AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete) — Amendment Number: — DOCUMENT CODE: 3

2. COUNTRY/ENTITY: KENYA

3. PROJECT NUMBER: 615-0240

4. BUREAU/OFFICE: AFRICA — 06

5. PROJECT TITLE (maximum 40 characters): STRUCTURAL ADJUSTMENT ASSISTANCE PROGRAM

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 12 DD 30 YY 91

7. ESTIMATED DATE OF OBLIGATION (Under 'B.' below, enter 1, 2, 3, or 4)
A. Initial FY 88 — B. Quarter 4 — C. Final FY 88

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY 88 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total	3000	-	3,000	3000		3000
(Grant)	(3000)	( )	( )	(3000)	( )	(3000)
(Loan)	( )	( )	( )	( )	( )	( )
Other U.S. 1.						
Other U.S. 2.						
Host Country		1,000	1,000		1,000	
Other Donor(s)						
TOTALS	3000	1,000	4,000	3000	1,000	4000

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	C. 2. Loan	D. OBLIGATIONS TO DATE 1. Grant	D. 2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	E. 2. Loan	F. LIFE OF PROJECT 1. Grant	F. 2. Loan
(1) DFA	660	720	-			3,000		3,000	
(2)									
(3)									
(4)									
TOTALS						3,000		3,000	

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 050

11. SECONDARY PURPOSE CODE: 180

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code							
B. Amount							

13. PROJECT PURPOSE (maximum 480 characters)

To provide technical assistance in support of the Structural Adjustment Assistance Program by financing, among other things, technical assistance, training and commodities to support the analysis for and undertaking of policy initiatives and institutional change by the Republic of Kenya.

14. SCHEDULED EVALUATIONS: Interim MM 12 YY 88 — MM YY — Final MM YY

15. SOURCE/ORIGIN OF GOODS AND SERVICES: [ ] 000 [ ] 941 [x] Local [x] Other (Specify) 935

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment.)

The methods of implementation and financing have been approved by the Mission Controller.

CONT: T. TOTINO

17. APPROVED BY — Signature: [signature] — Title: DIRECTOR/USAID/KENYA — Date Signed: MM 08 DD 18 YY 88

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM 09 DD 28 YY 88

AID 1330-4 (8-79)

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I. EXECUTIVE SUMMARY

Kenya is facing large financial imbalances both externally and internally. The imbalances are in part due to drastic fluctuations in commodity prices and export earnings, and in part to excessively expansionary fiscal policy. The latter can in turn be attributed to slow progress in reforms which have significant implications either directly on the budget or indirectly contributing to economic growth and revenue. Easy credit and financial policies to accommodate the large budget deficit contributed to a higher rate of inflation. Kenya's development priorities have to include cautious demand management and financial discipline. Without stabilization measures to reduce the budget deficit and to strengthen the balance of payments position, it would be difficult to accomplish sustained longer-term structural changes. These changes include both macroeconomic and sectoral policies. The former includes budgetary reform and import liberalization, while the latter focuses on fertilizer pricing and marketing policies, and capital market development issues. The macroeconomic policy changes have direct bearing on sectoral developments relevant to the A.I.D. program in Kenya. A substantial portion of the financing gap is expected to be filled by IMF assistance (both stand-by and structural adjustment facility) and the World Bank sectoral loans.

A. Program Purpose

The purpose of the Structural Adjustment Assistance Program (SAAP) is to support key sectoral and structural reforms through the provision of fertilizer and essential intermediate imports and technical assistance. The reforms under SAAP include fertilizer pricing and marketing policies, and policies to promote private enterprise development in the industrial and commercial sectors, as well as budgetary reform and debt management.

Under this Amendment, increased emphasis is placed on the agriculture sector, and, specifically, fertilizer policy reform (see Annex H: Agricultural Sector Analysis). This is facilitated by the use of the Development Fund for Africa (DFA).

The $7.5 million Development Fund for Africa component will be directed to support of the fertilizer reform program and to support related technical assistance for the overall reform program. The counterpart generations will be similarly focused on agriculture sector budgetary constraints. The $10 million from Economic Support Fund component will be used to improve the policy environment for the private sector. This includes import liberalization, capital market development, and better budget and debt management. The means through which this third and last Grant Amendment will contribute to the achievement of this purpose are by:

1. providing additional foreign exchange to replenish the private sector commodity import program;

2. utilizing local currency proceeds from the sales of imported commodities, both from this Amendment and prior A.I.D. programs, to encourage institutional changes and policy initiatives;

3. financing technical assistance to support the analysis for and undertaking of policy initiatives and institutional change;

4. continuing support of market-based fertilizer policies which promote rural distribution, liberalize import licensing approval process, and improve planning and analytic capability of the Fertilizer Inputs Unit of the Ministry of Agriculture;

5. supporting components of the GOK budget, including those agriculture sector projects in which A.I.D. has a special interest;

6. encouraging further import liberalization by implementing a new system of import licensing schedules and progress toward unrestrictive licensing for imports under Schedule 1;

7. initiating actions directed to the establishment of a Capital Market Development Authority; and

8. assisting the GOK in reducing its budget deficit through use of local currency proceeds from the sales of imported commodities, both from this Amendment and prior A.I.D. other programs.

B. Program Resources

This SAAP Amendment consists of an A.I.D.-financed private sector commodity import program and a complementary technical assistance support grant. The local currency generated (Counterpart Funds) from the sale of imported commodities also provides opportunities for policy conditionality and direction of resources to support of those sectors which which are of interest to A.I.D.

A total of $14.5 million is to be added for a private sector commodity import program similar to that financed in FY 84 and FY 85 under the Structural Adjustment Assistance Program (615-0213). In general, existing logistics and management systems will continue. An implementation plan is described in the Program Implementation Section.

Under this Program Grant Amendment, $2.2 million equivalent of local currency proceeds will be placed in a Trust Fund to be used by A.I.D. for operational support of the USAID/Kenya Mission and for monitoring of the CIP imports and counterpart deposits.

The local currency equivalent of $4.5 million accruing from the DFA component of the CIP will be used in support of components of the GOK agriculture and livestock budget, including those in which A.I.D. has a special interest. An equivalent of $5.0 million in counterpart funds will be used for mutually agreed upon private sector development activities. The remainder may be used to fund sectoral activities in the GOK development budget which are supportive of the general objectives contained in USAID's Country Development Strategy Statement, provided that adequate funding is given to high-priority USAID-financed activities.

Utilization of counterpart funds generated from prior A.I.D. programs (PL-480, private sector CIP and fertilizer imports) has also been conditioned on fertilizer and budget policy reform measures, as detailed in the Policy Conditionality Section.

A complementary Project Grant provides an additional $3.0 million for technical assistance. A total of $1.2 million will be used to fully fund the Resource Management for Rural Development Activity (HIID contract). The Ministry of Finance has requested A.I.D. to fund a long-term (2-year) technical advisor and selected short-term in-country consultants to assist the government in the creation of a functional Capital Market Development Authority. A total of $600,000 is planned for the funding of this activity. A total of $975,000 is planned for a noncompetitive extension of the Thunder and Associates Contract for approximately eight months. This extension is necessary to allow A.I.D. and the Kenyan Government time to assess and plan for technical assistance in this area under a new multi-year adjustment program to be developed in the next fiscal year. The justification for noncompetitive extension is given in Annex E of this Amendment. Additional funding of $100,000 is planned for assistance in locating U.S. suppliers for CIP importers, and evaluation activities. A total of $125,000 is set aside for policy-related studies and evaluation of the technical assistance component of this program and for planning future technical assistance.

C. Summary of A.I.D. Inputs Costs

The proposed $17.5 million Program Amendment will be allocated as follows:

Component		($000)
Commodity Import Program		14,500
Technical Assistance Project of which:		3,000
Sectoral Planning (HIID consultancy)	1,200	
Microcomputer Section at Ministry of Finance	975	
Capital Market Development Authority	600	
CIP Evaluation and Importer Assistance	100	
Studies and Evaluation of Technical Assistance	125	
Total		17,500

D. Policy Conditionality

The disbursement of the local currency generated under this Amendment, as well as earlier A.I.D. agreements, is conditioned upon satisfaction of policy performance benchmarks which are detailed in Sections IV and VI of this Amendment. The policy agenda is fully consistent with Kenya's development priorities in economic stability and structural adjustment. The policy changes emphasized in this program are also consistent with other donors' reform efforts, notably those of the IMF and the World Bank.

II. MACROECONOMIC ANALYSIS AND NEAR-TERM OUTLOOK

A. Overall Economic Performance, 1986-1987

Key economic indicators show that the Kenyan economy performed exceptionally well in 1986. Real Gross Domestic Product (GDP) grew by 6.5 percent. Major factors that contributed to this growth were: (a) favorable weather conditions that stimulated agricultural production; (b) favorable external terms of trade (high coffee prices and low oil prices); and (c) continued improvement in domestic economic policies (namely, good exchange rate management, less stringent foreign exchange allocation and provision of producer price incentives for key agricultural crops).

The high GDP growth in 1986 was accompanied by an improvement in per capita income. Real GDP per capita grew by 2.5 percent in 1986 as compared with the negative average annual growth rate of 1.9 percent during 1982-1985 period. Modern sector wage employment increased by 3.9 percent in 1986. Average real wages increased by 3 percent in 1986, compared to the decline of 2.4 percent in 1985.

Value added in agriculture rose by 4.8 percent in 1986, following an increase of 3.5 percent in 1985. The pronounced increase in agricultural output in 1986 resulted largely from increased production of major commodities such as maize, wheat, coffee, beans, potatoes and milk. This was mainly attributable to good weather, a sharp rise in world prices of coffee, a suspension of coffee export quotas, and domestic policy measures undertaken to enhance producer price incentives and timely input delivery (especially fertilizers).

Real manufacturing output rose by 5.9 percent in 1986. It is the highest growth rate in the past six years. With the exception of the transport equipment industry whose value added declined by 12 per cent, all other industries registered positive real rates of growth. Substantial growth occurred in food manufacturing, beverages, metal and non-metallic mineral products, petroleum and other chemicals, textiles, non-electrical equipment, and paper and paper products. The overall improvement in manufacturing performance is attributable to: (a) improvements in the local supply of agricultural raw materials, making possible increases in the rate of capacity utilization for agro-industries; (b) increased availability of foreign exchange for the importation of required industrial material inputs; (c) reduction in manufacturing costs arising from low oil prices; and (4) increased domestic consumption of manufactured goods, partly due to removal of sales tax and reduction of prices for certain industrial commodities.

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A noteworthy development in 1986 was the decline in inflation as measured by consumer prices. The Consumer Price Index (CPI) rose by only 4.4 percent in 1986. A reduction of domestic prices of petroleum products, and an increase in food production resulting in moderate increases in the food index, in part contributed to the fall in the inflation rate.

Gross output at current prices is estimated to have risen by 16.7 percent, while domestic demand grew by 15.3 percent in 1986 (Table 1). The high growth in domestic demand was partly due to a significant increase in public consumption which went up by 23.4 percent. Private consumption, on the other hand, increased by 5 percent.

Gross investment grew by 37.4 percent in 1986, compared with 18.2 percent in 1985. Investment was particularly strong in building and construction, plant and equipment, and transport equipment. Inventories grew at a significant rate of 65.5 percent in 1986, compared with the decline of 7.9 percent in 1985. Gross investment was largely financed from domestic saving. Imports increased by 16.4 percent, while exports increased by 18.5 percent in 1986.

The performance of the Kenyan economy in 1987 has been influenced by the country's structural weaknesses and its sensitivity to developments in the international economic environment. Overall real GDP growth is expected to decline from 6.5 percent in 1986 to 5.7 percent in 1987. Worsening external terms of trade and lower growth of agricultural production are the main sources for reduced overall economic growth. Kenya's terms of trade deteriorated by 24 percent in 1987. Coffee and tea prices fell by 36 and 19 percent respectively, while petroleum prices went up by almost 9 percent. The growth of agriculture's value added is forecast to fall from 4.8 percent in 1986 to 3.8 percent in 1987. The manufacturing sector is expected to maintain its previous growth of 6 percent.

Inflation is estimated to rise to 7.2 percent in 1987, compared to 4.4 percent in 1986. This is partly due to: (a) increases in world oil prices; (b) higher domestic food prices, resulting from emerging drought conditions that have depressed overall food supply, as well as the decontrol of meat prices which has contributed to higher consumer prices, especially for the middle income group in urban areas; and (c) expansionary fiscal and monetary policies.

B. Balance of Payments Developments

The favorable terms of trade and strong growth in tourism accounted for a smaller current account deficit in 1986. The deficit was reduced from $92 million to $88 million (1.3 percent of GDP). With a smaller current account deficit and substantial improvement in the capital account, Kenya had an overall balance of payments surplus of $90 million. The foreign exchange reserves by the end of 1986, after payments of $105 million to the IMF, was estimated at SDR 363 million or equivalent to 15 weeks of imports.

Kenya's windfall benefits from the favorable terms of trade proved to be short-lived. Coffee prices began to fall during the second half of 1986 and levelled off by mid-1987. Oil prices, on the other hand, began to rise late 1986 and stabilized at a higher level in 1987. Consequently, the current account deficit tripled to $415 million (5.2 percent of GDP) in 1987.

Total merchandise exports fell by 16.5 percent as export earnings from coffee declined almost than 50 percent. Imports, already high in 1986, had been further swollen by increases in government spending. Government imports rose by 29 percent. Net export earnings from services increased moderately. Net unilateral transfers showed an increase of more than $70 million. This was largely as a result of increases in official grants which grew by 42 percent.

In the capital account, official net long-term capital inflows were estimated at $284 million, more than triple the already high level of 1986. This was mainly associated with a large hydroelectric power project and government imports of military and defense goods. However, private net long-term and short-term inflows continued to fall reflecting declining investments and increases in capital outflows. Net private long-term capital inflows fell from $29 million in 1986 to $9 million in 1987, while net short-term capital inflows were about $23 million compared to $64 million in 1986.

Although capital flows were larger, they were not adequate to finance the increase in the current account deficit. The overall balance of payments deficit was estimated at $99 million (1.2 percent of GDP). It was financed by the drawing down of foreign exchange reserves. The reserves by the end of 1987 were estimated to be SDR 205 million, or equivalent to 8 weeks of imports.

C. Fiscal and Monetary Developments

1. Fiscal Developments

The temporary economic boom of 1986 and the end of the IMF-sponsored stabilization policy led to the relaxation of fiscal and financial discipline. The expansionary fiscal policy which began in 1985 was intended to stimulate recovery following the drought. It continued and accelerated in fiscal 1986 and 1987. The budget deficit grew from 5.2 percent of GDP in 1985 to 5.6 and 8.1 percent of GDP in 1986 and 1987 respectively.

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The large deficits of the last two years came at the time when there were substantial increases in government revenue. Revenues increased by 18 and 15 percent in 1986 and 1987 respectively, while grants declined by 40 percent in 1986, but increased by almost three-fold in 1987. The ratio of government revenue and grants to GDP reached the government's target of 24 percent.

Government outlays, on the other hand, grew more rapidly than revenue and grants. They exceeded the budgeted levels substantially during the last two years. Total spending went up by more than 24 percent per year, with development expenditures rising by 54 percent in fiscal 1987. Extra-budgetary spending (through the supplementary budget mechanism) in fiscal 1987 is estimated to be about 10 percent higher than budgeted. Five major factors contributed to growth in expenditure:

(a) additional subsidies and transfers to the National Cereals and Produce Board (NCPB);

(b) large increases in the education budget to support the double intake of university students and the implementation of the new education system;

(c) higher debt service payments;

(d) a higher wage bill as a result of increases in wages in 1986; and

(e) spending for the All Africa Games.

2. Monetary Developments

Kenya's monetary and financial policies generally accommodate and are influenced by fiscal and balance of payments developments. In fiscal 1986, the entire budget deficit was financed by domestic banking and nonbanking sources. Net foreign financing was actually negative. The domestic sources also financed about 92 percent of the 1987 budget deficit. The government policy to rely on domestic financing sources was intended to avoid raising the external debt servicing burden, and to remove increased liquidity arising from the 1986 favorable balance of payments position.

The financing of the budget deficit during the last two years led to high credit growth. Total domestic credit grew by almost 30 percent between mid-1986 and mid-1987. During the same period, the growth of net credit to the government averaged 60 percent and accounted for almost 40 percent of total domestic credit.

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During the first half of 1986, total money supply grew at an annual rate of 30 percent, more than doubling the growth in fiscal 1985. As the current account deficit in the balance of payments widened and net foreign assets declined substantially in mid-1987, the growth of money supply slowed down to an annual rate of 9 percent in 1987. The loosening of monetary and credit policies has refueled inflationary pressures and financial instability.

Kenya's monetary authority is aware of the emerging problem and has attempted to restrict money supply and domestic credit growth. In early December 1987, the Central Bank issued a circular to the banking system to restrict its lending activity to nongovernmental entities to 0.8 percent growth per month. Unless the budget deficit, and the consequent credit expansion to the central government for deficit financing, is brought under control, the likelihood of crowding out the credit available for the private sector will increase. Whether the monetary authority will be able to continue the cautious policy stance it is presently pursuing, depends on the size of the budget deficit and the resulting pressure to accommodate the fiscal policy.

