development Program (615-0213), this fertilizer will be allocated by the government Fertilizer Committee to private sector firms for distribution and sale. All fertilizer allocations will be financed under a system of commercial bank guarantees. The Mission has reasonable assurances that the fertilizer will be efficiently distributed based on experiences of prior A.I.D. fertilizer programs, and our knowledge of the Kenya's fertilizer industry as described below.

Approximately 80 percent of all fertilizer used in Kenya is imported in bagged form. Bulk fertilizer imports are bagged either in Nakuru, 300 miles inland, or at the port in Mombasa. Since most fertilizer imports coincide with the start of the two cropping seasons, considerable congestion may be encountered at the port. Sufficient facilities exist at the port for storage of bagged fertilizer. However, bulk fertilizer must be immediately bagged or railed to the Central Highlands city of Nakuru. The binding constraint is normally the availability of truck and rail transport to move fertilizer out of the port.

Bulk fertilizer is offloaded with shell type grabs which are capable of handling up to 1200 tons per day. The Kenya Railways, however, is only able to provide sufficient bulk rail wagons to move an average of 450 tons per day out of the port. Bagging facilities in Nakuru, where previous USAID financed fertilizer has been bagged, is well managed and efficiently operated. The facilities are able to bag up to 800 tons of 50kg bags per day with bulk storage capacity of 8000 tons. Locally made bags are of good quality and can be manufactured by several private sector companies in sufficient quantities in very short time. Offloading, transport, and bagging of A.I.D.-financed bulk fertilizer from Mombasa to Nakuru in 1985 took place with a loss rate of approximately 2 percent, which is well within industry standards.

2. Economic Support Fund Country Criteria

FAA Sec. 502.B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the country made such significant improvements in its human rights record that furnishing such assistance is in the national interest?

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Customs clearance and documentation of fertilizer imports consigned to the Government are handled by the government Coast Clearing Agent. Adequate controls are applied to minimize diversion of commodities and to document losses for insurance claims if necessary.

d. Donor Coordination

All donors of fertilizer to Kenya are in agreement that changes are necessary to bring about increased overall use of fertilizer especially by smallholders. Recent donor meetings have discussed ways to condition donor fertilizer to implement the necessary policy reforms. Discussions on donor coordination through conditionality are in the early stages. At this point only USAID, the World Bank, and the Netherlands are actively involved in conditionality. Other donors normally do not condition their fertilizer but agree in principle to support policy reform measures aimed at improved distribution of fertilizer in Kenya.

Three major studies have recently been completed to analyze the current fertilizer distribution system in Kenya and to recommend improvements to increase market efficiency and overall use of fertilizer especially by smallholders. The three studies are the 1985 Evaluation of the 1984 USAID Agricultural Development Program (ADP), the World Bank Agricultural Inputs Review, and the Netherlands funded Fertilizer Pricing study. The latter study, the scope of which had substantial USAID input, was carried out by the Government of Kenya as a covenant to USAID's FY 1984 Agricultural Development Program. All three studies conclude that the Government must remove commercial allocations and pricing restrictions, institute a better system of coordinating donor and commercial imports, and facilitate a larger number of stronger distribution organizations to market fertilizer and other agricultural inputs to smallholders in rural areas. (See Annex C.)

e. Objectives of the Fertilizer Market Development Program

Over the next three years, USAID will develop, in conjunction with the Government of Kenya, an improved system of fertilizer marketing which promotes increased availability and use of fertilizer, particularly by smallholders in rural areas. The main goals for reform in the fertilizer import and distribution system are to:

- increase levels of fertilizer use on all crops, and especially in high potential areas among smallholders;

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- eliminate the need for government involvement in the allocation and pricing of fertilizer;

- strengthen private sector marketing organizations to enable them to develop distribution networks and extension services; and

- coordinate aid imports so that they do not undermine commercial imports.

The First Year:

Major policy reforms that will be negotiated with the Government of Kenya in the first year of the FY 1986-88 Progra include:

- allowing all end-users who import more than 2000 tons pe year to receive unrestricted import allocations;

- providing established distributors with guaranteed impor allocations of at least as much as they imported the previous year;

- expanding the total quantity allocated to each importer to include an allowance for 20 percent carry-forward stocks;

- awarding allocations in a timely fashion, twice a year, in February for the short-rains, and August for the next year's long rains;

- announcing wholesale and retail prices in a timely fashion, twice a year, January for the long rains, and August for the short rains;

- establishing retail ceiling prices to provide a larger gross margin sufficient to encourage retail marketing organizations to provide extension services and to distribute fertilizer in rural areas;

Years Two and Three:

In years two and three of the program, additional steps will be discussed toward removing the system of import allocations entirely and toward increased reliance on the market for pricing decisions. Specifically:

- fertilizer will be moved to Import Schedule 1A thus eliminating the need for government involvement in allocation of fertilizer to private sector firms.

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- fertilizer prices would not be established by the Government of Kenya but rather, in the case of retail sales in Kenya, on the basis of the competitive market situation. Wholesale prices, or costs of imported fertilizer would be based on international market prices. There would be no government involvement in pricing.

- the government allocation process would be eliminated e.g. private firms would be free to purchase as much fertilizer as they wanted. An expanded network of retail outlets/stockists would be in place to serve smallholders throughout Kenya.

- the government role in the fertilizer sector would be one of monitoring/regulating, product analysis, bag weight, the current fertilizer situation, etc. The current allocation and price control role would be eliminated.

- 10 to 15 private firms would have established a widespread retail marketing system serving the farmer with fertilizer, technical information, as well as product marketing information usually provided by the government extension service.

- the Kenya National Fertilizer Association would be functioning as the channel of communication between the Government and the fertilizer industry.

4. Commodity Requirements of the International Security and Development Cooperation Act of 1985

The International Security and Development Cooperation Act of 1985 requires that ESF funds utilized for commodity import programs be designed such that those imports be used to meet the long term development needs of African countries. Specifically, the Act requires that import funds be used in accordance with the following criteria; and requires that AID conduct annual evaluations of the extent to which these criteria are met.

--Section 801(a)(1). "Spare parts and other imports shall be allocated on the basis of evaluations, by the agency primarily responsible for administering part I of that Act, of the ability of likely recipients to use spare parts and imports in a maximally productive, employment generating, and cost effective way."

Based on AID's Kenya experience in fertilizer programs (see Annex C) and a recent evaluation of the entire Structual Adjustment Program, it is a premise of this program that private sector distribu- tion of the imported fertilizer and exclusive use of private sector importers under the general Commodity Import Program will maximize use of these imports in a productive, cost effective manner conducive to employment generation. USAID/Kenya will schedule an annual evaluation of fertilizer and general commodity imports beginning fifteen months after conditions precedent for the FY86 ESF Agreement have been met. The evaluations will review all port clearance and end use data being maintained by project monitoring systems, and, on a sample basis, will survey private sector importers to determine the ability of recipients to use imports in a maximally productive, employment generating way. The evaluations will review the demand for imports of U.S. origin in Kenya in general, and demand for imports of U.S. origin under program 615-0240 in particular. Based on findings, the evaluations will make recommendations regarding the future mix of fertilizer and non-fertilizer imports under program 615-0240. The evaluations will make further recommendations regarding the practicability and desirability of adopting a more narrow eligibility list under the general Commodity Import Program as may be necessary to maximize development impact while effectively utilizing available program funding. In keeping with Section 801(b), an initial evaluation and survey will be executed by an independent outside contractor with the assistance of the USAID/Kenya Project Office and the USAID/Kenya Agriculture Office as part of the scheduled mid-term evaluation. The second evaluation and survey will be jointly executed in-house by the USAID/Kenya Project Office and the USAID/Kenya Agriculture Office and will update the findings of the initial evaluation. A third evaluation will be executed by an independent outside contractor, with USAID assistance, as part of the final evaluation.

(Note: Outside evaluations have been conducted recently of AID's fertilizer program (June 1985) and the 1983-85 Structural Adjustment Program (December 1985--draft) which provided funding for fertilizer imports, general U.S. imports (CIP), and technical assistance.)
--Section 801(a)(2). "Imports shall be coordinated with investments in accordance with the recipient country's plans for promoting economic development. The agency primarily responsible for administering Part I of that Act shall assess such plans to determine whether they will effectively promote economic development."