D. Near-Term Outlook

As shown in Tables 2 and 3, Kenya's financial imbalances, external and internal, are likely to remain at least for the next two to three years.

Balance of Payments. For the next three years (1988-1990) Kenya is expected to face a difficult balance of payments situation. Kenya is facing a cumulative current account deficit, excluding unilateral transfers, of more than $1.5 billion over the next three years. Normal capital flows and transfers are expected to finance about 90 percent of the deficit, leaving a cumulative overall deficit of about $130 million for the next two years. The overall deficit is expected to be eliminated by 1990.

The IMF standby arrangement and structural adjustment facility is expected to finance most of the 1988 deficit. However, because of large drawdowns of reserves in 1987, a significant portion of the IMF resources will also go to replenish the official reserve position over the next three years. This together with repayments to the IMF will leave an estimated total financing gap of about $320 million during the next three years. Most of the resources to fill the 1988 gap are likely to come from the World Bank's agricultural and industrial sector loans. In 1989 and 1990, a gap of $40-60 million remains after taking into account the anticipated World Bank industrial sector loan. This forecast is probably on the optimistic side. The projected unfilled gaps, especially in 1989 and 1990, could be bigger.

Fiscal and Monetary. The expansionary fiscal policy of the last two years is clearly not sustainable. In the 1988 budget speech, the government restated its intention to reduce the budget deficit in order to improve the balance of payments position and to sustain noninflationary growth. According to the Kenyan authorities, the projected budget deficit for fiscal 1988 is 5.5 billion shillings ($325 million) or 4.2 percent of GDP. However, this depends on two crucial assumptions: (a) a large increase in grant receipts (83 percent); and (b) no extrabudgetary spending through the supplementary budget mechanism. According to the latest estimates, the budget deficit is expected to be 5.6 percent of GDP or 2 billion shillings higher than originally projected. The actual disbursement of grants will be about 1.3 billion shillings lower and the extrabudgetary spending is estimated at 2 billion shillings, while actual revenue performs slightly better.

With inflation rising again and with the IMF program in place, restrictive monetary and credit policies are likely to be pursued. The growth of money supply is projected to be less than 10 per cent throughout 1988. Total domestic credit growth will decline from 19 percent at the end of 1987 to 11 percent by June 1988 and about 7 percent by December 1988. Net domestic credit to the government will decrease from more than 10 percent at the end of 1987 to about 8 percent by the end of fiscal 1988. It is expected to decline further to 5 percent by the end of 1988. The growth of net domestic credit to the private sector is to remain at about 11 to 14 percent during most of 1988.

E. Implications for A.I.D. Adjustment Program

The analysis suggests that in the medium-term (2-3 years) economic and financial stabilization should be of high priority. The financial imbalances in 1987 are in part due to drastic fluctuations in commodity prices and export earnings, and in part to excessively expansionary fiscal policy. The latter can in turn be attributed to slow progress in reforms which have significant implications either directly on the budget or indirectly contributing to economic growth and revenue. Kenya's development priorities have to include more cautious demand management and financial discipline. Without stabilization measures to reduce the budget deficit and to strengthen the balance of payments position, it would be difficult to accomplish sustained longer-term structural and sectoral changes.

Given the current economic situation and financial constraint as well as the need to maintain an import level consistent with a reasonable economic growth rate, the A.I.D. FY-1988 Structural Adjustment Assistance Program (SAAP) Amendment will focus on helping Kenya achieve economic and financial stability. The assistance under the SAAP can help

TABLE 1

KENYA: Selected Indicators of Macroeconomic Developments, 1981 - 1987

	1981	1982	1983	1984	1985	1986	1987
National income, employment, and prices:							
GDP growth rate, real (percent)	4.25	0.14	1.46	2.37	3.74	6.48	5.13
Gross investment, nominal (% change)	8.82	-10.98	5.66	9.84	18.21	37.44	....
Private fixed investment	18.18	-8.80	20.64	-9.72	41.63	24.93	....
Public fixed investment	14.53	-6.70	-8.87	22.81	2.03	46.75	....
Changes in stocks	-19.96	-27.89	-6.11	66.49	-7.89	65.52	....
Consumption, nominal (% change)	13.94	15.03	8.05	11.98	12.35	9.26	21.39
Government	7.99	12.32	13.23	5.80	14.08	23.38	12.15
Private	15.92	15.87	6.50	13.95	11.84	4.99	24.68
Gross national savings, nominal (% change)	16.56	-4.65	41.93	1.95	20.59	52.22	1.46
Gross investment, nominal (% of GDP)	28.39	22.42	21.15	21.03	21.80	25.67	....
Private fixed investment	13.32	10.77	11.60	9.49	11.78	12.61	....
Public fixed investment	10.66	8.82	7.18	7.98	7.14	8.98	....
Changes in stocks	4.41	2.82	2.36	3.56	2.88	4.08	....
Consumption, nominal (% of GDP)	80.60	82.22	79.32	80.43	79.25	74.18	80.07
Government	19.06	18.98	19.19	18.38	18.39	19.44	19.39
Private	61.54	63.24	60.13	62.04	60.86	54.74	60.68
Gross domestic savings, nominal (% of GDP)	16.90	14.03	18.24	16.79	17.95	22.98	19.93
Resource gap, nominal (% of GDP)	-12.20	-8.72	-3.80	-5.02	-4.87	-3.58	....
Agricultural production, real (% change)	6.22	2.77	10.70	6.50	-11.28	15.49	....
Industrial production, real (% change)	5.07	0.77	4.54	4.10	4.64	5.89	....
Total wage employment (% change)	1.84	2.12	4.52	2.41	4.89	3.92	....
Private	1.10	0.04	4.64	2.25	3.74	3.48	....
Public	2.68	4.44	4.40	2.59	6.12	4.38	....
GDP deflator (% change)	10.35	12.61	10.39	7.89	9.91	9.63	6.97
Consumer prices (% change)	20.27	17.43	10.24	8.33	9.25	4.38	7.00
Trade and payments:							
Exports, goods & services (mn. U.S. dols.)	1808.91	1725.55	1661.23	1670.75	1596.05	1891.20	1783.60
Imports, goods & services (mn. U.S. dols.)	2589.08	2182.61	1784.16	1958.77	1878.31	2185.67	2456.17
Current account deficit							
(mn. U.S. dollars)	562.82	387.50	7.48	110.70	91.38	87.99	400.95
(% of GDP)	9.57	7.23	0.14	2.07	1.55	1.27	5.22
Overall balance (-deficit)							
(% of GDP)	-3.41	-1.42	4.00	0.84	-1.72	1.31	-1.25
Gross international reserves							
(mn. SDRs)	215.00	210.00	379.00	416.00	380.00	363.00	205.00
(weeks of imports)	7.15	7.08	15.16	16.58	15.85	15.13	8.55
Terms of Trade (% change)	-13.93	-4.76	-6.00	17.02	-16.36	11.96	-24.27
Terms of Trade, non-oil items (% change)	-14.05	-3.85	-12.00	22.73	-19.44	6.90	-23.66
Nominal effective exchange rate							
(1982 = 100)	112.00	100.00	100.90	101.70	81.30	77.70	77.50
Real effective exchange rate							
(1982 = 100)	103.30	100.00	105.10	105.60	97.30	95.10	79.10

March 31, 1988

TABLE 1 (Cont'd)

KENYA: Selected Indicators of Macroeconomic Developments, 1981 - 1987

	1981	1982	1983	1984	1985	1986	1987
Public finance:							
Revenue and grants (% change)	20.27	11.26	8.56	6.73	15.80	14.99	22.22
Expenditure (% change)	24.93	4.91	-1.28	8.78	24.32	15.67	24.82
Revenue and grants (% of GDP)	26.16	25.57	24.70	23.71	24.45	24.35	26.01
Expenditure (% of GDP)	34.87	32.14	28.24	27.63	30.58	30.64	33.42
Budget deficit (% of GDP)	9.49	6.47	3.58	3.94	5.25	5.58	8.11
Domestic financing of deficit							
Bank (% of GDP)	2.78	2.63	0.11	1.20	0.91	1.85	4.96
Nonbank (% of GDP)	1.82	2.25	2.08	2.57	3.11	4.65	2.48
Foreign financing (% of GDP)	4.89	1.59	1.40	0.16	1.24	-0.92	0.66
Money and credit:							
Money (M2) supply growth	12.92	13.84	6.56	12.86	10.20	27.55	9.22
Domestic credit growth	26.22	28.86	0.12	10.72	12.48	29.04	17.72
Government	79.02	61.67	-18.49	11.01	10.15	53.72	30.10
Other public entities	-6.63	114.84	85.59	13.97	13.44	16.40	22.15
Private sector	11.97	10.23	7.13	10.17	13.60	17.85	8.83
Interest rate, annual							
Saving deposit (minimum, percent)	10.00	12.50	12.50	11.00	11.00	11.00	11.00
Bank lending rate (maximum, percent)	14.00	16.00	15.00	14.00	14.00	14.00	14.00
Saving deposit (minimum, percent)	-8.54	-4.20	2.05	2.47	1.60	6.34	3.74
Bank lending rate (maximum, percent)	-5.21	-1.22	4.32	5.23	4.35	9.22	6.54
Public and publicly-guaranteed debt:							
External Debt:							
Outstanding & disbursed							
(mn. of U.S. dollars)	2646.12	2799.74	2946.16	3037.08	3018.49	3466.81	3931.94
(% of GDP)	44.99	52.23	53.20	56.80	51.09	50.10	51.23
Debt service (% of export earnings)	18.17	22.91	24.93	27.43	31.96	30.89	34.72
Debt service (% of gov. revenue and grants)	22.39	29.54	31.29	36.91	36.62	36.60	31.96
Interest payments (% of export earnings)	8.85	10.99	10.53	11.16	11.31	11.46	12.97
Interest payments (% of gov. rev. and grants)	10.91	14.17	13.21	15.02	12.73	13.58	11.93
Domestic Debt:							
Outstanding & disbursed							
(mn. of KL)	380.00	675.00	886.55	990.20	1130.85	1482.55	1751.20
(% of GDP)	12.56	19.79	23.21	23.47	23.51	26.40	27.73
Debt service (% of gov. rev. and grants)	6.93	9.38	10.43	12.53	14.60	15.12	....

TABLE 2

KENYA: BALANCE OF PAYMENTS
(in millions of U.S. dollars)

	1985	1986	1987	1988 (Projections)	1989 (Projections)	1990 (Projections)
CURRENT ACCOUNT, NET	-91.4	-88.0	-401.0	-301.6	-228.8	-148.2
Exports, f.o.b.	942.2	1152.0	926.1	965.9	1053.0	1147.9
of which:						
Coffee	281.2	478.6	252.2	266.5	292.5	312.0
Tea	233.5	213.5	203.1	208.0	234.0	260.0
Petroleum Products	118.8	73.9	55.6	53.3	55.9	58.5
Other	308.7	385.9	415.2	438.1	470.6	517.4
Imports, c.i.f.	1469.2	1683.4	1853.4	1868.1	1955.2	2046.2
of which						
Government	94.4	316.7	394.5	240.5	262.6	286.0
Oil	461.0	300.3	333.7	351.0	364.0	378.3
Other	913.8	1066.3	1125.3	1276.6	1328.6	1381.9
TRADE BALANCE	-527.0	-531.4	-927.4	-902.2	-902.2	-898.3
Services (net)	244.7	237.0	254.8	302.9	362.7	423.8
Investment Income	-206.1	-238.1	-294.9	-314.6	-327.6	-336.7
Travel	233.5	282.7	327.2	360.1	393.9	429.0
Other	217.3	192.4	222.5	257.4	296.4	331.5
Unilateral Transfers (net)	190.9	206.5	271.6	297.7	310.7	326.3
Private	81.2	57.5	67.3	74.1	78.0	84.5
Official	109.7	149.0	204.4	223.6	232.7	241.8
CAPITAL ACCOUNT, NET	-10.2	178.3	305.2	218.4	184.6	204.1
Long-term (net)	-47.7	113.8	283.3	196.3	162.5	182.0
Official	-55.8	84.5	274.2	183.3	145.6	159.9
Private	8.1	29.3	9.1	13.0	16.9	22.1
Short-term (net)	37.6	64.5	22.0	22.1	22.1	22.1
ERRORS AND OMISSIONS	0.0	0.0	0.0	0.0	0.0	0.0
OVERALL BALANCE	-101.5	90.3	-95.7	-83.2	-44.2	55.9
FINANCING	101.5	-90.3	95.7	-14.3	-114.4	-132.6
Gross Reserves	36.6	19.9	204.4	-45.5	-71.5	-58.5
IMF Credit (net)	55.8	-105.6	-108.6	31.2	-42.9	-74.1
Purchases	123.9	0.0	0.0	117.0	84.5	26.0
Repurchases	-68.0	-105.6	-108.6	-85.8	-127.4	-100.1
Other Assets (net)	9.1	-4.7	0.0	0.0	0.0	0.0
FINANCING GAP				97.5	158.6	76.7

April 5, 1988

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TABLE 3

KENYA: SUMMARY OF GOVERNMENT FINANCE
(in million of shillings)

	1984/85	1985/86	Budget 1986/87	Estimated Actual 1986/87	Budget 1987/88	Projected 1987/88	Projections 1988/89	Projections 1989/90
GOVERNMENT REVENUE & GRANTS:	22077	25387	32041	31029	37276	36092	40263	44556
Revenue	20534	24291	28836	28218	32448	32504	36248	40381
Grants	1543	1096	3205	2811	4828	3588	4015	4175
EXPENDITURE:	27614	31941	36337	39870	42499	43534	45799	50066
Recurrent	20835	24444	26559	28346	30833	33178	34838	38595
Development	6779	7497	9778	11524	11666	10356	10961	11471
ADJUSTMENT	795	734		-831				
OVERALL CASH DEFICIT	-4742	-5820	-4296	-9672	-5223	-7442	-5536	-5510
FINANCING:	4742	5820	4296	9672	5223	7442	3788	3729
Foreign Financing (net)	1117	-963	1216	789	535	1272	134	175
Domestic Financing, of which:	3625	6783	3080	8883	4688	6170	3654	3554
Nonbank	2804	4851	....	2960	3188	4844	2485	2747
Bank & CSFC	821	1932	....	5923	1500	1326	1169	807
FINANCING GAP							1748	1781
				(in percent of GDP)				
MEMORANDUM ITEMS:								
Revenue and Grants	24.5	24.4	26.9	26.0	28.2	27.3	27.9	27.5
Revenue	22.7	23.3	24.2	23.7	24.6	24.6	25.1	24.9
Grants	1.7	1.1	2.7	2.4	3.7	2.7	2.8	2.6
Expenditure	30.6	30.6	30.5	33.4	32.2	33.0	31.7	30.9
Recurrent	23.1	23.4	22.3	23.8	23.4	25.1	24.1	23.8
Development	7.5	7.2	8.2	9.7	8.8	7.8	7.6	7.1
Overall Deficit	-5.3	-5.6	-3.6	-8.1	-4.0	-5.6	-3.8	-3.4

support imports of raw materials, intermediate and capital goods. These imports are necessary for economic growth and employment.

To achieve the stabilization objective, the highest priority area in the adjustment process is in public finance. A smaller budget deficit will help reduce monetary and credit growth and government borrowing. A less expansionary monetary policy consistent with the growth potential on the real side of the economy can help contain existing inflationary pressures. This will contribute to strengthening the balance of payments situation. To carry out the adjustment process, the Kenyan government sought IMF assistance in early 1987. The IMF assistance includes a stand-by arrangement and the use of the IMF Structural Adjustment Facility. The A.I.D. FY-1988 SAAP will provide additional resources for a similar macroeconomic adjustment program.

Together with balance of payments and budgetary support, A.I.D. will also attempt to encourage consistent and sustained implementation of certain policy changes. The priority reform areas are: (a) public expenditure reduction and restructuring, particularly with respect to financing of money-losing public enterprises (such as, the National Cereals and Produce Board); and (b) import policy consistent with promoting efficient uses of domestic resources, investment and growth. As discussed in the next section, though there have been some encouraging signs recently in budgetary reforms and import liberalization, consistent and sustained policy action is still missing. This SAAP Amendment could serve as a preparatory basis for continued dialogue for reform in the aforementioned areas in the context of a new multi-year policy-based program.

III. THE FY-1988 PROGRAM GRANT AMENDMENT

A. Background

Despite improved economic management and structural adjustment efforts, economic growth in Kenya during 1980-1987 was not sufficient to provide adequate employment opportunities, incomes, and basic social services for a growing population. Average per capita income, except for 1986 and 1987, declined by approximately one percent per year. For most of the 1980s, wage employment in the private sector grew less than 4 percent per year. The resulting gap between population and labor force growth and employment creation was a serious structural imbalance and a concern for the Kenyan Government.

Since the early 1980s, the Kenyan Government has attempted to address the problem. The Government's latest strategy document (Sessional Paper No. 1 of 1986) reiterated the concern for the employment gap. A medium-term framework (1988-1990) was outlined in the Policy Framework Paper (PFP). A major element of the development strategy is the role of the private sector. It emphasizes that private enterprises must play a dominant role in revitalizing the economy. The agricultural, industrial, and commercial sectors, to be supported by favorable policy environment, are expected to serve as the principal instruments for achieving the required output growth and employment.