USAID/Kenya has carefully reviewed Kenya's 1984-88 Development Plan and finds that the proposed $40 million Fertilizer Market Development Program is wholly consistent with the primary emphasis on agricultural development contained in the Plan. Both the proposed $40 million Fertilizer Market Development Program, and the proposed $28 million private sector Commodity Import Program, are consistent with the expanded emphasis in the 1984-88 Development Plan on a mixed economy and on private sector growth. Annual evaluations will assess private sector

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demand for goods of U.S. origin financed under Program 615-0240, and will assess the effectiveness of the Program in supplying the private sector with required goods in a timely fashion.

--Section 801(1)(3). "Emphasis shall be placed on imports for agricultural activities which will expand agricultural production, particularly activities which expand production for export or production to reduce reliance on imported agricultural products."

Some $43 million of the proposed $83 million of commodity imports under Program 615-0240 will be earmarked for fertilizer imports which will directly expand agricultural production including production for export. Annual evaluations will in addition, review the content of imports under the proposed $40 million general Commodity Import Program to determine the proportion of imports reasonably judged to have a direct impact on agricultural production.

--Section 801(a)(4). "Emphasis shall also be placed on a distribution of imports having a broad development impact in terms of economic sectors and geographic regions."

Some $40 million of the proposed $83 million of commodity imports under Program 615-0240 will be earmarked for general private sector imports which should have a broad development impact in terms of economic sectors and geographic regions. In addition, the use of fertilizers in Kenya is geographically widespread leading to a likely broad impact for the proposed $43 million Fertilizer Market Development Program. Annual evaluations will review the sectoral breakdown of goods imported under the general Commodity Import Program, and will review the geographic breakdown of fertilizer imports to the extent these can be traced through private sector distribution channels.

--Section 801(a)(5). "In order to maximize the likelihood that imports financed by the U.S. under such chapters are in addition to imports which would otherwise occur, consideration shall be given to historical patterns of foreign exchange uses."

USAID/Kenya has reviewed the declining pattern of U.S. exports to Kenya and has considered such patterns in the design of Program 615-0240. Program 615-0240 provides additional foreign exchange, credit incentives, and accelerated import license approval processes to help insure that program commodities are additive to the general level of imports. Annual evaluations will assess the operation and impact of such incentives and make recommendations for changes or strengthening.

5. Gray Amendment Requirements

A.I.D. encourages the participation to the maximum extent possible of historically black colleges and universities, and 8(a) firms, in this Program as prime contractors or as subcontractors.

For the CIP component of Program 615-0240, A.I.D. has published what is probably the most comprehensive list of host country importers ever prepared for a CIP. It contains the names and addresses, as well as the products they are interested in importing from the U.S. of approximately 1,300 Kenyan importers. This list is being distributed, gratis, to all of the thousands of firms on the mailing list maintained by A.I.D.'s Office of Small and Disadvantaged Business Utilization (OSDBU). This publicity will allow firms covered by the Gray Amendment to directly contact the Kenyan firm which is interested in importing the exact category of commodities which they produce. After that, if their product is competitive, their product can be chosen by the private sector importer.

For the FMDP component of Program 615-0240, the fertilizer procurements will also be advertised by OSDBU.

For the technical assistance portion of Program 615-0240, contractors will be selected in accordance with Part 19 of the Federal Acquisition Regulation. A.I.D. will make every reasonable effort to identify and make maximum practicable use of Gray Amendment institutions and firms. All selection evaluation criteria being found equal, the participation of such institutions or firms will become a selection factor. Also, the $100,000 budgeted under Program 615-0240 for a firm to assist small Kenyan business locate U.S. suppliers, will be procured on a set aside basis from an 8(a) firm.

B. Technical Assistance

As suggested in the recent Berg Evaluation of Program 615-0213, technical assistance has been an important component of ESF structural adjustment assistance to Kenya in recent years. Such assistance is often less confrontational than direct policy conditionality; can strengthen Kenya's capacity to devise and implement required structural adjustment policies and programs; and serves as an important means to broaden and strengthen overall policy dialogue. As of November 30, 1985 some $5.9 million of technical assistance has been committed under Program 615-0213 (of $8.0 million available before the Program's Terminal Date for Disbursement of June 30, 1987). An additional $6 million of such assistance is proposed over the three years of Program 615-0240 to maintain the quality and quantity of U.S. technical assistance support for structural adjustment. Technical assistance funds will support studies, consultancies, training, microcomputer hardware and software, project monitoring, and project evaluation as indicated below.

1. Policy formulation and policy implementation affecting private sector investment. Principal areas include: reduction and rationalization of administrative controls on investment; reduction of price controls; review of taxation and financial incentives; and stabilization and development of financial and capital markets.

90 person-months of technical assistance and 36 person-months of short-term training	$990,000

2. Improved balance of payments adjustment mechanisms. Principal areas include: effective protection and comparative advantage; export promotion; improved import monitoring and trade liberalization; exchange rate adjustment objectives and mechanisms.

72 person-months of technical assistance and 36 person-months of short-term training	$810,000

3. Improved planning, management, budgeting, and control in the Ministry of Finance and in the Ministry of Planning and National Development. Principal areas include: improved donor coordination and budgeting of donor projects; improved deposit, monitoring, programming, budgeting, and tracking of counterpart generations; improved integration of planning, budgeting, monitoring, and audit processes; improved internal and external debt monitoring.

108 person-months of technical assistance and 54 person-months of short-term training	$1,350,000

4. Parastatal rationalization, oversight, and divestiture. Principal areas include improved parastatal management and internal financial control systems; improved parastatal monitoring and external financial control systems; divestiture studies and implementation.

80 person-months of technical assistance	$800,000

5. Improved fertilizer marketing. Principal areas include fertilizer pricing, distribution, and use studies, and training in marketing skills.

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36 person-months of technical assistance and 36 person-months of short-term training — **$450,000**

6. Computer hardware, software and related technical assistance in the Ministry of Finance, the Ministry of Planning and National Development, and the Central Bank of Kenya — **$1,000,000**

7. CIP and FMDP monitoring and implementation, including 8A contract assistance to potential importers — **$450,000**

8. Project Evaluation. In addition to the final evaluation, and a mid-term evaluation, USAID will conduct a special evaluation of ESF-funded technical assistance

Mid-term (2 person-months)
Special (2 person-months)
Final (4 person-months) — **$150,000**

Total — **$6,000,000**

C. Conditions and Covenants

Consistent with the recent Berg Evaluation of Program 615-0213, policy conditionality under Program 615-0240 will be more limited, more measurable, and more highly concentrated on key development issues of interest to A.I.D. In keeping with this narrower focus, the U.S. will continue to support the IMF and the World Bank in setting the most rapid pace for reform that is consistent with Kenyan technical and institutional capabilities (and with short-term political stability). Continued Kenyan cooperation with the IMF and the World Bank will remain a critical factor in U.S. decisions concerning the type and level of future U.S. program assistance, although cross conditionality will not routinely be negotiated. Within the overall structural adjustment effort, U.S. policy dialogue and conditionality will emphasize: an improved national program of family planning; improved climate for private sector investment; continued balance of payments adjustment; budgetary reform; parastatal rationalization; more flexible pricing and marketing policies for agricultural inputs; and more flexible pricing and marketing for agricultural outputs. Specific conditions precedent and covenants for the initial year of the FY 1986-88 Program are listed below.

1. Conditions Precedent

A. First Disbursement

Prior to first disbursement of assistance under the Grant, or to the issuance by A.I.D. of documentation pursuant to which disbursement may be made, the Grantee will, except as the Parties may otherwise agree in writing, submit to A.I.D., in form and substance satisfactory to A.I.D.:

Evidence that a separate, numbered Special Account has been established in the Paymaster General into which the local currency proceeds from the sale of Eligible Items under this Agreement will be deposited in accordance with Section 5.4.

B. Additional Disbursement. Prior to the disbursement of funds under the Grant for the second and any subsequent procurements of fertilizer under this Agreement, or to the issuance by A.I.D. of documentation pursuant to which disbursement will be made with respect thereto, the Grantee will, except as the Parties may otherwise agree in writing, furnish to A.I.D., in form and substance satisfactory to A.I.D.:

(1) A full report on and accounting for all local currency proceeds generated under the FY 1984 Structural Adjustment Program Agreement, the FY 1984 Agricultural Development Program and the FY 1985 Structural Adjustment Program Agreement Amendment; and

(2) A detailed proposal for the use of the local currency proceeds generated or to be generated under the agreements listed in (1) above. In pre- paring this proposal, the Cooperating Country will take into consideration and specifically respond to a proposed local currency programming plan which will be provided by A.I.D. to the Cooperating Country.

2. FY 1986 Covenants

The Grantee shall covenant that, except as A.I.D. may otherwise agree in writing:

a. It will take all necessary steps to assure that all local currencies generated by this program are promptly deposited into the Special Account; ensure that bank guarantees are strictly enforced and limited to 180 days; and that fertilizers will be sold only to legitimate distributors.

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b. To further ensure effective fertilizer supply and distribution, it will:

(1) allow all major fertilizer distributors who import more than 2000 tons per year to receive import allocations up to their proven requirements;

(2) provide approved distributors with assured access to at least as much fertilizer as they imported the previous year;

(3) award import allocations in a timely fashion, twice a year, up to the end of February for the short rains, and up to the end of August for the next year's long rains;

(4) announce fertilizer prices in a timely fashion, twice a year, January for the long rains, and August for the short rains;

(5) establish retail ceiling prices to provide a gross margin sufficient to encourage retail marketing organizations to provide extension services and to distribute ferti- lizer in rural areas;

(6) establish a Fertilizer Unit within the Ministry of Agriculture and Livestock Development to monitor the Kenyan and world fertilizer situations and to develop a fertilizer information system covering national fertilizer needs, prices, imports, sales, stocks, importers performance, and research information on fertilizer response trials and cost/benefit studies. The information collected by this unit will be used for decision-making and to develop an import plan;

(7) implement a fertilizer pricing system which establishes wholesale and retail prices based on a Benchmark International C&F Price (BIP); and

(8) increase total fertilizer supply, consisting of commercial imports, donor aid, and carryforward stocks, in each annual fertilizer import plan consistent with estimated demand.

D. Local Currency

1. Deposit

The procedure and control over local currency deposits of counterpart Shilling generations in the 1986-88 Structural Adjustment Assistance Program will be similar to those used for both the 1984 and 1985 CIP programs. The monitoring and control over the provisions in these agreements has been substantially strengthened by the adoption in July 1985 of a uniform Accounting and Control System for Local Currency Counterpart Funds administered by the USAID Kenya Controller.

While prior agreements call for deposits of commodity proceeds to be made into special accounts and for periodic reports, the new system ensures that each agreement has a separate special account and that requests for deposit and regular follow ups are made by the USAID Controller. The new system also calls for copies of deposit slips to be forwarded to USAID in addition to regular reports.

The USAID Controller now meets regularly with Ministry of Finance officials responsible for counterpart funds in an effort to improve financial management of these local currency resources. During early 1986 a former A.I.D. controller will be contracted to provide technical assistance to the Ministry of Finance to improve its counterpart operations and to establish a Counterpart Funds Management Unit.

2. Programming

Prior to adoption of a uniform financial management system, programming of counterpart funds was difficult due to the lack of information on actual generations and availabilities. Under the new procedures, regular reports are produced by the USAID Controller delineating actual counterpart cash availabilities by separate special accounts. In addition, the system provides forecasts of counterpart generations designed to establish availabilities for ensuing fiscal periods for programming purposes.

Once overall availabilities are established, counterpart uses are bilaterally approved via Commitment Agreements, which describe the program, project, or activity to be funded as well as the source of funding, and other pertinent fiscal information. Once the counterpart use is formally committed, a Release Agreement is bilaterally executed which authorizes and instructs the custodian of the special counterpart account to release the local currency funds for the agreed use.

The USAID Controller in the periodic Status of Counterpart Funds Report, identifies both the amounts committed and released against each counterpart fund special account. In addition, a subsidiary report is produced for each special account that lists the amounts committed and released for each specific project or activity funded.

3. Use

Counterpart Shillings generated under Program 615-0240 will be utilized for mutually agreed development purposes in the public sector, and for establishment of a trust fund to support non-governmental development activities and to

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cover operating expenses of the A.I.D. Mission in Kenya. A bilateral understanding regarding the deposit, disbursement, and accountability of trust fund monies will be signed together with the FY 1986 ESF Agreement. The FY 1986 Agreement will allocate the first $5 million equivalent of the counterpart Shillings generated by the FY 1986 Program for trust fund purposes. First priority use of the $5 million set aside will be for the local currency operating expenses of the U.S. Government in Kenya (approximately $1.3 million), with second priority use for mutually agreed private sector development activities (approximately $3.7 million). Private sector uses may include medium and long-term industrial and agricultural credit; short and medium-term export credit; small and medium-scale credit guarantee programs; an export guarantee fund; export promotion; a technology transfer fund; and financing of fertilizer market development. Private sector activities requiring local currency support will be analyzed, selected, and developed in conjunction with the design and implementation of the proposed FY 1987 Private Enterprise Development Project (615-0238). Public sector uses of local currency generations include financing of the minimum 25 percent Kenyan contribution to joint U.S.-Kenyan projects; and financing of sectoral activities (e.g. agriculture, family planning) supportive of the general objectives at USAID's Country Development Strategy Statement.

4. Local Currency Requirements of the International Security and Development Cooperation Act of 1985.

Several sections of the International Security and Development Cooperation Act of 1985 address the generation, use, and monitoring of local currencies. These sections include:

a. Sec. 210 regarding the Foreign Assistance Act of 1961 Sec. 531. Authority (d), "To the maximum extent feasible, funds made available pursuant to this chapter for commodity import programs or other program assistance shall be used to generate local currencies, not less than 50% of which shall be available to support activities consistent with the objectives of sections 103 through 106 of this Act and administered by the agency primarily responsible for administering part I of this Act;

b. Sec 801(a)(6)(A), "Seventy five percent of the foreign currencies generated by the sale of such imports by the Government of the country shall be deposited in a special account established by that Government and, except as provided in subparagraph (B), shall be available only for use in accordance with the agreement for economic development activities which are consistent with the policy directions of section 102 of the Foreign Assistance Act of 1961 and which are the types of activities for which assistance may be provided under sections 103 through 106 of that Act," and

c. Section 801(a)(6)(B), "The agreement shall require that the Government of the country make available to the United States Government such portion of the amount deposited in the special account as may be determined by the President to be necessary for requirements of the United States Government."

The 1986 ESF Structural Adjustment Program addresses and meets the requirements laid out in these Section of the Act.

a. A trust fund will be established with a portion of the local currencies generated in order to offset the cost of maintaining a Resident Mission in Kenya in direct compliance with Section 801(a)(6)(B) of the Act. It is envisaged that these costs will amount to approximately $1.3 million per year, or about 4% of anticipated available local currency funds.

b. Additional funds in the trust fund may be used to finance private sector development activities which are consonant with joint development priorities of the Mission and the Government of Kenya.

c. Other local currency generations will be utilized to enable Kenya to partially or fully fund its contribution to joint U.S.-Kenya projects. Use of local currency funds for these purposes will assure that, at times of Kenyan budget austerity, implementation of joint projects will not be delayed due to late and/or insufficient host country funding.

d. Finally, any funds remaining after funding the activities in (c) above will be used to fund sectoral activities which are supportive of the general objectives contained in USAID's Country Development Strategy Statement.

Approximately 96 percent of available funds will be used for activities consistent with the policy directions specified in both revised Section 531(d) and Section 801(a)(b)(A) of the Act since they will be in keeping with overall Mission and Government of Kenya development objectives and disbursement of funds will require Mission consent. The remaining 4 percent will be utilized to cover the operating expenses of maintaining the A.I.D. Mission in Kenya.

V. Special U.S. Interests and Concerns

A. General Interests

Kenya continues to be one of the few countries in Africa which has a reasonable chance for medium-term growth led by a vigorous private sector. It has an almost unique record of political stability in its 25 years of independence, and a pragmatic civilian government which has fostered a commendable degree of personal freedom in the midst of a continent beset by repressive military dictatorships and faltering marxist-socialist experiments.

Whether the Kenyan style of relatively free, representative democracy and quasi-capitalistic economic institutions can deliver increased prosperity and better living for large numbers of Kenyans is an important question for U.S. interests in Africa. There are no perfect models of the types of political and economic institutions which the U.S. has hoped would develop in Africa--institutions which could foster acceptable rates of per capita growth in an environment of representative democracy and broad individual liberties. While not perfect, by any means, Kenya comes closer to that model, perhaps, than any other country on the continent.