The USAID Structural Adjustment Assistance Program (SAAP) initiated in 1986 is a three year program and is ending in FY 1988. The SAAP, together with the World Bank and the IMF programs, has assisted the Kenyan Government to promote a policy environment more conducive to the private sector, and specifically more market oriented policies in fertilizer pricing and marketing.

B. Program Purpose

The purpose of the Structural Adjustment Assistance Program (SAAP) is to support key sectoral and structural reforms through the provision of fertilizer and essential intermediate imports and technical assistance. The statement of purpose contained in the 1986 PAAD reads, "... 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." The purpose as stated in this Amendment differs from the original primarily through an added emphasis on sectoral as well as structural reform, and through recognition that the objectives of providing balance of payments support through fertilizer and commodity import programs, and technical assistance are secondary to the policy reform objectives.

The SAAP is a three year (1986-1988) $46.4 million program assistance package ($38.9 million ESF and $7.5 million DFA). The reforms under SAAP include fertilizer pricing and marketing policies, and policies to promote private enterprise development in the industrial and commercial sectors, as well as budgetary reform and debt management. Under this Amendment, increased emphasis is placed on the agriculture sector, and, within that sector, reforms in fertilizer policy (see Annex H: Agricultural Sector Analysis). This is facilitated by the use of the Development Fund for Africa (DFA).

The means through which this third and last $17.5 million Program Grant Amendment will contribute to the achievement of this purpose are by:

1. providing additional foreign exchange to replenish the private sector commodity import program;

2. utilizing local currency proceeds from the sales of imported commodities, both from this Amendment and prior A.I.D. programs, to encourage institutional changes and policy initiatives;

3. financing technical assistance to support the analyses for and undertaking of policy initiatives and institutional change;

4. continuing support of market-based fertilizer policies which promote rural distribution, liberalize import licensing approval process, and improve planning and analytic capability of the Fertilizer Inputs Unit of the Ministry of Agriculture;

5. supporting components of the GOK budget, including those components of the agriculture sector budget in which A.I.D. has a special interest;

6. encouraging further import liberalization by implementing a new system of import licensing schedules and progress toward unrestrictive licensing for imports under Schedule 1;

7. initiating actions directed to the establishment of a Capital Market Development Authority; and

8. assisting the GOK in reducing its budget deficit through use of local currency proceeds from the sales of imported commodities, both from this Amendment and prior A.I.D. other programs.

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C. Program Description

The objective of this third and last tranche of the SAAP is to continue to assist the Kenyan Government in pursuing necessary policies to achieve increased output growth and employment in agriculture and private industries. The $7.5 million Development Fund for Africa component of this Program Grant Amendment will be used to support sectoral adjustment in agriculture focused on fertilizer policy reform, and for support of related technical assistance for the overall reform program. The counterpart generations will be segregated and tracked for utilizations to include support of components of the GOK agriculture and livestock budget of special interest to A.I.D. The $10 million from Economic Support Fund component will be used to improve the policy environment for the private sector. This includes import liberalization, capital market development, and better budget and debt management.

1. Sectoral Adjustment in Agriculture

The increased emphasis on the agriculture sector in this Amendment is facilitated by the use of the DFA. The 1986 PAAD summarizes USAID's agriculture strategy:

> "In the immediate to short-term, the focus must be on both the development of an environment capable of providing the farming households with necessary inputs and incentives to intensify production per head per unit... in the longer-term, the focus must be on agricultural research and development of production enhancing technology (p. 48)."

USAID's sector strategy is elaborated in the Agricultural Sector Strategy Statement (June 1986).

An analysis of the development constraints faced by Kenya in the agriculture sector and the rationale for the agriculture sector components and conditionality of this Program are presented in Annex H to this PAAD Amendment. Fertilizer reforms continue to be given priority because they are seen by USAID as a critical means to achieve increases in production. In addition, at least $4.5 million in counterpart funds generated under this Amendment will by jointly programmed by USAID and the GOK to support of selected GOK expenditures in the agriculture sector.

a. DFA-supported Fertilizer Reform

Prior to 1983, fertilizer marketing and pricing were in disarray. The supply of fertilizer imports was very unreliable, with an oligopolistic market structure. Fertilizer imports and distribution were concentrated in the hands of a

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few importers. The largest distributor was the government-controlled Kenya Farmers Association (now changed to Kenya Grain Growers Cooperative Union). In addition, there were a few private importers who sold fertilizer mainly to large estate farms. Imports of fertilizer usually arrived late for the planting season due to poor planning. The pricing system and the import allocation and administration procedures were inefficient and cumbersome. It encouraged importers to over-invoice and did not provide incentives for finding less expensive sources of supply.

A.I.D.-supported reform objectives broadly fall into four areas:

(a) improving planning and liberalizing import licensing and allocations in order to ensure timely availability of right types of fertilizer in adequate quantities and at reasonable prices;

(b) increasing the number of private fertilizer distributors and strengthening private sector marketing and distribution networks which include extension services to promote proper use of fertilizer by smallholder farmers;

(c) changing the pricing structure to ensure adequate incentives for finding cheaper sources of supply and for promoting retail distribution of fertilizer in affordably small quantities for smallholder farmers;

(d) improving coordination of donor-financed fertilizer imports so that donor-financed fertilizer will not undermine commercially imported fertilizer.

These agricultural reform objectives are to be accomplished over a number of years. Considerable progress has been made under the A.I.D.-supported program. The first significant policy change was fully implemented with the government removing the KFA's monopoly in distribution of donor-financed fertilizer. There are now more than 35 fertilizer distributing firms and 44 approved importers, including cooperatives which are important suppliers to smallholder farmers. Since 1986 USAID-financed fertilizer has been retailed in smaller packages of 10, 25, and 50 kilo-bags. The smaller packaging makes fertilizer more readily available to smallholder users. Fertilizer supply has increased and imports have arrived in a more timely manner. The development of an annual import plan has also improved planning for determining the correct types and amounts.

The reform has introduced the use of fertilizer in areas which in the past had no access to fertilizer. These areas include the Northeastern and Western Kenya (for example, Kisii and Nyanza). About 55 percent of the beneficiaries of the

A.I.D. fertilizer program are small poor farmers. A significant number of the large farmers who benefited from the program are located in the sugar belt. The majority of the population in this area are poor outgrowers of sugar who have limited employment opportunities. By making sugar growing a more viable industry, our program has contributed to employment creation. The remainder of the large farmer beneficiaries are growing maize and wheat. The SAAP reform objective of packaging and distributing fertilizer in small quantities (for example, 10 or 25 kilogram bags instead of just 50 kilogram bags) made fertilizer more readily available to smallholder farmers and helped raised their productivity.

In 1986 the government established a Fertilizer Inputs Unit in the Ministry of Agriculture. The Unit is tasked with the data collection, analysis and monitoring of developments in fertilizer markets, imports and distribution. It also assists in the formulation of fertilizer policy and donor coordination. With the establishment of the Unit, the government was able to move toward market-based pricing policy. It implemented partially the recommendation of "Benchmark International Price" (BIP) in 1986. (See 1987 PAAD Amendment, pp. 21-22.) Further refinements and improvements in BIP-based pricing and retail margins are being encouraged by USAID and other donors, especially the World Bank. The Fertilizer Inputs Unit has also contributed to a better fertilizer import allocation process. Further improvements and timely announcement of import allocations and official prices remain one of the priority policy objectives.

While the BIP-based formula is not quite the same as complete removal of price controls, it is another encouraging and significant step toward privatizing and liberalizing the fertilizer import and distribution system. Moreover, if the fertilizer import liberalization continues so that more imports are permitted and the price ceilings are set adequately high, traders may be under pressure to sell fertilizer below the ceiling price level in order not to lose their shares of the market. If this takes place on a regular basis, price controls will become redundant and a basis for removing them will become more compelling.

USAID is undertaking an impact evaluation of the policy changes in this area. The evaluation should provide a basis for future programmatic actions in this subsector.

The FY-1988 Amendment. This Amendment proposes to assist the Kenyan Government in continuing and sustaining the reforms already adopted, as well as to support further progress in fertilizer import allocation policy. Under this Amendment the government has agreed to undertake the policy actions listed below. In addition, the release of unexpended counterpart funds generated under prior A.I.D. programs (approximately $55 million), as well as those generated under this Amendment, are conditioned upon the performance of these policy actions.

1. Continue to set the price of fertilizer based on the "Benchmark International Price" formula. This formula will contain adequate retail margins to encourage wider distribution to rural areas.

2. Review and initiate the implementation of the recommendations of the National Fertilizer Policy study, recently completed by the Ministry of Agriculture, for improving import allocation approval procedures with a view toward shortening the time and reducing the steps involved in the import licensing approval process.

b. Budgetary Support in Agriculture

Kenya's Sessional Paper No. 1 of 1986 on Renewed Economic Growth underlines the central importance of increasing agricultural prosperity to acheive economic growth by the year 2000. This is reflected in the USAID program which identifies increases in per capita food production as one of its three strategic objectives. In addition to policy change, USAID stresses basic food research and strenthening human resources in the sector as means to increase food output. The use of counterpart funds for budget support, including those PL-480 and DFA funds specifically earmarked for agriculture and rural development, will assist the GOK in meeting its commitments to fund high-priority USAID-financed research and human resources projects. These funds will also be programmed jointly by USAID and the GOK to finance other agriculture sector projects in the GOK budget.

2. ESF-supported Reforms

The DFA-supported fertilizer reform for the last year of this 3-year SAAP will be further strengthened and complemented by other reforms supported by the ESF component. This includes budgetary reform and changes in import policy which affect fertilizer, trade and industrial sectors. Furthermore, to accelerate private enterprise development and privatization, the ESF component will also support the development of the capital market. These other reforms have direct bearing on sectoral developments relevant to the A.I.D. program. The budgetary reform cuts across all sectors, but particularly in agriculture, health and family planning, and employment creation by the private sector. Reform in import policy generally affects the industrial and agricultural sectors, their capacity utilization and employment. Import liberalization, together with policy changes to promote capital market development and fertilizer pricing and marketing, directly contribute to A.I.D. achieving its principal private sector policy objective of employment creation.

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D. Program Resources

This SAAP Amendment consists of an A.I.D.-financed private sector commodity import program and complementary technical assistance support. The local currency generated (Counterpart Funds) from the sale of imported commodities also provides opportunities for policy conditionality and for direct budgetary support to those sectors and component activities within sectors of interest to A.I.D. The proposed $17.5 million provided by the SAAP will be allocated as follows:

Component		($000)
Commodity Import Program		14,500
Technical Assistance Project of which:		3,000
Sectoral Planning (HIID consultancy)	1,200	
Microcomputer Section at Ministry of Finance	975	
Capital Market Development Authority	600	
CIP Evaluation and Importer Assistance	100	
Studies and Evaluation of Technical Assistance	125	
Total		17,500

The approximately $55 million in unexpended counterpart generations from prior A.I.D. programs (PL-480, private sector CIP and fertilizer imports) constitute an "indirect" resource for the SAAP.

1. Private Sector Commodity Import Program

A total of $14.5 million ($4.5 million DFA and $10.0 million ESF) will be provided for a private sector commodity import program similar to the present CIP component of the SAAP (615-0213). In general, the present logistics and management system will continue. An implementation plan is described in the Program Implementation Section.

2. Counterpart Funds

Deposits of Local Currencies

Approximately $14.5 million equivalent in local currency will be generated through sales under the CIP component of this Amendment. These funds will be deposited in a Special Account with the Paymaster General. This Special Account will have two sub-accounts, "A" and "B," or equivalent mechanism for maintaining separate, non-comingled accounts. The generations from the $4.5 million DFA portion of the CIP will be deposited into sub-account "A," and the generations from the ESF portion will be deposited into sub-account "B."

For private sector importers and for public sector importers who do not resell the commodity imported, the required deposit to the Special Account will be the shilling equivalent of the dollars deposited by A.I.D. to the importer's correspondant bank in the U.S.; the relevant exchange rate will be the highest legal rate per dollar at the time A.I.D. makes its deposit of dollars to the correspondant bank. For public sector importers who do resell the commodity imported, the amount of the deposit to the Special Account will be the proceeds of the resale.

Programming of Counterpart Funds. Subject to the section on Policy Conditionality below, counterpart funds are earmarked as follows:

a. Kenyan Shillings 40 million (approximately $2.2 million) shall be entrusted to A.I.D. for deposit into a Trust Account to meet the requirements of A.I.D., according to the following schedule, subject to sufficient deposits. In the event of insufficient available deposits, the obligations pursuant to this schedule shall be cummulative.

January 15, 1989	Kenyan Shillings	15,000,000
July 15, 1989		15,000.000
October 15, 1989		10,000,000
Total	Kenyan Shillings	40,000,000

These funds shall be deposited to and withdrawn from the "1988 A.I.D. CIP Account," sub-account B, or equivalent separate, non-comingled account. The Trust Fund is to be used for operational support of the USAID/Kenya Mission and monitoring of the CIP imports and counterpart deposits.

b. The equivalent of $4.5 million in counterpart funds (accruing from the DFA component of the CIP) from sub-account "A," or equivalent separate, non-comingled account, and used in support of components of the GOK agricultural and livestock budget, including those in which A.I.D. has a special interest.

c. An equivalent of $5 million in counterpart funds from sub-account "B," or equivalent separate, non-comingled account, will be used for mutually agreed upon non-governmental enterprise development activities. Examples of possible uses for non-governmental enterprise activities include the Jua Kali (informal sector) program,

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the College of Insurance, Development Finance Corporation of Kenya, and the A.I.D.-supported Rural Private Enterprise project.

d. The balance of local currencies from sub-account "B," or equivalent separate, non-comingled account, may be used to fund sectoral activities in the GOK development budget which are supportive of the general objectives contained in USAID's Country Development Strategy Statement, provided that:

Counterpart funds generated from prior programs (PL-480, private sector CIP and fertilizer imports) are linked to fertilizer and budget reform measures, as detailed in the Policy Conditionality Section.

Monitoring and Accountability of Counterpart Funds. The present accounting procedures in programs 615-0213 and 615-0240 will be used for monitoring and control of local currency proceeds from the commodity import program. The Regional Financial Management Center (RFMC) has recently coordinated a review of the local currency generating program of the Kenyan Mission to determine the control strengths and weaknesses in the existing accounting system and to recommend corrective courses of action where necessary. The review, which was conducted by an independent accounting firm, concluded that adequate controls have been maintained for the ongoing CIP programs. The RFMC will continue to work closely and regularly with the Counterpart Fund Management Section in the Ministry of Finance.

The uses of counterpart funds will be agreed by the exchange of Project Implementation Letters (PILs) countersigned by the USAID Director and the Ministry of Finance authorized representative. In the PILs, special deposit account titles and numbers are agreed upon. The Kenyan Government is required to submit monthly status reports to RFMC.

To effect the specific use of counterpart funds, public sector activities to be financed by the funds are included in the government's annual budget. The activities are listed in the budget by vote, subvote, head, subhead, and line item, as appropriate. When the funds are transferred from the special accounts and their subsidiary accounts to the Exchequer, the government informs USAID accordingly. To effect the use of counterpart funds, the conditions precedent for disbursement of local currency must be met. Actual expenditures are verified one year later in a publication entitled The Appropriation Accounts issued by the Kenyan Government and certified by its Controller and Auditor-General.

3. Technical Assistance

The Amendment proposes an additional $3.0 million for technical assistance to be obligated through a complementary Project Grant Amendment. A total of $1.2 million will be used for Resource Management for Rural Development (HIID contract). This will fully fund the HIID contract.

The Ministry of Finance has requested A.I.D. to fund a long-term (2-year) technical advisor, office space and equipment for the executive body and salary expenses for the Kenyan executive when appointed, as well as selected short-term in-country consultants to assist the government in the creation of a functional Capital Market Development Authority. Amendment No. One budgets $600,000 for completion of a portion of this work. Additional funding may be provided in later years to cover the balance of the costs estimated to be needed to complete this work, contingent on the availability of funding.

A total of $975,000 is planned for a noncompetitive extension of the Thunder and Associates Contract for approximately eight months. This extension is necessary to allow A.I.D. and the Kenyan Government time to assess and plan for technical assistance in this area under a new multi-year adjustment program to be developed in the next fiscal year. A draft of the justification for noncompetitive extension is given in Annex E of this Amendment.

An additional $100,000 is planned for assistance to CIP importers to locate U.S. suppliers, and for evaluation activities.

A total of $125,000 is set aside for policy-related studies and evaluation of the technical assistance component of this program and for planning future technical assistance.

The method of payments for the technical assistance component is planned to be direct payments to contractors and suppliers on behalf of the Government of Kenya.

IV. POLICY CONDITIONALITY

Under this Amendment, the Government of Kenya has agreed to continue the adjustment process in the areas of fertilizer pricing and distribution policies, capital market development, import policy, and budgetary reform. For a discussion of the policy environment and constraints in the agriculture sector (especially fertilizer policy) and how this Amendment addresses those constraints, see Annex H.

A. Fertilizer Pricing and Distribution Policies

Background and Progress to Date. Prior to 1983, fertilizer pricing and marketing were in disarray. The pricing system, import allocation, and administrative procedures were inefficient and cumbersome. More than 85 percent of fertilizer imports and distribution were controlled by a public organization (Kenya Farmers Association--KFA). The remaining market share was concentrated in the hands of a few importers. The government was excessively involved in fertilizer import allocations and prices.