In addition, Kenya has been a voice for moderation and patience in African and other Third World fora, and a significant stabilizing force in Eastern Africa. The resolution of the long-simmering disputes which followed the break-up of the East African Community, the opening of the Tanzanian-Kenyan border, peace-keeping efforts with Somalia and Sudan, and the successful conclusion of peace efforts in Uganda, can all be attributed in large part to the growing significance of Kenya as a force for peace in the region.

Kenya's continued economic growth and improved general well-being are, unfortunately, not assured. The alarming rate of population growth in combination with a thin natural resource base create serious concern about Kenya's future. No country can maintain internal political and social stability in the face of mounting unemployment and decreasing per capita production of goods and services. Yet, this is likely to be the future scenario that will play out in Kenya unless the pace of growth is accelerated soon. Population growth must be reduced by enabling as many Kenyans as possible to choose smaller families, and by providing them with the information and with the access to services required for them to realize those personal choices. The production of goods for internal and external markets must be accelerated in order to create both jobs and increased incomes.

The U.S. is the leading bilateral donor in both these linked efforts - reducing the population growth rate and increasing production and employment. The Structural Adjustment Assistance program is at the heart of that effort as it provides foreign exchange, local counterpart, and technical assistance, directed at removing the structural problems which inhibit faster growth in the economy, and at improving the policy environment which, in part, establishes the limits to growth.

B. Project Specific

The U.S. has specific interests in maintaining and expanding liberalized availability of foreign exchange to the Kenyan private sector for procurement of general commodities from U.S. sources, as well as in expanding the availability of U.S. manufactured fertilizer to private sector distribution firms, independent cooperatives, and large and small scale end-users. The proposed private sector Commodity Import Program has been designed in part to shorten delays and reduce Government of Kenya administrative review of license requests, providing a de facto liberalization of import policy for U.S. goods (a liberalization which the ESF policy dialogue is also seeking to achieve on a broader basis as well). The proposed CIP will be of particular assistance to subsidiaries and representatives of U.S. firms in Kenya improving their access to imported inputs from U.S. sources. The proposed Fertilizer Market Development Program will directly utilize imports of U.S. fertilizer to expand overall fertilizer use in Kenya, and to expand the role of competitive, private sector marketing channels. Provision of such commodity support directly alleviates government concerns regarding excessive use of scarce foreign exchange for fertilizer imports, results in net savings of foreign exchange due to increased agricultural production, and develops Kenyan markets for products in which the U.S. can normally be expected to have an overall long-term cost advantage.

Annex A

Implementation Schedule: FY 1986-88 Commodity Import Program

Activity	Date
FY 1986 Grant Agreement signed	3/1/86
CP's satisfied	12/31/86
First Bank L/Comms issued by A.I.D.	2/1/87
Contractor hired to assist Kenya firms locate U.S. suppliers and to obtain quotations	2/1/87
Initial L/C's opened	3/1/87
Revised Importers List published by A.I.D./ Washington	3/1/87
First shipments from U.S.	4/1/87
Imports start arriving in Kenya	6/1/87
Initial counterpart deposits made into special account	7/1/87
Terminal Date for Financing Requests	3/1/89
Final Shipment from U.S.	12/31/89
Grant CIP funds fully disbursed	2/28/90
Final deposits into special account	5/31/90
Final withdrawals made from special account	12/31/90

Annex B

Implementation Schedule:
Fertilizer Market Development Program

Action	Date	Action Agent
FY 1986 PAAD Authorized	2/1/86	A.I.D./Washington
Project Agreement Signed	3/1/86	USAID/GOK
Market Demand/Fertilizer Response Study Complete	3/31/86	USAID
Submit Quarterly Report on Special Account	3/31/86	GOK
A National Fertilizer Association registered and Articles of Association approved	4/1/86	GOK
Request for A.I.D.-financed DAP for short rains (86) (from FY 85 program 615-0213)	4/15/86	GOK
Fertilizer Import Plan for 86/87 crop year completed	4/15/86	GOK
Advise eligible end-users of unrestricted import authority for crop year 1986/87	4/15/86	GOK
IFB issued for short rain (86) requirement (from FY 85 Program 615-0213)	5/15/86	A.I.D./Washington Kenya Embassy
Bank guarantees expired and all Shilling generations from FY 84 Agreement deposited in Special Account	6/30/86	GOK
Submit Quarterly Report on Special Account	6/30/86	GOK
Short rains (86) import requirements shipped from US port (from 1985 program 615-0213)	7/15/86	US Fertilizer supplier and freight agent
Request for A.I.D.-financed DAP for long rains (87) (from 1985 Program 615-0213)	8/1/86	GOK
Arrival of short rain (86) fertilizer imports to Mombasa (from 1985 program 615-0213)	8/30/86	Freight Agent

IFB issued for long rain (87) requirement (part from 1985 program 615-0213 and part from 1986 program 615-0240)	8/30/86	A.I.D./ Washington and Kenyan Embassy
Award long rain (87) import allocations to eligible distributors	8/30/86	GOK
Announce short rain (86) wholesale and retail prices. Wholesale price based on estimated "benchmark" international C&F price. Retail prices reflect greater margin to encourage downstream marketing.	8/30/86	GOK
Bagging and distribution of short rain (86) requirements to allocated parties	9/1/86 to 10/30/86	GOK
Submit Quarterly Report on Special Account	9/30/86	GOK
Long rain (87) requirement shipped from U.S. port (NLT 9/30/86 for 1985 program 615-0213 financed shipment)	10/15/86	US Fertilizer suppliers and freight agent
Arrival of long rain (87) fertilizer imports to Mombasa (from 1985 program 615-0213 and 1986 program 615-0240)	11/30/86	Freight Agent
Agreement on use of FY 85 generated counterpart Shillings	11/30/86	A.I.D. and GOK
Bagging and distribution of long rain (87) requirements to allocated parties	12/1/86 to 1/30/87	
Submit Quarterly Report on Special Account	12/30/86	GOK
Announce long rain (87) wholesale and retail prices. Wholesale price based on estimated "benchmark" international C&F price. Retail prices reflect greater margin to encourage downstream marketing.	1/15/87	GOK
Award short rain (87) import allocations to eligible distributors	2/28/87	GOK
Submit Quarterly Report on Special Account	3/31/87	GOK

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Fertilizer Import Plan for 87/88 crop year completed.	4/15/87	GOK
Request for A.I.D.-financed DAP for short rains (87) requirements (from 1986 program 615-0240)	4/15/87	GOK
Advise eligible end-users of unrestricted import authority for crop year 1987/88	4/15/87	GOK
IFB issued for short rains (87) requirements (from 1986 program 615-0240)	5/15/87	A.I.D./Washington and Kenyan Embassy
Bank guarantees expired and all Shilling generations from FY 85 program deposited in Special Account.	5/30/87	GOK
Submit Quarterly Report on Special Account	6/30/87	GOK
Request for A.I.D.-financed DAP for long rains (88) (from 1986 program 615-0240)	8/1/87	GOK
Short rain (87) requirements shipped from U.S. port (for 1986 program 615-0240)	8/15/87	US fertilizer Supplier and freight agent
Award long rain (88) import allocations to eligible distributors. Establish distributors guaranteed equivalent of long rain '87 allocation and allocation expanded to include 20% carry forward stock	8/30/87	GOK
Announce short rains (87) wholesale and retail prices, wholesale based on estimated "benchmark" international C&F prices.	8/30/87	GOK
IFB issued for long rains (88)requirement from 1986 program 615-0240)	8/30/87	A.I.D./Washington Kenyan Embassy
Arrival of A.I.D.-financed DAP for short rains (87) (from 1986 program 615-0240)	9/30/87	GOK

Submit Quarterly Report on Special Account	9/30/87	GOK
Bagging and distribution of short rain (87) requirements to allocated parties	10/1/87 to 11/30/87	GOK
Long rains (88) requirement shipped from U.S. port (from 1986 program 615-0240)	10/1/87	US Fertilizer Supplier and Freight Agent
Arrival of long rain (88) requirements (from 1986 program 615-0240)	11/15/87	GOK
Agreement on use of FY86 generated Shillings	11/15/87	GOK and A.I.D.
Bagging and distribution of long rain (88) requirements to allocated parties	12/1/87 to 1/30/88	
Submit Quarterly Report on Special Account	12/30/87	GOK
Announce long rain (88) wholesale and retail prices. Wholesale based estimated "benchmark" international C&F prices.	1/15/88	GOK
Award short rain (88) import allocations to eligible distributors. Establish distributors guaranteed equivalent of short rain 87 allocations and allocation expanded to include 20% carry forward stock	2/28/88	GOK
Bank guarantees expired and all Shilling generations from 1986 Program 615-0240 deposited in Special Account	6/30/88	GOK