Since 1984 A.I.D. has supported reform measures to expand private sector involvement in fertilizer marketing. The first policy change took place in 1984 with the government removing the KFA's monopoly in distribution of donor-financed fertilizer. There are now more than 35 fertilizer distributing firms and 44 approved importers, including cooperatives which are important suppliers to smallholder farmers. Fertilizer supply has increased and imports have arrived in a more timely manner. The development of an annual import plan has also improved planning for determining the correct types and amounts. Since 1986 USAID-financed fertilizer has been retailed in smaller packages of 10, 25, and 50 kilo-bags. The smaller packaging makes fertilizer more readily available to smallholder users.

In 1986 the government established a Fertilizer Inputs Unit in the Ministry of Agriculture. The Unit is tasked with the data collection, analysis and monitoring of developments in fertilizer markets, imports and distribution. It also assists in the formulation of fertilizer policy and donor coordination. With the establishment of the Unit, the government was able to move toward market-based pricing policy. It implemented partially the recommendation of "Benchmark International Price" (BIP) in 1986. Further refinements and improvements in BIP-based pricing and retail margins are being encouraged by USAID and other donors, especially the World Bank. The Fertilizer Inputs Unit has also contributed to a better fertilizer import allocation process. Further improvements and timely announcement of import allocations and official prices remain one of the priority policy objectives.

The FY-1988 Amendment. The Amendment proposes to assist the Kenyan Government to continue and sustain the reform already made, as well as to make further progress in fertilizer import allocation policy. Under this Amendment the government has agreed to undertake the following policy actions:

1. Continue to price fertilizer based on the "Benchmark International Price" formula. This formula will contain adequate retail margins to encourage wider distribution to rural areas.

2. Review and initiate the implementation of the recommendations of the National Fertilizer Policy study, recently completed by the Ministry of Agriculture, to improve import allocation approval procedures with a view toward shortening the time and reducing the steps involved in the import licensing approval process.

The resources obligated and generations created under previous SAAP Amendments will continue to support these policy measures. A.I.D. will continue to work closely with the World Bank to ensure that present policy direction is maintained and further progress is made.

B. Import Policy

Background and Progress to Date. Import policy involves a number of specific policies and regulations which affect an importer's decision. Key components of an import policy include: (a) exchange rate; (b) levels and remissions of tariffs and sales taxes; (c) credit for import financing (such as monetary and fiscal policies affecting credit availability), interest rate, and monetary liquidity like the "advance deposit scheme"; (d) the level of foreign exchange reserves; and (e) quantitative restrictions and foreign exchange rationing.

Implementation of the quantitative restrictions and foreign exchange rationing have taken many forms. They include: (a) delay in approval of license applications by Ministerial Import Committee, Foreign Exchange Approval Committee, and Central Bank of Kenya for exchange control purposes; (b) cumbersome clearance and handling procedures at the ports by Customs and port authorities; and (c) burdensome price verifications to control over-invoicing or dumping.

Import liberalization involves reducing quantitative restrictions and foreign exchange rationing, and placing more reliance on timely macroeconomic adjustment (such as monetary and exchange rate policies) and fiscal instruments (tariffs and sales taxes, for example). Moreover, under import liberalization, those few remaining quantitative restrictions should become transparent and more efficiently administered.

Progress on import liberalization in Kenya tends to be a function of the balance of payments situation, more specifically the level of foreign exchange reserves. A stop-go pattern has developed, but in general there has been significant import liberalization since 1980.

The major steps were the elimination of import bans and fewer cases of "no objection certificates" together with the issuance of the first "Red-book" of Import Licensing Schedules in 1981. The Red-book provides a means toward achieving transparency in import licensing administration. Subsequent issuances of the Red-book incorporated the shift of items from more restricted import schedules to the less restricted licensing schedule. However, this process of liberalization was interrupted several times during the past seven years. There was no issuance of the Red-book in 1986 and the licensing procedures became more restricted following declining foreign exchange reserves in early 1987.

In September 1987, the Red-book was again issued, but the restrictive licensing practice remains. In order to minimize this stop-go tendency, the government has recently carried out a comprehensive review of the present import licensing system. It is in the process of making major changes in the import licensing schedules to facilitate freely licensing procedures for high priority imports (raw materials, spares, intermediate and capital goods).

The present four import schedules are to be reorganized into three schedules. Their respective tariff rates will also be changed. The rates will be consolidated into two or three lower rates in order to make them less diversified. The intention is to have items under Import Schedule 1 licensed without restriction provided that items are properly classified and priced reasonably. This Schedule is similar to the present Schedule 1A, but it has a smaller number of items (about 20 percent less). Those items which in practice were not freely licensed under the present Schedule 1A have been removed. The proposed new Schedule 1 represents about one-third of all the import items, or 43 percent of the 1986 import bill. The average tariff rate for imports under this Schedule is 28 percent.

Kenya is now entering an important phase of import liberalization. It has engaged since mid-1987 in policy discussion with the World Bank as part of the negotiation of an industrial sector loan. However, to many skeptics Kenya's import liberalization policy has been uneven and not always sustained. This is partly due to the government's concern that imports may undermine import competing domestic firms and may adversely affect the foreign exchange reserve position. It is also partly due to vested interest groups who benefit from present import restrictions. Perhaps, the area in which least progress has been made is in the implementation of unrestrictive licensing procedures.

A presidential directive was issued in January 1988 to several licensing offices in the Treasury and Ministry of Commerce. The directive emphasizes the need to reduce delays in issuing import licenses, particularly for imports of raw materials and machinery, in order to allow industries to operate at full capacity.

The FY-1988 Amendment. The Amendment proposes to assist the Kenyan Government to make further progress in import liberalization. Under this Amendment the government has agreed to undertake the following policy actions:

1. Issue new Import Licensing Schedules containing the reorganized schedules by August 1988.

2. Permit goods on Schedule 1 to be licensed without restrictions provided that they are properly classified and priced reasonably.

A.I.D. proposes to use the resources under the commodity import program to support these policy measures. The additional foreign exchange, together with the IMF and the World Bank balance of payments support, should provide adequate cushioning in terms of the foreign exchange reserve position for import liberalization.

The disbursement of program funds will not be directly tied to any specific conditions precedent other than creation of necessary CIP accounts and subsidiary accounts.

C. Development of Capital and Money Markets

Background and Progress to Date. The financial sector in Kenya has grown substantially in terms of the number of banks and other financial institutions. However, most activities of these institutions are limited to provision of credit facilities. Equity and long-term debt financing as well as a secondary market structure are still lacking. This lack of well functioning capital and money markets is a major constraint for effective mobilization of long-term capital.

The Development Plan of 1984-88 and the 1986 Sessional Paper called for the development of capital and money markets. In 1984, a study carried out jointly by the Central Bank and the International Finance Corporation (IFC) recommended that a Capital Market Development Authority be set up. The major task of the authority is to create conditions conducive to active capital mobilization. The study identified a number of policy issues that the Authority is expected to address. They include: taxation of companies going public, protection of investors, tax and other incentives to induce companies to raise capital in the stock market, development of the Nairobi Stock Exchange, and improved services in brokerage, dealership and underwriting.

To implement the recommendations in the study, the Kenyan Government, in June 1987, created a Capital Market Development Committee involving the Ministry of Finance, Ministry of Planning, and the Central Bank. The committee's task is to prepare a program of action and reforms required for the establishment of the Capital Market Development Authority. With USAID assistance, the committee has formulated a program of action for establishing the Authority. The Ministry of Finance has requested USAID to finance a technical advisor to help establish the proposed Capital Market Development Authority as recommended by the committee.

The FY-1988 Amendment. The Amendment proposes to assist the Government to implement and accelerate the evolution of sound capital and money markets. Under this Agreement the government has covenanted to the following initial actions:

1. Complete the necessary legal and administrative requirements for making the Capital Market Development Authority operational by June 1989.

2. Review, the tax system to ensure that taxes do not create disincentives for issuance of public equity and debt instruments and to investors in such securities.

A.I.D. proposes to use the technical assistance component of the SAAP together with the Private Enterprise Development Project to pursue the dialogue and to ensure that necessary policy actions are taken. The Kenyan authorities have already requested A.I.D. to finance a long-term technical advisor. The long-term technical advisor will be complemented by short-term consultancies as needed.

D. Budgetary Reform

Background and Progress to Date. Central to Kenya's stabilization and structural adjustment strategies are improved public resource management and restraint of government spending growth to reduce the budget deficit. During fiscal 1986 and 1987, Kenya's discipline in pursuing stabilization measures waned. The budget deficits exceeded the planned targets substantially. Most of these deficits were financed by government's domestic borrowing which resulted in rapid growth of credit and money supply. The government projects a smaller budget deficit together with monetary and credit restraint in fiscal 1988. Some steps were also taken to improve revenue performance and grant disbursements. The government has also continued to improve its administrative procedures for planning and budgeting. Modest progress has been made in the Forward Budget mechanism. Budget projections are more realistic and timely. However, progress has been slow in containing subsidies and transfers to public enterprises. Their expenditures, particularly in grain marketing has accounted for a significant portion of the budget deficit. The budgeting process has to include public enterprise expenditure programs and reduction of extra-budgetary spending.

The FY-1988 Amendment. The Amendment proposes to assist the Kenyan Government to make further progress in the implementation of budgetary reform. Under this Amendment the government has agreed to undertake the following policy actions:

1. Provide adequate funding levels in the Forward and Annual Budgets for 1988/89 for high-priority, A.I.D.-financed activities (such as agricultural research and training, and helath and population programs).

2. Demonstrate that it has limited the 1987/88 national budget deficit financing from domestic sources to no more than 4.6 percent of Gross Domestic Product (GDP), about 6.2 billion shillings, of which not more than 1.3 billion shillings or 1 percent of GDP shall be from the domestic banking system.

3. Restrain overall government spending growth for Kenyan financial year 1988/89 in order to limit the budget deficit to 5.0 percent of GDP, or less.

4. For Kenyan financial year 1988/89, limit transfers and net lending to the National Cereals and Produce Board to the provision in the budget;

A.I.D. proposes to use previously held local currency stock (counterpart funds) to support the above actions. These funds are generated from past programs (PL-480, private sector CIP and fertilizer imports). The counterpart funds are intended for general budgetary support to reduce the deficit and the need for borrowing as consistent with the terms of the agreements pursuant to which that local currency was generated. These funds will finance expenditures already included in the budget. The counterpart funds from PL-480 will be used to support agricultural development activities. The counterpart funds generated from the FY 1988 Agreement will be programmed for non-governmental enterprise development activities, and for support of GOK budget expenditures for selected activities in the health and population sector and in the agricultural sector, especially research and training.

The release of these local currencies funds will be in tranches. The first tranche of counterpart funds is approximately 430 million shillings and the second tranch is approximately 550 million shillings. The release of each tranche of funds will be based on the conditions precedent detailed below in the section on Conditions Precedent, Covenants and Negotiating Status.

Prior to the disbursement of each tranche of counterpart funds, a policy review meeting will be held between the Kenyan Government and USAID. Progress in meeting performance criteria will be evaluated. The IMF evaluation of its program together with USAID's own assessment and other relevant reports to be given by the Government will provide the basis for appraising if the agreed performance criteria have been satisfied and the release of counterpart funds is warranted.

V. IMPLEMENTATION

A. Mission's Experience with CIPs

Kenya's present Commodity Import Program (CIP) is a component of the Structural Adjustment Program (615-0213), with funding in the amount of $15.0 million in FY 1984 and $13.0 million in FY 1985. The FY 1984 Program Grant Agreement was signed on September 25, 1984.

The program became operational in August 1985 when seven bank Letters of Commitment were established. Any item listed as eligible on A.I.D.'s Commodity Eligibility Listing, found as Appendix B to Handbook 15, is eligible under the CIP. By design, only private sector importers have been participants. As of December 31, 1987 four hundred and twenty six applications (with a value of $26,263,888) had been approved by A.I.D., of which three hundred and fifty four applications had been approved by the government (with a value of $20,536,883). Further, two hundred and thirty nine letters of credit had been opened with a total value of $15,383,543.

The CIP was evaluated early in 1987. It found the CIP functioning smoothly, and found that demand for eligible products was fully adequate at anticipated levels. Further, it found that the management and monitoring aspects of the CIP were generally excellent. It concluded that importer participation was conditioned on the fact that the CIP is an additional source of foreign exchange for which import licenses can be more quickly and easily obtained. From the point of view of the importer, another advantage is the 180 day grace period for deposit of the Kenya shilling cost of the imports, which is normally passed on by the banks. Firms interviewed were pleased with the CIP and reported positive effects of CIP commodities on productive capacity and general economic activity.

The evaluation mainly recommended that, because of the difficulty some importers were having in opening letters of credit, A.I.D. consider the possibility of making a credit guarantee available to such importers. This has been considered, but no workable way to do so has been discovered. The major difficulty to overcome is to design a guarantee scheme that has a minimal default rate and which is administratively feasible. The government has agreed in a covenant to explore such a scheme. The evaluation also recommended that one of the two banks which evidenced poor participation in the CIP be dropped, and that A.I.D. should consider dropping the second if the performance didn't improve. In response, the second bank has been dropped; the first has now started minimally participating and may soon be dropped. Lastly it recommended that a private sector CIP be continued.

B. General Responsibilities

Overall responsibility for carrying out the Kenyan side of the Agreement rests with the Ministry of Finance. However, the success of this CIP depends on the involvement of the several Kenyan commercial banks through which the funds will be channelled. The Kenya commercial cooperating banks will be open letters of credit and make payments into a special account of the required counterpart funds. The Central Bank's role is one that differs little from its role in ordinary foreign exchange operations. Annex D contains a description and organizations, committees and procedures involved in import administration.

A.I.D./Kenya's role will generally be one of day to day program monitoring. An experienced senior FSN who has had primary responsibility for implementation of A.I.D./Kenya's current CIP will be assigned management responsibility for the CIP to assure attainment of its objectives and to safeguard A.I.D.'s interest and investment. A contract firm will assist in the area of arrival accounting, and performing monthly verification of deposits into and withdrawals from the special account. The Mission will also advertise the CIP through A.I.D./W's Office of Small and Disadvantaged Business Utilization (SDB). Further, as under the current CIP, the Mission will review each import license application for commodity eligibility and evidence of competition, or evidence of a special supplier relationship. The Procurement Division of the Project Office will explain CIP procedures to importers and assist in locating U.S. suppliers when possible. The senior FSN, who heads the Procuremnt Division, has three and a half years experience with the current CIP, and will be supervised by an experienced USDH project development officer, and they will also have a secretary who is a personal services contractor. 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 verification of deposits into and withdrawals from the special account.

A.I.D./W's involvement will include issuance by FM/PAFD/BPCD of Letters of Commitment to the U.S. correspondent banks. SER/OP will be involved in approving Form 11 applications and in reviewing payment documents for compliance with A.I.D. Regulation One (form 11 approval checks for commodity eligibility, source/origin, and reasonableness of price.) SER/OP/COMS/M 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/OP/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.

C. Governing Regulations

Except as noted in section V. F. below with regard to DFA-funded procurements, A.I.D.'s standard financing and procurement procedures (A.I.D. Regulation One), will be applicable to all foreign exchange transaction under the grant.

1. Commodity Procurement:

The Kenya CIP program will primarily be run through the private sector. However, in rare instances a Government of Kenya request for procurement of a CIP-eligible commodity may be considered favorably if it will have an exceptional developmental impact. If such an impact can be demonstrated, USAID/Kenya would consider a request for the use of CIP funds for this purpose. When such public sector procurements are approved, the relevant Government entity will deposit into the special account the local currency equivalent of the amount to be financed, if required by FAA section 609. The Mission Director determined on August 12, 1988 to permit the use of non-interest bearing accounts at the Central Bank, in lieu of commercial interest bearing accounts.

Government bodies and their instrumentalities (parastatals) will be required to follow formal competitive bid procedures as described in A.I.D. Regulation One, Article 201.11, unless specifically waived. Public sector bodies will be defined as those entities listed as "Nonfinancial Public Enterprises" in the current "Government Finance Statistics Yearbook" published by the International Monetary Fund.

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

Publicity requirements. In order to proceed with negotiated procurement as described in Regulation One, USAID will publicize the CIP in the United States in the manner sometimes referred to as the "Columbia Plan." This will require an updating of the "A.I.D. Importer List" prepared in 1985 and published on June 4, 1986 by SDB. This list, when publicized and distributed in the U.S., will fulfill A.I.D.'s Section 201.23(b) requirements. The Kenya shilling equivalent of twenty five thousand dollars is budgeted in trust funds for this task.

2. Eligible Source-Commodities and Freight

Except as noted in section V.F. below with regard to DFA-funded procurements, the only source eligible for financing is A.I.D. Geographic Code 000, the United States. Eligible shipping therefore is restricted to U.S. flag vessels. Most imports under this program will be shipped on liner vessels. Lykes Lines provides regularly scheduled liner service from Gulf ports to Mombasa. A blanket Mission project specific shipping waiver exists for: 1) shipments from European ports up to 1,000 revenue tons, 2) shipments from Asian ports which are not served by American President Lines up to 500 revenue tons, 3) all breakbulk cargo (cargo which cannot be containerized) from Asian ports, and 4) from U.S. west coast ports, provided that cargo is not directed to that coast in an attempt to avoid use of U.S. flag service. Procurement under the CIP will be in accordance with the new DNA and source waiver. If justification exists to finance shipments on non-U.S. flag vessels in cases not covered by the blanket DNA/source waiver, SER/OP/TRANS will be requested to approve a DNA/source waiver on a case-by-case basis. Air freight will, however, also be eligible for A.I.D. financing, when such air freight is performed in accordance with section 201.13(b) of A.I.D. Regulation One. The decision whether to use air transportation will be made by the importer, in accordance with the usual commercial practice for the type of commodity and depending upon the urgency with which it is required.