Annex C

Unclassified
AID 11/27/85
DIR:CGladson
AGR:JThomas:ls:gk
1. PRJ:RRifenburg 2. PROG:DGreene 3. PROG:JStepanek
DIR AGR-2 PRJ, PROG ECON CHRON, RF

AMEMBASSY NAIROBI
SECSTATE WASHDC

AIDAC

E.O. 12356: N/A
SUBJECT: USAID/Kenya Agricultural Development Program (615-0230), Donor Coordination in Fertilizer Marketing in Kenya

REF: A) NAIROBI 28734 B) NAIROBI 20360 C) NAIROBI 5109 D) NAIROBI 15296

1. Donor Coordination in the supply and distribution of fertilizer in Kenya is beginning to have a significant impact on influencing the Government of Kenya to make policy and administrative reforms in its handling of fertilizer importation and marketing. Presently there are 10 donors of fertilizer to Kenya. Listed in order of magnitude, from the most to least amounts of fertilizer imported annually, they are: USAID, World Bank, Netherlands, Denmark, Norway, Sweden, Finland, Japan, Italy, and the FAO. Total donor imports in the 1985/86 crop year are expected to be 108,000 tons, or approximately 44 percent of fertilizer used in Kenya this crop year. Commercial importers are expected to finance 139,000 tons of fertilizer imports this year. Kenya does not produce any fertilizer. All domestic consumption must be imported.

2. Prior to 1983 all donor fertilizer was distributed by the Kenya Farmers Association (KFA), a Government of Kenya-managed cooperative charged with distributing agricultural inputs. In 1984 the KFA's administration was replaced and the organization was renamed the Kenya Grain Growers Cooperative Union (KGGCU). KGGCU operates 46 retail distribution outlets throughout the major grain growing areas of Kenya. Prior to 1983 all donor fertilizer was distributed by the KFA because it was believed that its relatively wide distribution network could assure availability of fertilizer to the smallholder in the rural areas. The Government of Kenya also insisted that donors distribute their fertilizer through the KFA. The KFA, therefore, faced little competition in the past with regard to pricing,

timeliness of delivery, or choice of type. Despite the KFA's relatively wide distribution network, only a third of its fertilizer was actually sold directly to the smallholder. Most of KFA's fertilizer, both commercial imports and donor supplied fertilizer, was sold to large estates and end users, or other distributors. In addition, KFA gave priority to selling its own commercially procured fertilizer supplies, while charging the Government of Kenya for storage and handling expenses of donor supplied fertilizer. Shilling generations from the sale of donor fertilizer were therefore late in being deposited, and sometimes were not deposited at all. For example, Approximately 30 million Shillings from the sale of USAID financed DAP by the KFA in October 1983 has still not been deposited with the Government of Kenya Treasury.

3. In 1983, USAID began discussions with the Government of Kenya on ways to achieve the following objectives: 1) to expand distribution of donor fertilizer by private sector firms, with a corresponding reduction in the KFA role, 2) to increase fertilizer distribution and use by smallholders in rural areas, and 3) to institute a mechanism to assure Shilling generations from the sale of donor fertilizer would be promptly deposited to Treasury. A system was developed whereby donor fertilizer would be available to both private sector distributors and the KFA under bank guarantees payable to Treasury within 180 days. At the time, there were only 2 major private sector distributors of fertilizer in Kenya. over the years, many distributors were driven out of business when the KFA was given exclusive marketing rights. USAID believed that by allowing these distributors, plus other smaller private sector agricultural input dealers, to purchase and distribute donor financed fertilizer, fertilizer would more likely be widely distributed at competitive prices to smallholders in rural areas.

4. As a test, the Government of Kenya agreed in October 1983 to allow 7,000 tons of the 14,000 tons financed under the 1982 Agricultural Sector Grant (615-0228) to be distributed under this system, with the balance to be distributed by the KFA. The system worked well. Six private sector firms promptly distributed the 7,000 tons of DAP and deposited the full Shilling value with the Treasury. On the other hand, the 7,000 tons sold by the KFA were slowly sold and the Shilling generations have still not been deposited with Treasury.

5. Following the success of the 1982 Agricultural Sector Grant, the 1984 Agricultural Development Program (ADP) (615-0230) was designed to finance approximately 50,000 tons of DAP imported to Kenya between March and December 1985. Under the terms of this Agreement, all the fertilizer would be available to both private sector firms and the KFA for distribution and financing under bank guarantees. 20,800 tons were imported in March and April of which 12,800 tons was distributed by 15 private sector firms and 8,000 tons was distributed by the KFA. All was paid for under bank guarantees and the Treasury has collected nearly 100 million Shillings from the sale of this fertilizer. The balance of the fertilizer to be financed from the 1984 ADP is now being allocated. 40 private sector firms had requested allocations totalling 245,000 tons vs. only 28,500 tons available.

6. Beginning with the 1984 Agricultural Development Program, it was intended by USAID and the Government of Kenya that all donor financed fertilizer (not just USAID's) would be available for distribution by both private dealers and the KFA with payments made under bank guarantees. Although the Government of Kenya requested the other donors to comply, all but Finland resisted. Fertilizer imports financed by the other donors continued to be distributed by the KFA (without bank guarantees) under the assumption (by some donors) that the fertilizer would be sold by the KFA to smallholders.

7. In late 1984 USAID began discussions with other donors of fertilizer to Kenya to explain how the A.I.D.-supported private sector distribution system worked, and to urge them to accept the Government of Kenya's request that their fertilizer be distributed under this system. In 1985 the World Bank joined the group of other donors of fertilizer to Kenya through its dollars 10 million Agricultural Sector Grant to be implemented Under the same conditions and procedures used by USAID in the 1984 ADP. The only difference was that fertilizer allocated to private sector firm would be purchased and imported directly by that firm rather than thru purchase by the Kenyan Embassy. Under the USAID system, the fertilizer is purchased by the Kenyan Embassy and consigned to the Treasury. USAID discussions with other bilateral donors are also beginning to pay off as the Netherlands Government has now agreed to distribute half of its 10,000 tons of calcium ammonium nitrate fertilizer (CAN) due to arrive in Kenya in December through private sector distributors. Pending a distribution study by the Hague on the disposition of this fertilizer, the Netherlands

Government may decide to distribute all of its future fertilizer imports to Kenya under the private sector distribution system. Denmark, Norway, and Sweden Embassy staff in Nairobi now agree in principle that increased private sector distribution of fertilizer is beneficial, but they must convince their respective governments that the private sector distribution scheme will allow more of their fertilizer to reach smallholders than through distribution by the KFA.

8. All donors of fertilizer to Kenya are in agreement that changes are needed to bring about increased overall use of fertilizer especially by smallholders. Recent donor meetings have discussed ways to condition donor fertilizer to implement the necessary policy reforms. Discussions on donor coordination through conditioning are in the early stages. At this point only USAID, the World Bank, and the Netherlands are actively involved in conditionality. Other donors normally do not condition their fertilizer but agree in principal to support policy reform measures aimed at improved distribution of fertilizer in Kenya.

9. Three major studies have recently been completed to analyze the current fertilizer distribution system in Kenya, and to recommend improvements to increase market efficiency and overall use of fertilizer especially by smallholders. The three studies are the Evaluation of the 1984 USAID ADP, the World Bank Inputs Study, and the Netherlands funded Fertilizer Pricing study. The latter was carried out by the Government of Kenya as a covenant to the 1984 USAID ADP. All three studies conclude that the Government must remove commercial allocations and pricing restrictions, institute a better system of coordinating donor and commercial imports, and facilitate a larger number of stronger distribution organizations to market fertilizer and other agricultural inputs to smallholders in rural areas.

10. A donors meeting was held on November 15, 1985 to discuss the various recommendations presented in the three reports. The donors also discussed what each is prepared to do to implement these recommendations. The major recommendations discussed were as follows:

- a) The Government of Kenya should move towards a total deregulated system of fertilizer importation and distribution. A clearly defined and planned program must be implemented to gradually transform the system over a period of time.