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

3. Size of Transactions

The minimum size of transactions under the grant will be set initially at $5,000 as in the current CIP. This low minimum transaction size has been chosen since A.I.D.'s experience with its current CIP suggest that the volume of imports in the $5,000-$50,000 range is likely to be large and to exclude them would unnecessarily delay disbursement. The maximum size will be $1,500,000, except with USAID's written consent. USAID has reserved the right to approve transactions above this amount in order to be able to require formal procurement procedures if appropriate, and also to prevent a few large importers from utilizing too great a portion of the funds.

4. Eligible Commodities

All items in the "A.I.D. Commodity Eligibility Listing - 1986 Edition," as from time to time amended, will be eligible for financing under the grant, subject to the special provisions appended to that listing. This listing excludes from financing luxury goods, explosives, items for police or military use, etc. This wide range of eligible commodities will facilitate fast disbursement.

5. Eligible Commodity-Related Services

Insurance. The current Kenya practice requires importers to purchase insurance only locally and in Kenyan Shillings. As in the current CIP, USAID will require that importers be informed that CIP funds may be used to finance marine insurance for CIP-financed goods but that any A.I.D.-financed insurance must be placed in the U.S.

Ocean and air freight. A.I.D. will finance 100% of the ocean freight or air freight of eligible commodities if importers so desire, subject to the source conditions contained in section 2 above.

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

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

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

6. Tied Aid Program

In accordance with Section 645 of the Trade and Development Enhancement Act of 1983 and the FY 1988 Continuing Resolution, up to $5 million in ESF funds will be available from the Tied Aid Program, with additional ESF funds available provided Congress is notified. It is unlikely that this Program will use funds available under the Tied Aid Program. Should a decision be made to utilize Tied Aid funds, AID/W will be consulted and Congressional notification made, if appropriate, since the $5 million limitation is Agency-wide.

D. Implementation

1. Method of Financing

It is planned that virtually all funds under the grant will be allocated to private sector importers and that the A.I.D. bank letter of commitment/letter of credit method of financing will be used. The Government is expected to utilize the same commercial banks in Kenya which are participating in the current CIP. Letters of commitment, initially in the amount of $1 or $2 million, will be opened in favor of each participating commercial bank. This amount will be increased as the funds are utilized. In the event an allocation is made to a public sector entity, the direct letter of commitment to supplier method of financing will be used.

2. Incentives

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

USAID has and will continue to ameliorate these A.I.D.-imposed and Government of Kenya disincentives. First, the Government covenants that import license applications be reviewed and approved or rejected with ten working days and further that the Central Bank issue a Foreign Exchange Allocation License number within five working days. Second, the current practice is that deposits of Kenyan Shillings are made by the cooperating commercial banks to the special account within 180 days after the sight L/C is paid in the U.S. In effect, this provides use of the Kenyan Shillings for 180 days interest free in lieu credit through usual channels. The benefits of the delayed payments will accrue mainly to the importers. Experience with the Mission's present CIP has shown that a 90 day interest free period is not sufficient incentive, but that a 180 day period is sufficient. A further incentive will be the GOK covenant that since no SGS inspection will be

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performed, the importer will pay only a 0.5% application fee to the Central Bank, which is one-third of the usual charge of 1.5%.

3. Disbursement Period

Under the present CIP during CY 1987 applications were approved by A.I.D. at an average monthly rate of $1,611,030, and approved by the government at an average monthly rate of $1,289,740. Given this experience, we expect that ninety-five per cent of the proceeds of the grant can be expected to be disbursed within a 24 month period after the grant is signed. However, long delivery time for some capital goods and some spare parts preclude full disbursement with 24 months. The terminal disbursement date will therefore be set 36 months from the grant agreement date and the terminal date for requesting disbursement authorizations will be set at 24 months from the grant agreement date.

4. Commodity Arrival and Utilization

The Government's system and records for tracking imports was evaluated when the FY'84 CIP was designed (see the FY'84 PAAD for a description of the Government's system). It was found inadaquate for A.I.D.'s purposes. It has remained unchanged. Thus, as in the FY'84 and FY'85 CIP, a private contractor will be hired with program funds to prepare reports on commodity arrival and utilization.

5. Technical Assistance for CIP Monitoring

A number of tasks, over and above those which will be fulfilled by A.I.D. staff, are envisioned under this CIP to effect smooth implementation and monitoring. The scope of the majority of these tasks is expected to be the same as those under Price Waterhouse's present contract (contract number 615-0213-C-00- 5021). In accordance with a Mission Assessment recommendation, the Kenya shilling equivalent of two hundred thousand dollars is budgeted in trust funds under this Agreement to pay for such contract assistance.

The GOK covenants that the Ministry of Commerce will give a copy of each approved import license to USAID, and will require each cooperating commercial bank to give USAID a copy of each L/C issued under the program, and further require that when payment documents are received by the participating local commercial bank, that a copy of each B/L is given to USAID. These records will be used by the contractor to compare with ships out-turn reports to determine when A.I.D.-financed goods are landed and to compare to customs' "Import Entry" forms to determine when the A.I.D.-financed goods have left each Kenyan port. The contractor will submit reports every two weeks to USAID showing which goods have cleared the ports, which ones have resulted in partial deliveries and therefore insurance claims should result, and which ones have been in the port for more than 30, 60, and 90 days. This system will enable USAID to follow up with importers and the GOK to facilitate port clearance and to ensure that when CIP funds were used to purchase marine insurance any marine insurance proceeds are used to procure other eligible CIP commodities.

The Government presently performs no end-use utilization accounting, although the Ministry of Commerce does not issue licenses which in its opinion would result in imports of more than 18 months' supply of goods by any one importer. The purpose of such controls is primarily to discourage hoarding. A.I.D.'s policy (HB 15, Chapter 10) requires consumption or use by the importer or sale or transfer by the importer for consumption or use within one year from the date the commodities are removed from customs, unless a longer period can be justified to A.I.D. by reason of force majeure, special market situations, or other circumstances. USAID proposes a deviation from A.I.D.'s usual policy in this regard to coincide with Government policy. Thus the relevant period will continue to be 18 months for goods financed under this agreement.

The contractor will perform end-use checks on CIP imports (and for fertilizer financed under this agreement) to ensure that this requirement is being met. Twenty-five per cent of the imports financed under this agreement will be checked for utilization within the stipulated time period. The twenty-five per cent will be calculated separately for the value of goods, for the number of transactions, and for the number of transaction outside of the metropolitan Nairobi area.

The same contractor will perform a monthly verification of cooperating Kenya commercial bank deposits into the CIP special account.

To speed implementation, and to assist smaller businesses to participate, USAID will also contract with a firm to help importers not fully familiar with the U.S. market to locate U.S. suppliers. Under the present CIP many of the smaller Kenyan importers have been unable to locate in a reasonable time manufacturers or other suppliers in the U.S.; and even when they are used to doing business with a particular U.S. supplier they have had difficulty in locating alternative suppliers to fulfill A.I.D.'s requirement for competition. This contractor will locate supplier sources in the U.S. on the most commercially sound basis. The contractor's role will be limited to matching potential suppliers and importers. The contractor will not assist importers to develop specifications, evaluate offers, nor be involved in contract negotiations between potential suppliers and importers.

Obtaining quotations currently takes one to three months by advertising. Also, letters written to potential U.S. suppliers are frequently not answered. This additional service to importers is expected to be of most benefit to small businesses. It is planned to procure the contractor under an 8a set-aside, and fifty thousand dollars has been budgeted in this PAAD for the task.

E. CIP Monitoring and Evaluation

1. Monitoring

The contractor hired to provide technical assistance under this program will assist in preparing many of the reports required to monitor the CIP imports accurately. However, each of the cooperating banks will be required to supply monthly statements, which they will secure from their U.S. correspondent bank, showing disbursements against the relevant bank letter of commitment.

2. Evaluation

One evaluation of the CIP is planned, beginning approximately one year after the first disbursement under this Amendment. The evaluation team will consist, at a minimum, of three people, for example a representative of M/SER/OP, a U.S. banker involved with private importers from the U.S. who is not associated with a correspondent bank participating in this program, and an economist with extensive experience in the private import sector of Kenya or other developing countries. Only twenty five thousand dollars is budgeted under this Amendment for this evaluation because most evaluation costs will be funded from operating expenses for U.S. Direct Hire A.I.D. employees.

F. DFA Procurement Plan

The CIP program has operated under a one-year blanket Determination of Non-Availability (DNA) for shipments from certain U.S. ports, which was renewed for one year on July 14, 1988 by SER/OP/TRANS and applies, in part, to the selection of vessels for shipment of DFA-funded commodities.

All of the technical assistance funded by this amendment ($3,000,000) will be DFA-funded. Of this amount, $2,175,000 is planned as additional funding for existing contracts with U.S. organizations. It is planned that an additional $600,000 for the Capital Markets Development Authority will be used to "buy-in" to an existing PRE financial markets contract with a U.S. firm. Should this "buy-in" not materialize, this $600,000 may be used to finance a PSC. If necessary, the DFA procurement flexibility will be utilized for the Technical

Assistance grant, with appropriate, written justification. The balance of $225,000 will be used for various short-term studies and other assistance activities.

VI. CONDITIONS PRECEDENT, COVENANTS AND NEGOTIATING STATUS

A. Condition Precedent to the Disbursement of Dollar Grant

Except as A.I.D. may otherwise agree in writing, prior to any disbursement of the dollar funds made available under this Amendment, or to the issuance by A.I.D. of documentation pursuant to which such payment will be made, the Cooperating Country shall, in form and substance satisfactory to A.I.D., provide documentation that the Grantee has established a separate, numbered Special Account entitled "1988 A.I.D. CIP Account" and two subsidiary accounts thereunder, "A" and "B," or made equivalent arrangements for deposit of currency of the Cooperating Country in amounts equal to all proceeds accruing to the Cooperating Country or any authorized agent thereof as a result of the sale or importation of the Eligible Items.

B. Conditions Precedent to the Release and Utilization of Prior and To Be Generated Local Currencies

The Cooperating Country agrees that release and uses of all unexpended Local Currencies generated under previous A.I.D.-financed CIPs, fertilizer import programs and PL-480 Title I Programs, in addition to all Local Currencies generated pursuant to the Agreement and all Amendments thereto, shall be subject to the following Conditions Precedent. The permissible uses of such Local Currencies shall remain in accord with the terms of the instrument under which that Local Currency was generated.

1. Conditions Precedent to the Release of the First Tranche of Local Currency

Except as the Parties may otherwise agree in writing, prior to the release of a first tranche of Local Currency (430 million shillings) other than Local Currencies to be entrusted to A.I.D. pursuant to the Trust Account provisions of this Amendment, the Cooperating Country shall, in form and substance satisfactory to A.I.D.:

a. Review with A.I.D. the 1988/89 Forward Budget and demonstrate that adequate funding levels are provided for high priority A.I.D.-financed activities.

b. Demonstrate that the funding levels agreed upon by A.I.D. and the Cooperating Country during the review of the 1988/89 Forward Budget have been incorporated in the 1988/89 Annual Budget.

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c. During the fourth quarter of Kenyan financial year 1987/88, review with A.I.D. the 1987/88 national budget deficit, and demonstrate that the 1987/88 budget deficit financing from domestic sources will be limited to no more than 4.6 percent of the Gross Domestic Product (GDP) (about 6.2 billion shillings), of which not more than 1.3 billion shillings or 1 percent of the GDP shall be from the domestic banking system.

d. Demonstrate that the Cooperating Country is continuing to price fertilizer based on the "Benchmark International Price" formula, with adequate retail margins.

2. Conditions Precedent to the Release of the Second Tranche of Local Currency Subsequent to March 31, 1989

Except as the Parties may otherwise agree in writing, prior to release of the second tranche of Local Currency subsequent to March 31, 1989 (up to 550 million shillings, subject to available deposits), other than Local Currency to be entrusted to A.I.D. pursuant to the Trust Account provisions of this Amendment, the Cooperating Country will, in form and substance satisfactory to A.I.D.:

a. Demonstrate that government domestic borrowing for financial year 1987/88 did not exceed 4.6 percent of GDP (approximately 6.2 billion shillings), of which not more than 1.3 billion shillings or 1 percent of GDP was from the domestic banking system.

b. Demonstrate that the budget deficit for Kenyan financial year 1988/89 will be limited to 5.0 percent of GDP or less.

c. Demonstrate that for Kenyan financial year 1988/89, transfers and net lending to the National Cereals and Produce Board will be limited to the provision in the budget.

d. Demonstrate that it is continuing to price fertilizer based on the "Benchmark International Price" formula, with adequate retail margins.

3. Additional Disbursements

Except as the Parties may otherwise agree in writing, no Conditions Precedent shall apply to Local Currencies in excess of those set forth in sub-sections 1 and 2 above.

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C. Covenants Related to Administration of the Commodity Import Program

1. Reports and Records

Except as A.I.D. may otherwise agree in writing, the Cooperating Country, with respect to the commodities financed under this Amendment, covenants to furnish A.I.D. such reports and information relating to the goods and services financed by this Amendment and the performance of Cooperating Country's obligations under this Amendment as A.I.D. may reasonably request. These reports and information shall include but not be limited to; (i) a list of all importers registered with the Government of the Cooperating Country, (ii) a copy of each approved Import License Application for goods financed under this Amendment, (iii) a copy of the "Import Entry" form for each consignment of goods financed under this Amendment, and (iv) a copy of the "Out-Turn" report for each ocean vessel carrying goods financed under this Amendment.

2. Validity of Licenses

The Cooperating Country, with respect to all commodities financed under this Amendment, covenants to issue all Import Licenses and all Foreign Exchange Allocation Licenses with a validity of not less than six months, except as A.I.D. may otherwise agree in writing.

3. Size of Transactions

The Cooperating Country covenants that no letter of credit issued pursuant to this Amendment shall be in an amount less than Five Thousand Dollars ($5,000) nor more than One Million, Five Hundred Thousand Dollars ($1,500,000), except as A.I.D. may otherwise agree in writing.

4. License Application Fee

The Cooperating Country covenants that it will inform all importers financed under this Amendment that, in recognition that no Society General Surveillance or other inspection will be required for CIP commodities, the usual one and a half percent import license application fee paid to the Central Bank will be reduced to one half of one percent for CIP commodity import license applications, except as A.I.D. may otherwise agree in writing.

5. Kenya Exchange Control Notice No. 19

The Cooperating Country covenants that with respect to Exchange Control Notice No. 19, guarantees issued to Kenya-Registered companies, regardless of owner nationality, will not be considered as local borrowing under this Amendment, and further agrees to so notify importers, except as A.I.D. may otherwise agree in writing.

6. Insurance

The Cooperating Country agrees that it will inform Kenyan importers that funds from this Amendment are available to cover marine insurance costs as set forth in Section 3.9 of the Agreement, except as A.I.D. may otherwise agree in writing.

7. Timeliness of Approvals

The Cooperating Country covenants that, except as A.I.D. may otherwise agree in writing:

a. the Central Bank of Kenya will process all applications for Foreign Exchange Allocation Licenses under this Amendment within a maximum of five working days, such five days to include the time before sending to the Ministry of Commerce and Industry as well as the time between the return from the Ministry of Commerce and Industry and the despatch to A.I.D.; and

b. the Ministry of Commerce and Industry will review and process all Import License applications under this Amendment within a maximum of ten working days after receipt from the Central Bank of Kenya.

8. Letter of Credit Guarantee

The Cooperating Country covenants to participate in meetings with representatives from the banking industry, A.I.D., and the Ministry of Finance. The purpose of these meetings is to consider establishing a letter of credit guarantee scheme to assist small importers unable to open letters of credit due to insufficient security. If it is found desireable and feasible by the participants of the meeting, the Cooperating Country covenants to implement such a letter of credit guarantee scheme in at least one bank which participates in the Commodity Import Program, except as A.I.D. may otherwise agree in writing,

D. Other Covenants

1. Import Policy

Except as A.I.D. may otherwise agree in writing, the Cooperating Country convenants that:

a. It will issue the new Import Licensing Schedules containing the reorganized schedules by August 1988.

b. It will permit goods on Schedule 1 licensed without restrictions, provided that they are properly classified and reasonably priced.

2. Capital and Money Markets

Except as A.I.D. may otherwise agree in writing, the Cooperating Country convenants that:

a. It will complete the necessary legal and administrative requirements for making the Capital Market Development Authority operational by June 1989; and

b. It will review the tax system to ensure that taxes do not create disincentives for issuance of public equity and debt instruments and to investors in such securities.

3. Fertilizer Pricing and Distribution

The Cooperating Country covenants that, it will review and implement the recommendations of the National Fertilizer Policy study, recently completed by the Ministry of Agriculture, to improve import allocation approval procedures to shorten the time and reduce the steps involved in the import licensing approval process, except as A.I.D. may otherwise agree in writing.