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- b) Large end users requiring at least 2,000 tons of fertilizer per year should be allowed to directly import sufficient fertilizer to meet their annual requirements. This accounts for approximately 120,000 tons of fertilizer imported annually for coffee, tea and sugar.

- c) The major existing distributors providing fertilizers to smallholders and smaller estates should be given a guaranteed minimum allocation so they are able to plan the expansion of their distribution facilities.

- d) Other smaller distributors would be given priority allocations, mainly through donor imports, based on the following criteria:

  - Track record of fertilizer imports
  - An established distribution network
  - Access to storage and packaging facilities
  - Large consignments for economies of scale in purchase and freight.

- e) Allocations should be made twice a year. In February for the short-rains and August for the next year's long-rains.

- f) In order to increase commercial stocks, the total quantity allocated needs to be adjusted to include a component for carry forward stocks.

- g) Documentation and approval procedures for commercial importers should be streamlined so that only Central Bank of Kenya approval is necessary.

- h) A new unit with adequate manpower should be created within the ministry of Agriculture to carry out fertilizer requirement planning, monitoring and evaluation. The administrative tasks related to allocation and imports should fall under a Deputy Secretary in the Ministry of Agriculture who would become the chairman of the Allocation Committee.

- i) The distributor and retail prices should be announced by the Price Controller twice a year until sufficient competition develops to permit lifting of all price controls. prices should be announced:

  - on January 1 for the long-rains, and
  - August 1 for the short-rains.

- j) Announced prices should be based on estimated benchmark international C & F prices rather than on actual C & F values as at present to encourage acquisition of low cost supplies.

- k) The old pricing formula of C & F plus 30 percent plus 100 Shillings should be replaced to reduce monopoly profits of wholesalers and to increase margins to retailers thereby encouraging expansion of retail networks. A new formula developed for distributor prices for bagged fertilizer sold in various sized bags, and based on benchmark international C & F prices prevailing in the previous three months should be implemented. The prices would apply to both commercial and aid imports, and will allow a 5 percent net margin for distributors.

- l) The announced distributor prices will not apply to the direct end users importing fertilizer commercially. As they are both the importer and end user, the fertilizer is not bought and sold within Kenya.

- m) The retail ceiling price should be calculated at 10 percent above the wholesale price. This would cover the rural transport cost as well as the retailer's margin. differential Retail prices should be announced for 50, 25, and 10 Kgs bags, in each district to promote availability of fertilizer in small bags for use by smallholders.

- n) Prices in the field should be monitored by the Ministry of Agriculture so as to establish the extent to which prices charged fall below the ceiling prices. At the point where competition causes this to be generally the case, the Government should consider lifting price controls as they will have been proved to be redundant.

- o) In order to ensure additional incentives for importers to carry out active promotion in the form of advertising, sales representatives and soil-testing facilities, the price formula should include one percentage point on the c & f price as a promotional allowance.

- p) Donor and commercial imports must be integrated to enable private sector distributors to plan ahead. A new system is proposed whereby allocations of both aid and commercial import quotas are made at the same time to promote adequate planning by private sector importers. This will require definite commitments of the value, type and sources by the donors prior to April for imports in the next 12 months. Any end-user or distributor could be allocated either an aid allocation or a commercial allocation.

- q) To make commercial and aid imports as interchangeable as possible, procedures for aid imports should follow as closely as possible procedures used for balance of payment support. The importer who receives an aid allocation should deal with the donor in the same way as he deals with a commercial supplier to agree on prices and payment terms, and then to arrange details of freight and discharge. The present lengthy process involving protracted negotiations between the Treasury and the donor to finalise details should be avoided.

- r) In order to increase the African share of commercial imports, the Government-owned commercial banks should give 100 percent locally owned importers additional lines of credit to increase their import capacity. These credit lines would be at relatively low risk because they are generally covered by the physical commodity itself up to its point of sale.

- s) To overcome the sluggish growth of fertilizer consumption at under 2.5 percent per year which has persisted since 1972, a new institution is proposed to plan ways to expand sales and lower costs to the farmer. This institution could also monitor international prices and carry out an annual review of distributor and retail margins. The new institution should be outside government machinery to avoid budgetary and personnel constraints. It should represent the interests of government, the trade, and the farming community, and have a small, permanent secretariat to plan and execute initiatives. It could be financed by a 1 percent levy on all L/Cs opened by importers, and a 1 percent levy on aid imports.

11. Donors represented at the November 15 meeting discussed the recommendations and the ability and willingness of each donor to condition its fertilizer to help implement the recommendations. In principle, all donors agreed to accept the recommendations. The representative from Denmark indicated it would be difficult for his government to make funding commitments one year in advance because a major portion of Danish fertilizer imports result from year-end funding. The representative from Norway indicated that his government

would most likely still restrict distribution to the KGGCU in order to target its use by the smallholder. Although a full consensus by all donors to implement the recommendations presented in the pricing study has not been reached, and some donors still need to work with their home offices to present a justification to break away from their agreements with the KGGCU, substantial progress is being made.

12. The next step in donor coordination is to prepare a final set of recommendations on improved fertilizer marketing for presentation to government. The Government of Kenya will be asked to respond to the recommendations. The Government of Kenya response will form the basis for USAID negotiations in the development of our future fertilizer marketing programs. Trail##

Annex D

Kenya: Value of Fertilizer Imports
All Sources, 1980 - 1984
(Millions of U.S. dollars)

SITC	Description	1980	1981	1982	1983	1984
562 110	Ammonium Nitrate	0.2	0.6	1.2	0.6	0.6
562 120	Ammonium Sulphonitrate	2.7	0.4	0.0	6.9	4.6
562 130	Ammonium Sulphate	0.1	5.1	3.2	1.3	0.9
562 140	Calcium Nitrate	2.2	0.0	0.1	0.0	0.0
562 160	Urea	9.8	1.8	1.6	2.1	1.0
562 190	Other	2.5	5.4	7.4	7.0	1.7
562 221	Single Superphosphates	3.1	1.7	0.5	1.2	0.4
562 223	Triple Superphosphates	2.6	6.3	2.1	0.0	0.0
562 290	Other	0.0	1.6	4.5	1.8	0.0
562 310	Potassium Chloride	0.0	0.0	0.0	0.0	0.1
562 320	Potassium Sulphate	0.2	1.1	0.0	0.0	0.0
562 390	Other	9.5	0.5	4.7	3.1	0.5
562 910	NPK	4.0	8.2	1.2	5.0	4.5
562 920	Nitrogen, Phosphorous	0.3	7.0	2.0	1.6	2.5
562 930	Nitrogen, Potassium	3.6	0.1	0.1	0.0	0.0
562 991	Ammonium Phosphates	0.1	13.3	0.0	5.9	1.5
562 999	Other	0.0	0.0	0.0	1.2	1.2
Total		40.8	53.2	28.6	37.7	19.2

Source: Ministry of Finance, Customs and Excise Department. Special Exercises USAID/Kenya November 1982, May 1983, and December 1985.

Notes: Includes USAID, donor, and commercial fertilizer imports. Minor misclassifications of fertilizers may have occurred at port.

Exchange Rates: 1 U.S. dollar = Ksh 7.4202 (1980); 9.0475 (1981); 10.922 (1982); 13.312 (1983); and 14.414 (1984). Source: average annual values from IMF, International Financial Statistics, 1985.

Annex E

Kenya: Quantity of Fertilizer Imports
All Sources, 1980 - 1984
(Metric Tons)

SITC	Description	1980	1981	1982	1983	1984
562 110	Ammonium Nitrate	7,619	2,656	4,851	2,830	2,065
562 120	Ammonium Sulphonitrate	1,000	1,987	0	22,780	15,500
562 130	Ammonium Sulphate	16,751	25,895	18,959	7,000	6,500
562 140	Calcium Nitrate	467	0	300	0	0
562 160	Urea	6,878	4,827	7,248	11,355	4,732
562 190	Other	29,115	27,627	39,450	28,306	7,542
562 221	Single Superphosphates	14,863	9,086	3,200	7,800	2,000
562 223	Triple Superphosphates	3,009	22,060	22,488	0	0
562 290	Other	7,588	5,011	15,000	4,980	0
562 310	Potassium Chloride	3	144	1	0	489
562 320	Potassium Sulphate	0	3,500	0	0	0
562 390	Other	610	2,211	20,950	15,260	2,500
562 910	NPK	29,762	36,654	5,220	24,561	17,461
562 920	Nitrogen, Phosphorous	2,010	23,138	4,209	3,510	10,501
562 930	Nitrogen, Potassium	1,036	190	218	30	0
562 991	Ammonium Phosphates	8,951	41,678	0	16,748	5,009
562 999	Other	4	2	1	5,516	37
Total		129,672	206,667	129,608	150,677	74,336

Note: Columns may not add due to rounding errors. Minor misclassification of fertilizers may have occurred at port.

Source: Annual Trade Report; Customs & Excise Dept., Ministry of Finance; 1981 - 1984.

Annex F

Kenya: Value of Fertilizer Imports
U.S. Origin, 1980 - 1984
(Millions of U.S. dollars)

SITC	Description	1980	1981	1982	1983	1984
562 110	Ammonium Nitrate	0.0	0.0	0.0	0.0	0.0
562 120	Ammonium Sulphonitrate	0.0	0.0	0.0	2.9	0.0
562 130	Ammonium Sulphate	0.0	0.0	0.0	0.0	0.0
562 140	Calcium Nitrate	0.0	0.0	0.0	0.0	0.0
562 160	Urea	0.0	0.0	0.0	0.0	0.0
562 190	Other	4.0	0.0	0.0	0.0	0.0
562 221	Single Superphosphates	0.0	0.0	0.0	0.0	0.0
562 223	Triple Superphosphates	0.0	5.9	0.0	0.0	0.0
562 290	Other	0.0	1.4	0.0	1.8	0.0
562 310	Potassium Chloride	0.0	0.0	0.0	0.0	0.0
562 320	Potassium Sulphate	0.0	0.0	0.0	0.0	0.0
562 390	Other	0.0	0.0	0.0	1.2	0.0
562 910	NPK	0.0	0.0	0.0	0.0	0.0
562 920	Nitrogen, Phosphorous	0.0	1.9	2.0	0.8	0.0
562 930	Nitrogen, Potassium	0.0	0.0	0.0	0.0	0.0
562 991	Ammonium Phosphates	2.0	12.3	0.0	0.0	0.0
562 999	Other	0.0	0.0	0.0	0.0	0.0
Total		6.1	21.5	2.0	6.6	0.0
USAID fertilizer import arrivals		0.0	20.0	0.0	4.4	0.0

Source: Ministry of Finance, Customs and Excise Department. Special Exercises for USAID/Kenya November 1982, May 1983, and December 1985.

Notes: Includes USAID and commercial fertilizer imports. Minor misclassifications of fertilizers may have occurred at port.

Exchange Rates: 1 U.S. dollar = KSh 7.4202 (1980): 9.0475 (1981); 10.922 (1982); 13.312 (1983); and 14.414 (1984). Source: average annual values from IMF, International Financial Statistics, 1985.

Annex G

INITIAL ENVIRONMENTAL EXAMINATION
or
CATEGORICAL EXCLUSION

Country	KENYA
Program Title and Number	Structural Adjustment Assistance Program (615-0240)
Funding	FY 1986-88 ESF Grant, $74 million
IEE/CE Prepared by	Stephen A. Klaus, Projects Division

Environmental Action Recommended:

Positive Determination ____________________

Negative Determination $40 million Fertilizer Imports

or

Categorical Exclusion $28 million C.I.P. General Commodities, and $6 million of Technical Assistance

A negative threshold decision is recommended for the approximately $40 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 $28 million worth of general commodities to be financed by A.I.D. Under the C.I.P. portion as described in this PAAD, and for the $6 million in technical assistance as described in this PAAD. The C.I.P. Portion and the technical assistance portion both meet the criteria for categorical exclusion in accordance with Section 216.2 of regulation 16, and are therefore excluded from further review. (See attached justification.)

Action requested by: [signature] AFR/PA for
Charles L. Gladson
Mission Director
Date: 4/15/86

Concurrence: Bessie L. Boyd
African Bureau Environmental Officer
Bessie L. Boyd, AFR/TR/SDP
Date: 4/17/86

Mary Alice Kleinjan
General Counsel for Africa
Mary Alice Kleinjan, GC/AFR
Date: 4/15/86

A. Program Description:

The purpose of this Structural Adjustment Assistance Program (615-0240) is to provide the Republic of Kenya with balance of payments and technical assistance support while the Government of Kenya implements the policy changes necessary to accelerate the structural adjustment of the economy. This purpose will be achieved in part by financing approximately $40 million of U.S. fertilizer and associated transportation services in support of a Fertilizer Market Development Program, and by financing approximately $28 million of general U.S. exports in support of a private sector Commodity Import Program (CIP). In addition, up to $6 million of technical assistance will be financed in support of structural adjustment goals.

Continued external balance of payments support is required to help insure 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 19 percent of imported fertilizer is used on maize. Some 26 percent of fertilizer is used on coffee, and some 18 percent on tea, both major export crops with strong smallholder participation. 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 expanded private sector distribution of fertilizer and improved marketing to both small and large holders.

Approximately $40 million provided through this Grant will be used to procure approximately 160,000 metric tons of manufactured fertilizers. As with previous A.I.D.-financed fertilizer programs, the fertilizer in the first year of the program 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 firms and cooperatives for sale to farmers. In later years, direct private sector tendering and importation are also envisioned.

The policy initiative linked to this program emphasizes the further development of agricultural input supply reforms initiated in previous Agreements. Specifically the Fertilizer Market 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 from the sale of fertilizer will become available within 180 days under a system of commercial bank guarantees. The proceeds of fertilizer sales, and CIP imports, will be used to defray the costs of priority development activities included in the Government of Kenya 1987/88 and subsequent year development budgets, especially those supported by other A.I.D. programs and projects, specifically including family planning and private sector activities. A portion will also be used to establish an operating expense trust fund.

B. Identification and Evaluation of Environmental Impacts of the Fertilizer to be Imported under the Fertilizer Market 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. 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 phosphate, hyperphosphate, triple super phosphate, diammonium phosphate (DAP), mono-ammonium phosphate (MAP), muriate of potash, sulphate of potash and NPK (mixed fertilizer). To the extent that provision by A.I.D. of necessary foreign exchange will guarantee the delivery of required fertilizer inputs, overall fertilizer usage may be greater in 1987-89 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 formulations proposed for financing will be of the types generally 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 the Government and private sector 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. The 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 Government of Kenya 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 licensing by government are not contemplated. The program will have its effects primarily through 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. <u>Recommended Environmental Action</u>

1. In accordance with A.I.D. 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 A.I.D. will not have significant impact on the physical and natural environment.

2. In accordance with A.I.D. 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, A.I.D. 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. The program will not provide financing for the procurement or use of pesticides.

3. In accordance with A.I.D. regulation 16, it is recommended that a catagorical exclusion be granted pursuant to Section 216.2 (c)(2)(i), which provide an exclusion with respect to technical assistance.

Annex H

3A(2) - NONPROJECT ASSISTANCE CHECKLIST

CROSS-REFERENCES: IS COUNTRY CHECKLIST UP TO DATE?	Yes, and is attached hereto.
HAS STANDARD ITEM CHECKLIST BEEN REVIEWED?	Yes, and is attached hereto.

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 86 Continuing Resolution. Sec. 524; FAA Sec. 634(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 was submitted on March 21, 1986 and the 15th day waiting period expired without objection on April 4, 1986.

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, see pp. 19-20 b) Yes, see pp. 25-31 c) No d) Yes, see pp. 25-27 e) Yes, see pp. 27-31 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 A.I.D. 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); FY86 Continuing Resolutions 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.	This is a commodity import program which does not require local currencies for implementation. Host country owned local currencies generated under the program will be used for agreed upon development purposes. U.S. owned local currencies are not available.

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 assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? — Yes

9. FY 1986 Continuing Resolutions, Sec. 533. Is disbursement of the assistance conditioned solely on the basis of the policies of any multilateral institution? — No

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 maximum extent feasible, does it reflect the policy directions of part 1 of the FAA?	Yes through provision of budget and balance payments support during a period of economic slowdown. These economic benefits in turn will promote political stability.
b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities?	No
c. FAA Sec. 531(d). Will funds b used to the maximum extent feasible,to generate local currencies, not less than 50 percent of which will be used to support FAA Section 103-106- type activities?	Yes
d. ISDCA of 1985 Sec. 205. Will ESF funds made available for commodity import programs be used for the purchase of agricultural commodities of United States-origin? If so, what percentage of the funds will be so used?	No
e. International Security and Development Cooperation Act of 1985, Sec. 207. Will ESF funds be used to finance the construction or the operation or 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

f. <u>International Security and Development Cooperation Act of 1985, Sec. 801</u>. For Commodity Import and sector programs, will the agreement require that import be used to meet long-term develop ment needs in accordance with the following criteria:

Yes, see Section IV A.4 c the PAAD.