VII. SPECIAL U.S. INTERESTS AND CONCERNS

Kenya is geo-politically important to the United States because of its strategic location on the Indian Ocean coast. Kenya plays an important role in peace maintenance and other foreign policy objectives, particularly in the region of Eastern Africa. Kenya has become one of the main gateways for Africa in terms of all kinds of transport and communication facilities. All land-locked states of East Africa are linked to the Indian Ocean by Mombasa port. Kenya's road networks link her with many neighboring states. Nairobi, the capital city of Kenya, serves to connect the region with the rest of the world by her air transport system.

Kenya's overall approach to socio-economic development has been market oriented and pro-Western. It is generally based on economic pragmatism with increasing emphasis on private sector involvement. This general approach to development has contributed to both political and economic stability since independence. Kenya has survived several regional political and economic shocks and has continued to play a significant role in promoting peace and stability in the region. It has cooperated with the United States in promoting the U.S. strategic and foreign policy objectives through her important role in the region. It is important for the United States to help maintain Kenya's economic stability and its economic development in order to enable her to continue to play the role of maintaining political and economic stability in the region.

Kenya has been a voice for moderation in African and other Third World fora. It has contributed in a large part to peacekeeping efforts with Somalia and Sudan, the opening of the Tanzania-Kenya border, and the resolution of the disputes which followed the breakup of the East African Community. Kenya's success in normalizing relations with her neighbors enabled them to crate an environment for regional development and cooperation. For this purpose, two regional institutions were created: (1) the Preferential Free Trade Area, comprising 15 countries of Eastern and Southern Africa; and (2) the Intergovernmental Authority on Drought and Development, comprising Djibouti, Ethiopia, Somalia, Sudan, Uganda and Kenya.

Kenya's economic growth and development, however, is constrained by its high population growth rate. The alarming population growth combining with a small resource base has limited the growth of employment opportunities. Increasing unemployment makes it more difficult to maintain political and economic stability. The United States is one of the leading bilateral donors in assisting the Government of Kenya to address the population problem and in promoting economic growth. The structural Adjustment Assistance Program together with other A.I.D.-supported projects provide resources, technical assistance and assists Kenya in promoting a policy environment more conducive to economic growth.

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VIII. ENVIRONMENTAL CONCERNS

The Initial Environmental Examination or Categorical Exclusion in the FY-1986 Program Assistance Approval Document (615-0240) covers this proposed Amendment.

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5C(1) - COUNTRY CHECKLIST

Listed below are statutory criteria applicable to: (A) FAA funds generally; (B)(1) Development Assistance funds only; or (B)(2) the Economic Support Fund only.

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FY 1988 Continuing Resolution Sec. 526 Has the President certified to the Congress that the government of the recipient country is failing to take adequate measures to prevent narcotic drugs or other controlled substances 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). (This provision applies to assistance of any kind provided by grant, sale, loan, lease, credit, guaranty, or insurance, except assistance form the Child Survival Fund or relating to international narcotics control, disaster and refugee relief, or the provision of food or medicine.) If the recipient is a "major illicit drug producing country" (defined as a country producing during a fiscal year at least five metric tons of opium or 500 metric tons of coca or marijuana) or a "major drug-transit country" country" (defined as a country that is a significantly affecting the United States, through which such drugs are transported, or through which such significant sums of drug-related profits are laundered with the knowledge or complicity of the government), has the president in the March 1 International Narcotics Control Strategy Report (INSCR) determined and certified to the Congress (without Congressional enactment, within

N/A

30 days of continuous session, of a resolution disapproving such a certification), or has the President determined and certified to the Congress on any other date (with enactment by Congress of a resolution approving such certification), that (a) during the previous year the country has cooperated fully with the United States or taken adequate steps on its own to prevent illicit drugs produced or processed in or transported through such country from being transported into the United States, and to prevent and punish drug profit laundering in the country, or that (b) the vital national interests of the United States require the provision of such assistance?

3. Drug Act Sec. 2013. (This section applies to the same categories of assistance subject to the restrictions in FAA Sec. 481(h), above.) If recipient country is a "major illicit drug producing country" or "major drug-transit country" (as defined for the purpose of FAA Sec 481(h), has the President submitted a report to Congress listing such country as one (a) which, as a matter of government policy, encourages or facilitates the production or distribution of illicit drugs; (b) in which any senior official of the government engages in, encourages, or facilitates the production or distribution of illegal drugs; (c) in which any member of a U.S. Government agency has suffered or been threatened with violence inflicted by or with the complicity of any government officer; or (d) which fails to provide reasonable cooperation to lawful activities of U.S. drug enforcement agents, unless the

N/A

President has provided the required certification to Congress pertaining to U.S. national interests and the drug control and criminal prosecution efforts of that country?

4. 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) the debt is not denied or contested by such government? — No

5. FAA Sec. 620(e)(1). If assistance is to a government, has it (including any 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 obligations toward such citizens or entities? — No

6. FAA Sec. 620(a), 620(f), 620D; FY 1988 Continuing Resolution Secs. 512, 554. Is recipient country a Communist country? If so, has the President determined that assistance to the country is vital to the security of the United States, that the recipient country is not controlled by the international Communist conspiracy, and that such assistance will further promote the independence of the recipient country from international communism? will assistance be provided, either directly or indirectly, to Angola, Cambodia, Cuba, Iraq, Libya, Vietnam, South Yemen, Iran or Syria? Will assistance be provided to Afghanistan without a certification? — No

7. FAA Sec. 6020(j). Has the country permitted, or failed to take adequate measures to prevent, damage or destruction by mob action of U.S. property? — No

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

9. FAA Sec. 620(o); Fishermen's Protective Act of 1967 (as amended) Sect. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing vessel because of fishing activities in international waters? (b) If so, has any deduction required by the Fishermen's Protective Act been made? — No

10. FAA Sec. 620(q); FY 1988 Continuing Resolution Sec. 518. (a) Has the government of the recipient country been in default for more than six months on interest or principal of any loan to the country under the FAA? (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 FY 1988 Continuing Resolution appropriates funds? — (a) No (b) No

11. FAA Sec. 620(s). If contemplated assistance is development loan or to come from Economic Support Fund, has the Administrator taken into account the percentage of the country's budget and amount of the country's foreign exchange or other resources spent on military equipment? (Reference may be made to the annual "Taking Into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator or the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.) — Yes

12. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have relations been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption? — No

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13. 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. operating Year Budget? (Reference may be made to the Taking into Consideration memo.)

Kenya was not in arrears as of June 30, 1988

14. FAA Sec. 620A. Has the President determined that the recipient country grants sanctuary from prosecution to any individual or group which has committed an act of international terrorism or otherwise supports international terrorism?

No

15. ISDCA of 1985 Sec. 552(b). Has the Secretary of State determined that the 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

16. FAA Sec. 666(b). 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

17. FAA Secs. 669, 670. Has the country, after August 3, 1977, delivered to any other country or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards, and without special certification by the President? 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? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.)

No

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

No

19. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Assembly of the U.N. on Sept. 25 and 28, 1981, and did it fail to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the Taking into Consideration memo.)

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 FY88 OYB

20. FY 1988 Continuing Resolution Sec. 528. 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 State?.

No

21. FY 1988 Continuing Resolution Sec. 513. Has the duly elected Head of Government of the country been deposed by military coup or decree? If assistance has been terminated, has the President notified Congress that a democratically elected government has taken office?

No

22. FY 1988 Continuing Resolution Sec. 543. Does the recipient country fully cooperate with the international refugee assistance organizations, the United States, and other governments in facilitating lasting solutions to refugee situations, including resettlement without respect to race, sex, religion, or national origin?

Yes

23. FY 1988 Continuing Resolution Sec. 576. Has the country been placed on the list provided for in Section 6(j) of the Export Administration Act of 1979 (currently Libya, Iran, South Yemen, Syria, Cuba, or North Korea)? — No

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria

FAA Sec. 116. 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? — No

FY 1988 Continuing Resolution Sec. 538. Has the President certified that use of DA funds by this country would violate any of the prohibitions against use of funds to pay for the performance of abortions as a method of family planning, to motivate or coerce any person to practice abortions, to pay for the performance of involuntary sterilization as a method or family planning, to coerce or provide any financial incentive to any person to undergo sterilizations, 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

2. Economic Support Fund Country Criteria

FAA Sec. 502B. 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 President found that the country made such significant improvement in its human rights record that furnishing such assistance is in the U.S. national interest?

No

FY 1988 Continuing Resolution Sec. 549. Has this country met its drug eradication targets or otherwise taken significant steps to halt illicit drug production or trafficking?

Yes

3(A)2 - NONPROJECT ASSISTANCE CHECKLIST

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

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? Yes

HAS STANDARD ITEM CHECKLIST BEEN REVIEWED? Yes

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 1988 Continuing Resolution Sec. 523; FAA Sec. 634A. Describe how authorization and appropriations committees of Senate and House have been or will be notified concerning the project.

The Committees were notified in the Congressional Presentation. Also A Congressional Notification was submitted in March 1988 and the hold was lifted on July 12, 1988.

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

No further legislative action is required for this grant.

3. FAA Sec. 209. Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.

No

4. FAA Sec. 601(a). Information and conclusions on 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.

This assistance will finance primarily imports of commodities by private firms from the United States. As such it will directly increase international trade and foster private initiative. Since more firms will have access to foreign exchange as a result of the program, competition will be encouraged and monopolistic practices discouraged. Many pieces of equipment imported will use technologies not otherwise available in Kenya, thus improving the technical efficiency of industry, agriculture and commerce. No impact is expected on cooperatives or trade unions.

5 FAA Sec. 601(b). Information and conclusions 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).

In the CIP 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 Secs. 612(b), 636(h); FY 1987 Continuing Resolution Secs. 507, 509. Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services.

U.S. owned local currencies are not available.

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

The U.S. does not own excess Kenya Shillings.

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. FAA 121(d). If assistance is being furnished under the Sahel Development Program, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of A.I.D. funds?

N/A

10. FY 1987 Continuing Resolution Sec. 532. Is disbursement of the assistance conditioned solely on the basis of the policies of any multilateral institution?

No

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA?	Yes through provision of budget and balance payments support during a period of economic slowdown benefits in turn will promote political stability.
b. FAA Sec. 531(e). Will assistance under this chapter be used for military or paramilitary activities?	NO
c. FAA Sec. 531(d). Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies?	Yes
If so, will at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106?	Yes
d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?	Yes
e. FY 1988 Continuing Resolution. If assistance is in the form of a cash transfer (a) are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds? (b) will all local currencies that may be generated with funds rovided as a cash transfer to such a country also be deposited in a special account to be used in accordance with FAA Section 609 (which requires such local currencies to be made available to the U.S. government, as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by	N/A

the FAA would themselves be available)? (c) Has Congress been properly notified in detail as to how the funds will be used, including the U.S. interests that will be served by the assistance, and, as appropriate, the economic policy reforms that will be promoted by the cash transfer assistance?

2. Nonproject Criteria for Development Assistance

a. FAA Secs. 102(a), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by expanding access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

The program will provide additional imports most of which are raw materials, intermediate and capital goods. These imports will allow industrialists and farmers to increase their economic activities and employment opportunities. The local currency proceeds from the sales of these imports will provide resources both for the government and the private sector to undertake projects which will directly benefit the poor both in the urban and rural sectors. The technical assistance component of of this program will also help improve the efficiency of public resource allocation and use, particularly at the district level. Principal beneficiaries of the program will be private enterpreneurs who eill benefit from additional foreign exchange for imported goods. These additional imports will indirectly benefit end-users of imports or products which use imports as inputs. These end-users include women, cooperatives, self-help groups, small farmers and urban poor.

b. FAA Secs. 103, 103A, 104, 105 106, 120-21. Is assistance being made available (include only applicable paragraph which corresponds to source of funds used; if more than one fund source is used for assistance, include relevant paragraph for each fund source): (1) [103] for agriculture, rural development or nutrition; if so

The fertilizer marketing reforms specifically promoted by this program will increase the agricultural productivity and income of the rural poor. Further

(a) extent to which activity is specifically specifically designed to increase productivity and income of rural poor; [103A] if for agricultural research, account shall be taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made; (b) extent to which assistance is used in coordination with efforts carried out under Sec. 104 to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value: Improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration programs explicitly addressing the problem of malnutrition of poor and vulnerable people; and (c) extent to which activity increases national food security by improving food policies and management and' by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

the increased fertilizer availability and utilization which are expected to result from these reforms will directly contribute to national food security.

(2) [104] for population planning under Sec. 104(b) or health under Sec. 104(c); if so, extent to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the

N/A

needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems, and other modes of community outreach.

(3) [105] for education, public administration, or human resources development; if so, (a) extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, and strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education and training of people of developing countries in such disciplines as are required for planning and implementation of public and private development activities.

N/A

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

N/A

(i)(a) concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and (b) facilitative of research on and development and use of small-scale, decentralized, renewable energy sources for rural areas, emphasizing development of energy resources which are environmentally acceptable and require minimum capital investment;

(ii) concerned with technical cooperation and development, especially with U.S. private and voluntary, or regional and international development, organizations;

(iii) research into, and evaluation of, economic development processes and techniques;

(iv) reconstruction after natural or manmade disaster and programs of disaster preparedness;

(v) for special development problems, and to enable proper utilization of infrastructure and related projects funded with earlier U.S. assistance;

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

(5) [120-21] for the Sahelian region; if so, (a) extent to which there is international coordination in planning and implementation; participation and support by African countries and organizations in determining development priorities; and a long-term, multi-donor development plan which calls for equitable burden-sharing with other donors; (b) has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of projects funds (dollars or local currency generated therefrom)?

N/A

c. FAA Sec. 107. Is special emphasis placed on use of appropriate technology (defined as relatively smaller, cost-saving, labor using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

No

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

The CIP recognizes the needs of Kenyan importers by providing them with foreign exchange for imports. It is designed to encourage "transparency" in license approvals instead and moving to less government dictation of imports. The technical assistance element will specifically support the institutional development of the Ministry of Finance in computerization, the Ministry of Planning and National Development in rural planning, and in the creation of a new Capital Markets Development Authority to increase the efficiency of the Kenyan capital market.

e. FAA Sec. 101(a). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes

f. FY 1988 Continuing Resolution. Have local currencies generated by the sale of imports or foreign exchange by the government of a country in Sub-Saharan Africa from funds appropriated under Sub-Saharan Africa, DA been deposited in a special account established by that government, and are these local currencies available only for use, in accordance with an agreement with the United States, for development activities which are consistent with the policy directions of Section 102 of the FAA and for necessary administrative requirements of the U.S. Government?

All local currency generated by this program will be deposited in a special account established by government for use in accordance with an agreement for development activities consistent with the policy directions of section 102 at the FAA and the administrative expenses of the U.S. Government.

5C(3) - STANDARD ITEM CHECKLIST

Listed below are the statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

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

A. PROCUREMENT

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

This PAAD amendment does not provide financing specifically for procurement of goods from small businesses. However, procurements under the CIP will be widely advertised and small businesses will have the opportunity to participate in supplying goods to the extent they care to do so. Under the CIP, procurement of services except for those incidental to commodity procurement is not anticipated. Under the technical assistance portion of the PAAD Amendment most funding will be used to incrementally fund existing contractors. If other TA procurement is undertaken, small business will be given an opportunity to furnish it.

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

Yes

3. FAA Sec. 604(d). If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?

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.

4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If non-U-S. procurement of agricultural commodity or product thereof is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.)

N/A

5. FAA Sec. 604(g). Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible under Code 941 and which have attained a competitive capability in international markets in one of these areas? (Exception for those countries which receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries.)

No construction or engineering services will be procured.

6. FAA Sec. 603. Is the shipping excluded from compliance with the requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent 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 such vessels are available at fair and reasonable rates?

No

7. FAA Sec. 621(a). If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? Will the facilities and resources of other Federal agencies be utilized, when they are particularly suitable, not competitive 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.

8. International Air Transportation Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?

Yes

9. FY 1988 Continuing Resolution Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States?

All AID-direct contract will contain a termination for convience clause.

10. FY 1988 Continuing Resolution Sec. 524. If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109, are contract expenditures a matter of public record and available for public inspection (unless otherwise provided by law or Executive order)?

N/A

B. CONSTRUCTION

1. FAA Sec. 6011(d). If capital (e.g., construction) project, will U.S. engineering and professional services be used?

N/A

2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable?

N/A

3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the CP), or does assistance have the express approval of congress?

N/A

C. OTHER RESTRICTIONS

1. FAA Sec. 122(b). If development loan repayable in dollars, is interest rate at least 2 percent per annum during a grace period which is not to exceed ten years, and at least 3 percent per annum thereafter?	N/A
2. FAA Sec. 301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights?	N/A
3. FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries?	Yes
4. Will arrangements preclude use of financing:	
a. FAA Sec. 104 (f); FY 1987 Continuing Resolution Secs. 525, 540. (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterlizations as a means of family planning; or (4) to lobby for abortion?	1) Yes 2) Yes 3) Yes 4) Yes
b. FAA Sec. 483. To make reimbursements, in the form of cash payments, to persons whose illicit drug crops are eradicated?	Yes

c. FAA Sec. 620(g). To compensate owners for expropriated or nationalized property, except to compensate foreign nationals in accordance with a land reform programs certified by the President? — Yes

d. FAA Sec. 660. To provide training, advice, or any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? — Yes

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

f. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained? — Yes

g. FY 1988 Continuing Resolution Sec. 503. To pay pensions, annuities, retirement pay, or adjusted service compensation for prior or current military personnel? — Yes

h. FY 1988 Continuing Resolution Sec. 505. To pay U.N. assessments, arrearages or dues? — Yes

i. FY 1988 Continuing Resolution Sec. 506. To carry out provisions of FAA section 209(d) (transfer of FAA funds to multilateral organizations for lending)? — Yes

j. FY 1988 Continuing Resolution Sec. 510. To finance the export of nuclear equipment, fuel, or technology? — Yes

k. FY 1988 Continuing Resolution Sec. 511. For the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights? — Yes

l. FY 1988 Continuing Resolution Sec. 516. To be used for publicity or propaganda purposes within U.S. not authorized by Congress? — Yes

5C(2) - PROJECT CHECKLIST

Listed below are statutory criteria applicable to projects. This sections divided into two parts. Part A includes criteria applicable to all projects. Part B applies to projects funded from specific sources only: B(1) applies to all projects funded with Development Assistance; B(2) applies to projects funded from Development Assistance loans; and B(3) applies to projects funded from ESF.

CROSS REFERENCES:	IS COUNTRY CHECKLIST UP TO DATE?	Yes.
	HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT?	Yes.

A. GENERAL CRITERIA FOR PROJECT

1. FY 1988 Continuing Resolution Sec. 523; FAA Sec. 634A. If money is sought to obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified?

   Congress was notified of the project in the FY87 Congressional Presentation (page 203 Annex 1, Africa) and a CN was forwarded and expired without objection on April 9, 1986 (86 ST 108269).

2. FAA Sec. 611(a)(1). Prior to an obligation in excess of $500,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance, and (b) a reasonably firm estimate of the cost to the U.S of the assistance?

   Yes. Adequate financial plans have been carried out and there is a reasonably firm estimate of the cost to the U.S.

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

   No legislation is required.

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4. FAA Sec. 611(b); FY 1988 Continuing Resolution Sec. 501. If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See A.I.D. Handbook 3 for guidelines.)

N/A.

5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and total U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively?

N/A.

6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.

No. The program is a country-specific activity.

7. FAA Sec. 601(a). Information and conclusions on whether projects 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.

Development of the Capital Market Development Authority will directly foster private initiative and discourage monopolist practices by increasing access to capital market transactions. Cooperatives, credit unions and savings and loan associations may also participate more widely in a liberalized capital market.

8. FAA Sec. 601(b). Information and conclusions on how project 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).

Yes. U.S. contractors will provide the technical assistance funded by this program.

9. FAA Sec. 612(b), 636(h). 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 U.S. are utilized in lieu of dollars.

The U.S. owns no excess Kenyan Shillings which could be used in lieu of U.S. dollars. The KShilling equivalent of at least $4.5 of counterpart funds generated by the program will be used to support activities in the agriculture and livestock sectors. In addition, not less than $5.0 million of local currency will replace dollars for private enterprise and entrepreneurship development programs.

10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

No. The U.S. does not own excess Kenya currency.

11. FY 1988 Continuing Resolution Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. procures of the same, similar or competing commodity?

The principal commodities produced for export in Kenya are coffee and tea. Any surplus on world markets of these commodities which may result from increased productivity in the Kenyan agricultural sector will not injure U.S. producers.

12. FY 1988 Continuing Resolution Sec. 553. Will the assistance (except for programs in Caribbean Basis Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports, of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work floves or leather wearing apparel?

No.

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13. <u>FAA Sec. 119(g) (4)-(6).</u> Will the assistance (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity; (b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other wildlife habitats; (c) support efforts to identify and survey ecosystems in recipient countries worthy of protection; or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas?	a) No. b) No. c) No. d) No.
14. <u>FAA Sec. 121(d).</u> If a Saleh project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (either dollars or local currency generated therefrom)?	N/A.
15. <u>FY 1988 Continuing Resolution</u> If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from sources other than the United States Government?	N/A.
16. <u>FY 1988 Continuing Resolution Sec. 514.</u> If funds are being obligated under an appropriation account to which they were not appropriated, has prior approval of the Appropriations Committees of Congress been obtained?	Funds are being obligated to the account to which they were appropriated.

17. FY 1988 Continuing Resolution Sec. 515. If deob/reob authority is sought to be exercised in the provision of assistance, are the funds being obligated for the same general purpose, and for countries within the same general region as originally obligated, and have the Appropriations Committees of both Houses of Congress been properly notified?

N/A.

18. FY Continuing Resolution Sec. 541. If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.?

N/A.

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

(a) FY 1988 Continuing Resolution Sec. 558 (as interpreted by conference report). If assistance is for agricultural development activities (specifically, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training), are such activities (a) specifically and principally designed to increase agricultural exports by the host country to a country other than the United States, where the export would lead to direct competition in the third country with exports of a similar commodity grown or produced in the United States, and can the activities reasonably be expected to cause substantial injury to U.S. exporters of a similar agricultural commodity; or (b) in support of research that is intended primarily to benefit U.S. producers?

a) No.
b) No.

(b) FAA Secs. 102(b), 111, 113, 281(a). Describe extent to which activity will (a) effectively involve the poor in development by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, dispersing investment from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward a better life, and otherwise encourage democratic private and local governmental

a) Improved fertilizer marketing, which will result from the conditionality of the overall program supported by this technical assistance, will directly increase access by the rural poor to a key agricultural input.
b) as a major fertilizer distributor, the Kenya Grain Growers Cooperative Union will be strengthened by this program.
c) the increased food self-reliance which can result from increased productivity in the agricultural sector is the most basic of self-help efforts.
d) as the majority of the farming population of Kenya, women will

institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries.

benefit from increased efficiency in the agricultural sector
e) no impact is anticipated on regional cooperation.

c. FAA Secs. 103, 103A, 104, 105, 106, 120-21. Does the project fit the criteria for the source of funds (functional account) being used?

Yes. The source of funds is the 1988 CR (Sub-Saharan African Development Assistance account).

d. FAA Sec. 107. Is emphasis placed on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

Utilization of fertilizer which will be promoted by this program is a labor-intensive technology.

e. FAA Secs. 110, 124(d). Will the recipient country provide at least 25 percent of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?

Yes.

f. FAA Sec. 128(b). If the activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority?

Yes. Improvements in the fertilizer distribution system which will result from the program supported by this technical assistance will increase the access of small-holder agriculturalists to this important agricultural input.

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

By promoting the role of private sector fertilizer distributors in the input supply system, the program supports wider participation in the development process.

h. FY 1988 Continuing Resolution Sec. 538. 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 sterilization? — No.

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

i. FY 1988 Continuing Resolution. Is the assistance being made available to any organization or program which has been determined to support or participate in the management of a program of coercive abortion or involuntary sterilization? — No.

If assistance is from the population functional account, are any of the funds to be made available to voluntary family planning projects which do not offer, either directly or through referral to or information about access to, a broad range of family planning methods and services? — N/A.

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

k. FY 1988 Continuing Resolution. What portion of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and — There is no specific funding benchmark for such organizations.

universities, colleges and universities having a student body in which more than 20 percent of the students are Hispanic Americans, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)?

1. FAA Sec. 118(c). Does the assistance comply with the environmental procedures set forth in A.I.D. Regulation 16? Does the assistance place a high priority on conservation and sustainable management of tropical forests? Specifically, does the assistance, to the fullest extent feasible: (a) stress the importance of conserving and sustainably managing forest resources; (b) support activities which offer employment and income alternatives to those who otherwise would cause destruction and loss of forests, and help countries identify and implement alternatives to colonizing forested areas; (c) support training programs, educational efforts, and the establishment or strengthening of institutions to improve forest management; (d) help end destructive slash-and-burn agriculture by supporting stable and productive farming practices; (e) help conserve forests which have not yet been degraded by helping to increase production on lands already cleared or degraded; (f) conserve forested watersheds and rehabilitate those which have been deforested; (g) support training, research, and other actions which lead to sustainable and more environmentally sound practices for timber harvesting, removal, and processing; (h) support

Yes. The original PAAD for this program dated April 1986 included a categorical exclusion for the technical assistance element which includes the technical assistance provided by this amendment. For a-k, the technical assistance provided to the Ministry of Planning and National Development will assist Government planning in these areas.

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research to expand knowledge of tropical forests and identify alternatives which will prevent forest destruction, loss, or degradation; (i) conserve biological diversity in forest areas by supporting efforts to identify, establish, and maintain a representative network or protected tropical forest ecosystems on a worldwide basis, by making the establishment of protected areas a condition of support for activities involving forest clearance or degradation, and by helping to identify tropical forest ecosystems and species in need of protection and establish and maintain appropriate projected areas; (j) seek to increase the awareness of U.S. government agencies and other donors of the immediate and long-term value of tropical forests; and (k)/utilize the resources and abilities of all relevant U.S. government agencies?

m. FAA Sec. 118(c)(13). If the assistance will support a program or project significantly affecting tropical forests (including projects involving the planting of exotic plant species), will the program or project (a) be based upon careful analysis of the alternatives available to achieve the best sustainable use of the land, and (b)/take full account of the environmental impacts of the proposed activities on biological diversity?

N/A.

n. FAA Sec. 118(c)(14). Will assistance be used for (a) the procurement or use of logging equipment, unless an environmental assessment indicates that all timber

a) No.
b) No.

harvesting operations involved will be conducted in an environmentally sound manner and that the proposed activity will produce positive economic benefits and sustainable forest management systems; or (b) actions which significantly degrade national parks or similar protected areas which contain tropical forests, or introduce exotice plants or animals into such areas?

o. FAA Sec. 118(c)(15). Will assistance be used for (a) activities which would result in the conversion of forest lands to the rearing of livestock; (b) the construction, upgrading, or maintenance of roads (including temporary haul roads for logging or other extractive industries) which pass through relatively undegraded forest lands; (c) the colonization of forest lands; or (d) the construction of dams or other water control structures which flood relatively undegraded forest lands, unless with respect to each such activity an environmental assessment indicates that the activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development?

a) No.
b) No.
c) No.
d) No.

p. FY 1988 Continuing Resolution If assistance will come from the Sub-Saharan Africa DA account, is it (a) to be used to help the poor majority in Sub-Saharan Africa through a process of long-term development and economic growth that is equitable, participatory, environmentally sustainable, and self-reliant; (b) being provided in accordance with the policies contained in section 102 of the FAA;

a) Yes. particularly through technical assistance to the Ministry of Planning and National Development which has District Focus for Rural Development as a major mandate.
b)Yes.
c) PVO participation is not consistent with the objectives of this activity
d) Yes. The assistance is specifically designed to support structural reform of the economy.

(c) being provided, when consistent with the objectives of such assistance, through African, United States and other PVOs that have demonstrated effectiveness in the promotion of local grassroots activities on behalf of long-term development in sub-Saharan Africa; (d) being used to help overcome shorter-term constraints to long-term development, to promote reform of sectoral economic policies, to support the critical sector priorities of agricultural production and natural resources, health, voluntary family planning services, education, and income generating opportunities, to being about appropriate sectoral restructuring of the Sub-Saharan African economies, to support reform in public administration and finances and to establish a favorable environment for individual enterprise and self-sustaining development, and to take into account, in assisted policy reforms, the need to protect vulnerable groups; (e) being used to increase agricultural production in ways that protect and restore the natural resource base, especially food production, to maintain and improve basic transportation and communication networks, to maintain and restore the nature resource base in ways that increase agricultural production, to improve health conditions with special emphasis on meeting the health needs of mothers and children, including the establishment of self-sustaining primary health care systems that give priority to preventive care, to provide increased access to voluntary family planning services, to improve basic literacy and

e) Yes. The policy reforms supported by the program will promote increased agricultural production.

mathematics especially to those outside the formal educational system and to improve primary education, and to develop income-generating opportunities for the unemployed and underemployed in urban and rural areas?

2. Development Assistance Project Criteria (Loans Only)

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

N/A.

b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20 percent of the enterprise annual production during the life of the loan, or has the requirement to enter into such an agreement been waived by the President because of a national security interest?

N/A.

c. FY 1988 Continuing Resolution. If for a loan to a private sector institution from funds made available to carry out the provisions of FAA Sections 103 through 106, will loan be provided, to the maximum extent practicable, at or near the prevailing interest rate paid on Treasury obligations of similar maturity at the time of obligating such funds?

N/A.

d. FAA Sec. 122(b). Does the activity give reasonable promise of assisting long-range plans and programs designed to develop economic resources and increases productive capacities?

N/A.

3. Economic Support Fund Project Criteria

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA?

N/A.

b. FAA Sec. 531(e). Will this assistance be used for military or paramilitary purposes?

N/A.

c. ISDCA of 1985 Sec. 207. Will ESF funds be used to finance the construction, operation or 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 on the Non-Proliferation of Nuclear Weapons or the Treaty for the Prohibition of Nuclear Weapons in Latin America (the "Treaty of Tlatelolco"), cooperates fully with the IAEA, and pursues nonproliferation policies consistent with those of the United States?

N/A.

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

Yes. (as required for DFA)

5C(3) - STANDARD ITEM CHECKLIST
FOR THE TECHNICAL ASSISTANCE
ELEMENT OF THE PROGRAM

Listed below are the statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

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

A. PROCUREMENT

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

   Grant-financed host-country and direct contracts will follow A.I.D. contracting procedures which contain provisions for small business participation.

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

   Yes.

3. FAA Sec. 604(d). If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?

   Yes, if financed under the Program.

4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If non-U-S. procurement of agricultural commodity or product thereof is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.)

   No agricultural commodities or products will be financed by this project assistance.

5. FAA Sec. 604(g). Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible under Code 941 and which have attained a competitive capability in international markets in one of these areas? (Exception for those countries which receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries.)

No construction or engineering services will be procured with this assistance.

6. FAA Sec. 603. Is the shipping excluded from compliance with the requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent 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 such vessels are available at fair and reasonable rates?

No.

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

Technical assistance will be furnished by private enterprise to the fullest extent practicable. Participation of other federal agencies is not anticipated.

8. International Air Transportation Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?

Yes.

9. FY 1988 Continuing Resolution Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States?

Yes. Such a provision will be included in all such contracts.

10. FY 1988 Continuing Resolution Sec. 524. If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109, are contract expenditures a matter of public record and available for public inspection (unless otherwise provided by law or Executive order)?

Yes.

B. CONSTRUCTION

1. FAA Sec. 6011(d). If capital (e.g., construction) project, will U.S. engineering and professional services be used?

N/A.

2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable?

N/A.

3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the CP), or does assistance have the express approval of congress?

N/A.

C. OTHER RESTRICTIONS

1. FAA Sec. 122(b). If development loan repayable in dollars, is interest rate at least 2 percent per annum during a grace period which is not to exceed ten years, and at least 3 percent per annum thereafter?

N/A.

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

3. FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? — Yes.

4. Will arrangements preclude use of financing:

a. FAA Sec. 104 (f); FY 1987 Continuing Resolution Secs. 525, 540. (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterlizations as a means of family planning; or (4) to lobby for abortion?

1) Yes

2) Yes

3) Yes

4) Yes

b. FAA Sec. 483. To make reimbursements, in the form of cash payments, to persons whose illicit drug crops are eradicated? — Yes.

c. FAA Sec. 620(g). To compensate owners for expropriated or nationalized property, except to compensate foreign nationals in accordance with a land reform programs certified by the President? — Yes.

X
011

d. FAA Sec. 660. To provide training, advice, or any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? — Yes.

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

f. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained? — Yes.

g. FY 1988 Continuing Resolution Sec. 503. To pay pensions, annuities, retirement pay, or adjusted service compensation for prior or current military personnel? — Yes.

h. FY 1988 Continuing Resolution Sec. 505. To pay U.N. assessments, arrearages or dues? — Yes.

i. FY 1988 Continuing Resolution Sec. 506. To carry out provisions of FAA section 209(d) (transfer of FAA funds to multilateral organizations for lending)? — Yes.

j. FY 1988 Continuing Resolution Sec. 510. To finance the export of nuclear equipment, fuel, or technology? — Yes.

k. FY 1988 Continuing Resolution Sec. 511. For the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights? — Yes.

l. FY 1988 Continuing Resolution Sec. 516. To be used for publicity or propaganda purposes within U.S. not authorized by Congress? — Yes.

OFFICIAL FILE

ANNEX B

REPUBLIC OF KENYA

MINISTRY OF FINANCE

Proj. 615-0240

Telegraphic Address: FINANCE-NAIROBI
Telephone: 338111
When replying please quote
Ref. No. EA/FA 9/016
and date

THE TREASURY
P.O. Box 30007
NAIROBI, KENYA
21 April 1988.

Director,
USAID Mission to Kenya,
P.O. Box 30261,
NAIROBI.

FILE IDENT No.