1. allocation of imports based on evaluation of the ability of likely recipients to use such imports in a maximally productive, employment generating and cost effective way;

2. imports coordinated with host country's effective economic development plan;

3. emphasis on imports for expansion of agricultural production;

4. emphasis on imports with broad development impact;

5. insure imports are in addition to historical patterns of foreign exchange uses;

6. at least 75% of local currency generations deposited into special account and used for agreed upon economic development purposes consistent with FAA Sections 102-106;

7. local currencies as necessary for requirements of USG.

g. <u>ISDCA of 1985 Sec 207.</u> Will ESF funds be used to finance the construction of, or the operation of maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such country is a party to the Treaty for the Prohibition of Nuclear Weapons in Latin American (the "Treaty of Tlatelolco"), cooperates fully with the IAEA, and pursues non-proliferation policies consistent with those of the United States? **No**

h. <u>FAA Sec. 609.</u> If commodities are to be granted so that sale proceeds will accure to the recipient country, have Special Account counterpart arrangements been made? **Yes**

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 implementation, or covered in the agreement by exclusion (as where certain uses of funds are permitted, but other uses not).

These times 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 businesses 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 at 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 and 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. <u>FAA Sec. 604(d)</u>. If the cooperateing 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. <u>FAA Sec. 604(e) ISDCA of 1980 Sec. 705(a).</u> If offshore procurement of an agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity price of such commodity is less than parity?	N/A
7. <u>FAA Sec 604(f)</u>. 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. <u>FAA Sec. 608.(a)</u>. Will U.S. Government excess personal property be utilized wherever practicable in lieu of the procurement of new items?	Yes, although it is not likely that it will be practicable for this private sector program.
9. <u>Merchant Marine Act of 1936 Sec. 901(b). Sec. 603, FAA</u>. 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 least fair and reasonable rates.	Yes

10. <u>International Air Transport and Fair Competitive Practices Act, 1974</u>. If air transportation of persons or property is financed on a grant basis, will provision be made that U.S.-flag carriers will be utilized to the extent such services are available?	Yes
11. <u>FY 85 Continuing Resolution, Sec. 504</u>. 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. <u>FAA Sec. 621</u>. 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 competative with private enterprise and made available without undue interference with domestic programs	Yes the technical assistance will be furnished by private enterprise on a contract basis to the fullest extent practicable. It is not anticipated that the facilities of other federal agencies will be utilized.

B. <u>OTHER RESTRICTIONS</u>

1. <u>FAA Sec. 620(h)</u>. Do arrangements preclude promoting or assisting the foreign aid projects or activities of communist-bloc countries contrary to the best interest of the United States?	Yes
2. <u>FAA Sec. 636 (i)</u>. Is financing prohibited from use, without waiver, for purchase, long-term lease, exchange, or guaranty of sale of motor vehicles manufactured outside the United States?	Yes
3. <u>FAA Sec. 122(b)</u>. 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 86 Continuing Resolution Sec. 526. To pay for performance of abortions or involuntary sterilization or to motivate or coerce persons to abortions? to pay for performance of involuntary sterilizations as a 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. Finance police training or other law enforcement assistance, except for narcotics programs? — Yes

d. FAA Sec. 662. For CIA activities? — Yes

e. FY 86 Continuing Resolution Sec. 503. To pay pensions, etc., for military personnel? — Yes

f. FY 86 Continuing Resolution Sec. 503. To pay U.N. assessments? — Yes

g. FY 86 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 86 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 86 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 86 Continuing Resolution Sec. 516. to be used for publicity on propaganda purposes within U.S. not authorized by Congress? Yes

1. FAA Sec. 488. To reimburse persons, in the form of cash payments, whose illicit drug crops are eradicated? Yes

3A(1) - COUNTRY CHECKLIST - Kenya FY 1986

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FAA Sec. 481; FY 1986 Continuing Resolution Sec. 527. Has it been determined or certified to the congress by the president that the government of the recipient country has failed to take adequate measures or steps to prevent narcotic and psychotropic drugs or other controlled subsances (as listed in the schedules in section 202 of the Comprehensive Drug Abuse and Prevention Control act of 1971) which are cultivated, produced or processed illicitly, in whole or in part, in such country or transported through such country, from being sold illegally within the jurisdiction of such country to United States Government personnel or their dependents or from entering the United States unlawfully?

   No

2. FAA Sec. 481(h)(4). Has the President determined that the recipient country has not taken adequate steps to precent a) the processing, in whole or in part, in such country of narcotic and psychotropic drugs or other controlled substances, b) the transportation through sucn country of narcotic and psychotropic drugs or other controlled substances, and c) the use of such country as a refuge for illegal drug traffickers?

   No

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

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

5. FAA Sec. 620(a), 620(d), 620(f) FY 1985 Continuing Resolution Sec. 512. Is recipient country a Communist country? Will assistance be provided to Angola, Cambodia, Cuba, Laos, Syria, Vietnam, Libya, or South Yemen? Will assistance be provided to Afghanistan or Mozambique without a waiver? — No

6. FAA Sec. 620(j). Has Country permitted, or failed to take adequate measures to prevent, the damage or destruction, by mob action of U.S. property? — No

7. FAA Sec. 620(l). Has the country failed to enter into an agreement with OPIC? — No

8. FAA Sec. 620(o); Fishermen's Protective Act of 1967, as amended, Sec. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing activities in International Waters? — (a) No

b. If so, any destruction required by the Fishermen's Protective Act been made? | (b) N/A

9. FAA Sec 620(q); FY 86 Continuing Resolutions Sec. 518.
(a) Has the government of the recipient country been in default for more than six months on interest or principal of any A.I.D. loan to the country? | (a) No
(b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the appropriation bill (or continuing resolution) appropriates funds? | (b) No

10. FAA Sec. 620(s). If contempleted assistance is development loan or from Economic Support Fund, has the Administrator taken into account or the amount of foreign exchange or other resources which the country has spent on military equipments? | Yes

11. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption? | No, diplomatic relations have not been severed.

12. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the A.I.D. Administrator in determining the current A.I.D. OYB? | Kenya was not in arrears as of September 30, 1985.

13. FAA Sec. 620(a). Has the country aided or abetted, by granting sanctuary from persecution to, any individual group which has committed an act of international terrorism? | No

14. <u>ISDCA of 1985 Sec. 522(b).</u> Has the Secretary of State determined that the country is a high terrorist threat country after the Secretary of Transportation has determined, pursuant to Section 1115(e)(2) of the Federal Aviation Act of 1958, that an airport in the country does not maintain and administer effective security measures?

    No

15. <u>FAA Sec. 666</u>. Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA?

    No

16. <u>FAA Sec. 669, 670</u>. Has the country after August 3, 1977, delivered or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device?

    No

17. <u>FAA Sec. 670.</u> If the country is a non-nuclear weapon state, has it on or after August 8, 1985, exported illegally (or attempted to export illegally) from the U.S. any material, equipment, or technology which would contribute significantly to the ability of such country to manufacture a nuclear explosive device?

    No

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

    Kenya was represented at the meeting and failed to disassociate itself from the communique. This was taken into consideration by the Administrator when approving the FY86 OYB.

19. <u>FY1 1986 Continuing Resolution, Sec. 541.</u> Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions? — No

Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilizations? — No

Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning? — No

20. <u>FY 1985 Continuing Resolution Sec. 530</u>. Has the recipient country been determined by the President to have engaged in a consistent pattern of opposition to the foreign policy of the United States? — No

B. <u>FUNDING CRITERIA FOR COUNTRY ELIGIBILITY</u>

<u>DEVELOPMENT ASSISTANCE COUNTRY CRITERIA</u>

1. <u>FAA Sec. 116</u>. Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy? — The Department of State has not so determined.

2. <u>Economic Support Fund Country Criteria</u>

FAA Sec. 502.B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the country made such significant improvements in its human rights record that furnishing such assistance is in the national interest?	No