USAID/KENYA

Dear Sir,

RE: REQUEST FOR ADDITIONAL - ASSISTANCE UNDER THE STRUCTURAL ADJUSTMENT ASSISTANCE PROGRAMME GRANT (615-0240)

DATE REC: 4/22/88
REPLY DUE: 5/2
ACTION TO: PROG

	INFO
DIR	I
D/DIR	I
RHDSO	
RHUDO	
RIG/A	
RIG/II	
RFMC	I
PROG	
HR	
PRJ	I
PH	
AGR	
EXO	
PER	
GSO	
RS	I
CONTROL	I
OAS	

In the past, the USA Government has provided support to our Government under the Structural Adjustment Assistance Programme and we take this opportunity to record our sincere thanks for this assistance.

As discussed in the recent meeting on the FY 1988 PAAD Amendment (615-0240) it has been established that we need further assistance in the area of balance of payment support and the implementation of structural adjustment measures. In this regard, we hereby request that the Structural Adjustment Assistance Programme Agreement dated 6th June, 1986 between the Republic of Kenya and the United States of America be further amended to provide for additional assistance in an amount not exceeding Seventeen Million Five hundred Thousand United States Dollars ($17,500,000).

Yours sincerely,

W. A. J. TUVA,
For: PERMANENT SECRETARY/TREASURY.

ACTION COPY
Action taken: ....
No action necessary..........
(Initials) (Date)

Annex C

IMPLEMENTATION PATH AND SCHEDULE FOR COMMODITY IMPORT PROGRAM

A. Implementation Path for Commodity Import Program

1. Government and USAID sign Agreement

2. USAID hires a contractor to update the list of all Kenyan importers for use in meeting AID's advertising requirements.

3. Ministry of Finance designates the same six cooperating local banks being used in the current CIP by signing six Financing Requests (FRs).

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

5. AID/Washington reviews FRs, issues bank L/Comms to U.S. correspondent banks named in FRs, and informs USAID/K that L/Comms issued.

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

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

8. The Ministry of Commerce then returns the application to the CBK where a Foreign Exchange Allocation License number is issued in pro-forma fashion. Two copies of the approved Import License are given to USAID/Kenya for forwarding to the importer.

9. The Kenya cooperating bank issues L/C to supplier. Confirmation of L/C is made by correspondent bank and L/C formally notifies supplier that import is to be AID-financed under Reg. One. L/C contains special AID-financed instructions (shipping, marking, form 11 approval, etc.).

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

11. Correspondent bank informs Kenya cooperating bank that payment to U.S. supplier has been effected and sends documents to the Kenya cooperating bank. Then the Kenya cooperating bank turns documents over to importer upon receipt from U.S. correspondent bank (with one copy of Ocean Bill of Lading or Air Waybill being given to USAID/Kenya).

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

13. Bank makes a deposit of equivalent shillings (at the rate of exchange in effect on the day of disbursement by AID) into the special account 180 days after AID disburses.

14. The AID contractor audits deposits

15. The AID contractor monitors end-use to discourage hoarding.

B. Implementation Schedule for Commodity Import Program

Implementation is scheduled to occur according to the following timetable starting from the date this Amendment is signed:

Grant agreement signed........................	1 week
CP's satisfied................................	4 weeks
Contractor hired to update list of importers..	6 weeks
Bank L/Comm's issued by AID...................	8 weeks
Initial L/C's opened..........................	10 weeks
First shipments from U.S......................	14 weeks
List of importers sent to AID/W to fulfill AID's advertising requirements......	6 months
Imports start arriving in Kenya...............	6 months
Initial Deposits made into Special Account....	10 months
First Yearly Evaluation of CIP................	18 months
Terminal date for requesting FR's.............	30 months
Final shipment from U.S.......................	36 months
Grant fully disbursed.........................	36 months
Final deposits into special account...........	42 months
Final withdrawals made from special account...	44 months

DESCRIPTION OF ORGANIZATIONS, COMMITTEES, AND PROCEDURES INVOLVED IN IMPORT ADMINISTRATION

1. Overview

The involvement of the various groups in the import administration process is best summarized by the sequence of events beginning with importer application and ending with the delivery of goods. Following this summary, the detailed operation of each group is described. The annex only describes current procedures for non-CIP applications as of January, 1988 which are subject to change. Importers expect a minimum of two months for the approval process before an L/C can be opened. The overall process is:

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

b) C&I/Import-Export Department verifies I/L App., submits it to Import Management Review Committee, and a week later to the Minister's Committee on Import Administration, which have approval authority, if application is approved, issues an approval number and retains one copy of pro-forma invoice and septuplicate copy of I/L App.;

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

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

e) Importer takes the documents to a commercial bank which issues a letter of credit (L/C) and retains copies of pro-forma invoice, original and duplicate copies of the I/L App. (or if an L/C is not used forwards Purchase Order to supplier);

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

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

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

i) The correspondent bank sends the payment documents to the local commercial bank who sends the documents to the Central Bank of Kenya/Foreign Exchange Department (CBK/FD) for release of the foreign exchange to the corresponding bank in the country of the good's origin (usually from CBK or the bank's foreign exchange reserves held in that country), CBK/FD clears documents concerning transactions in excess of KShs 100,00 through CBK/EC to verify the authenticity of submitted documents against the original applications, and the commercial bank then releases the documents to the importer to use for customs clearances;

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

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

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

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

2. Import Quota System

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

Schedule IA, a subdivision of the former Schedule I, which includes the highest priority imports. Goods on this schedule are subject to tariff only and are unrestricted by quota. Licensing procedures are supposed to be fully automatic; but the Import Management Review Committee still reviews each I/L App. and denies applications if insufficient FX is available, or if the importer has requested too large a quantity; It includes such goods as medicine, raw materials, spare parts, agriculture inputs and selected capital equipment, and commodities essential for export. Some goods one might think properly belong on this schedule are prohibited from import to protect local industries. In 1984 and 1985 ESF Agreements AID covenanted the moving of a greater number of item to Schedule IA.

Schedule IB, the remaining portion of former Schedule I, which includes somewhat lower priority items. For these items, licenses and foreign exchange will be allocated subject to foreign exchange availability.

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

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

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

3. Committees

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

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

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

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

(c) Import Management Review Committee

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

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

The following are the detailed procedures of IED. First the importer obtains from his commercial bank an I/L App. Copies of the form can be obtained from any commercial bank. The forms must be typed, 7 copies. For selected items, the consent of a ministry must be obtained. For example, the consent of the Ministry of Health is required for importation of drugs and pharmaceuticals. The consent form (unnumbered) must accompany the applications when they are submitted. In addition, 4 copies of an invoice from the supplier must be submitted and, finally, a check for one and half percent of the C&F value of the goods to be imported must be submitted with the I/L App. This and one half percent is used primarily to fund the SGS inspection and only secondarily to offset Ministry of Commerce and Industry's costs associated with administering import licenses.

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

-- The application forms (7 copies)
-- Ministry consent forms (2 copies if required)
-- Invoice from the supplier (4 copies)
-- A check of 1.5% of the C&F value of goods.

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

1. Returned to importer to give to commercial bank;
2. Same as one above;
3. Returned to importer to give to customs for port release;

4. SGS Inspection Order to SGS in country of goods' origin;
5. Central Bank of Kenya retains;
6. SGS Nairobi for their use as necessary;
7. Retained by Ministry of Commerce, Import/Export Department.

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

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

1VD

ACTION: AID-3 INFO: ECON RLO

VZCZCNA0432 20-JUN-88 TOR: 13:08
OO RUEHNR CN: 36147
DE RUEHC #6921 1700059 CHRG: AID
ZNR UUUUU ZZH DIST: AID
O 180102Z JUN 88 ZDK CTG URSVC ADD:
FM SECSTATE WASHDC
TO AMEMBASSY NAIROBI IMMEDIATE 1519
BT
UNCLAS STATE 196921

Corrected copy
Para 2.

AIDAC

E.O. 12356: N/A

SUBJECT: FY 1988 PROGRAM GRANT AMENDMENT (615-0240)

REF: (A) STATE 188509 (B) STATE 174613 (C) STATE 170529

1. APPRECIATE ALERT TOE'S ASSISTANCE IN PREPARING REVISED PROGRAM GRANT AMENDMENT A COPY OF WHICH WAS DELIVERED TO MISSION ON 6/11/88. THE FOLLOWING IS A SYNOPSIS OF THE QUESTIONS RAISED DURING THE AID/W PAAD AMENDMENT REVIEW. MISSION SHOULD TAKE THESE UNDER CONSIDERATION IN FINALIZING THE PAAD AMENDMENT:

-- WHAT ARE ELIGIBLE COMMODITIES UNDER THE CIP? IS THERE A FERTILIZER RESERVE? ARE DISBURSEMENTS LIKELY TO BE HELD UP IF DEMAND FOR A SPECIFIC ELIGIBLE COMMODITY IS LOW?

WILL THE TA COMPONENT BE PROJECTIZED? WOULD IT BE USEFUL TO SPELLOUT THAT OF THE DOLS 7.5 MILLION DFA COMPONENT, DOLS 4.5 MILLION WILL BE USED FOR THE CIP AND DOLS 3.0 MILLION

FOR TECHNICAL ASSISTANCE?

-- IS IT THE MISSIONS INTENTION NOT TO INCLUDE COVENANTS IN THE AMENDMENT? FROM THE EXISTING TEXT, IT APPEARS THAT THERE WILL BE NO CONDITIONS PRECEDENT TO IMMEDIATE DISBURSEMENT OF FX. IS THIS CORRECT OR SHOULD THE PAAD AMENDMENT BE REVISED TO REFLECT OTHERWISE.

-- WHY IS SO MUCH EMPHASIS PLACED ON THE RELEASE OF LOCAL CURRENCY WHICH AFTER ALL, BELONGS TO THE GOK.

2. AFTER FULLY CONSIDERING AND ADDRESSING THE ABOVE POINTS, MISSION DIRECTOR OR THE INDIVIDUAL ACTING IN HIS ABSENCE IS HEREBY DELEGATED AUTHORITY TO APPROVE THE FY 1988 PAAD AMENDMENT. OBLIGATION MAY TAKE PLACE FOLLOWING THE EXPIRATION OF THE 15 DAY STATUTORY CONGRESSIONAL NOTIFICATION REQUIREMENT.

3. THE STATUS OF THE CONGRESSIONAL NOTIFICATION WILL BE

THE SUBJECT SEPTEL. SHULTZ
BT
#6921

NNNN

Project 615-0240

OFFICIAL FILE

VZCZCNAI
RR RUEHC
DE RUEHNR #6950 173 **
ZNR UUUUU ZZH
R 211218Z JUN 88
FM AMEMBASSY NAIROBI
TO SECSTATE WASHDC 3081
BT
UNCLAS NAIROBI 16950

FILE IDENT No.

CLASS: UNCLAS
CHRGE: AID
APPRV: DIR:HAUSMAN
DRFTD: PROG:SHAYKIN
CLEAR: 1. AGR:JGINGERICH
2. PRJ:GFERTOLIN
DISTR: DIR PRJ AGR
PROJ RF

AIDAC

E.O. 12356: N/A
SUBJECT: FY 88 SAAP PAAD AMENDMENT (615-0240)

REF: STATE 196921

1. THIS CABLE RESPONDS TO POINTS RAISED IN PARAGRAPH 1 OF REFTEL. IT SHOULD BE READ IN CONJUNCTION WITH CHAPTERS V AND VI OF THE FY 88 SAAP PAAD AMENDMENT.

2. ALL ITEMS IN THE A.I.D COMMODITY ELIGIBILITY LISTING- 1986 EDITION WILL BE ELIGIBLE FOR FINANCING UNDER THE GRANT, SUBJECT TO THE SPECIAL PROVISIONS APPENDED TO THAT LISTING. THE GEOGRAPHIC CODE IS 000 (U.S.). THERE IS NO SPECIFIC FERTILIZER RESERVE IN THE FY 1988 AMENDMENT SINCE AMPLE FERTILIZER IMPORTS ARE FINANCED UNDER THE FY 1987 AMENDMENT. EXPERIENCE WITH THE CIP UNDER THE FIRST TWO YEARS OF THE CURRENT SAAP DEMONSTRATES THAT IT IS HIGHLY UNLIKELY THAT DISBURSEMENTS WILL BE HELD UP BECAUSE OF INADEQUATE DEMAND; ON THE CONTRARY, IN THE LAST YEAR DEMAND HAS EXCEEDED RESOURCES.

3. THE TA WILL BE HANDLED THROUGH A SMALL NUMBER OF DISCRETE OBLIGATIONS. THE PAAD AMENDMENT STATES THAT US DOLS 7.5 MILLION IN DFA WILL BE USED BOTH TO CONTINUE SUPPORT OF THE FERTILIZER REFORM PROGRAM AND FOR SUPPORT OF RELATED TECHNICAL ASSISTANCE FOR THE OVERALL REFORM PROGRAM. TA ACCOUNTS FOR US DOLS 3 MILLION OF THE DFA FUNDS PROVIDED BY THIS AMENDMENT. EXPERIENCE WITH TA IN THE PAST (I.E. 615-0213) AND CURRENT SAAPS HAS SHOWN THAT PROJECTIZATION OF TA COMPONENTS IS NOT PRACTICAL OR NECESSARY.

4. COVENANTS ARE SPECIFIED IN CHAPTER VI OF THE PAAD AMENDMENT AND SECTIONS 4 AND 5 OF THE GRANT AGREEMENT AMENDMENT.

5. EMPHASIS IS PLACED ON THE RELEASE OF LOCAL CURRENCY BECAUSE OF THE RELATIVE SIZE OF THE RESOURCES INVOLVED, K SHILLINGS 430 MILLION OR APPROXIMATELY US DOLS 25 MILLION EQUIVALENT IN FY 1988 ALONE, AND BECAUSE THEIR RELEASE IS CRITICAL TO THE GOK IN MEETING TARGETS UNDER ITS BUDGET RATIONALIZATION PROGRAM AND IMF AGREEMENTS.

5. THE ABSENCE OF CONDITIONS PRECEDENT TO FOREIGN EXCHANGE DISBURSEMENT IS AN ACT OF COMMISSION, NOT

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OMISSION. RAPID DISBURSEMENT OF NEW CIP RESOURCES BEST SERVES THE OBJECTIVE OF PROMOTING GROWTH OF THE PRIVATE SECTOR. IT ALSO REWARDS THE GOK FOR PROGRESS DEMONSTRATED UNDER THE ENTIRE 3-YEAR SAAP. THE DFA-SUPPORTED FERTILIZER REFORM COMPONENT REQUIRES, THROUGH COVENANTS, THE CONTINUATION OF ACTIONS BEGUN UNDER EARLIER PHASES OF THE PROGRAM. SIMILARLY, THE ESF-SUPPORTED CAPITAL MARKET AND IMPORT LIBERALIZATION REFORMS ARE THE PRODUCTS OF AN ON-GOING POLICY DIALOGUE WHICH HAS BEEN HIGHLY COLLABORATIVE. AT THE SAME TIME, BUDGET RATIONALIZATION IS MORE APPROPRIATELY LINKED TO LOCAL CURRENCY CPS AS STATED ABOVE. AS EVIDENCE OF THE COLLABORATIVE ENVIRONMENT SURROUNDING THE POLICY DIALOGUE AID/W MAY NOTE THAT THE COVENANT ON ISSUANCE OF REVISED IMPORT LICENSING SCHEDULES HAS BEEN SATISFIED AHEAD OF SCHEDULE. FURTHERMORE, IT IS IMPLICIT IN PRELIMINARY DISCUSSIONS REGARDING THE PROPOSED FY 1989 PROGRAM FOR ECONOMIC STABILIZATION AND SECTORAL ADJUSTMENT (615-0243), THAT CONTINUING PROGRESS IN POLICY REFORM IS A CONDITION FOR FUTURE NON-PROJECT ASSISTANCE. CONSTABLE

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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: ______ Date: ______
Charles L. Gladson
Mission Director

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

______ Date: ______
General Counsel for Africa
Mary Alice Kleinjan, GC/AFR

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 ermissible criterion for nitrate (determined as nitrogen) in ublic drinking water is 10 milligrams per litre. Overuse of itrates and phosphates can also contribute to over-growth of bjectionable plant forms in lakes and other standing bodies of ater. The Government of Kenya Ministry of Water Development has ver 100 stations which monitor the quality of water. Chemical ests are regularly carried out, and no sources with unsafe uantity of nitrates and phosphates linked to fertilizer use have een identified. While conditions among developing countries vary idely, it is clear that Kenya falls nearer to the bottom than to he top of the list of developing countries in terms of omparative fertilizer use. Required fertilizer imports of pecific types will be assured within the limits of the quantities nd types projected for government licensing this year. uantities beyond those already projected for licensing by overnment are not contemplated. The program will have its ffects primarily through improvements in the balance of payments nd through increases in development revenues available to overnment in agreed-upon areas. Such effects, though important n underwriting significant and ongoing structural adjustments in he Kenya economy, are generalized rather than specific and affect he overall environment in a manner that is primarily indirect.

. <u>Recommended Environmental Action</u>

. In accordance with A.I.D. Regulation 16, it is recommended hat a negative determination is appropriate for the fertilizer to e financed under the Program. The primary objective of the rogram is to provide balance of payments and budgetary assistance hile also financing the import of fertilizer. As noted above, he use of fertilizer financed by A.I.D. will not have significant mpact on the physical and natural environment.

. In accordance with A.I.D. regulation 16, it is recommended hat a categorical exclusion be granted pursuant to Section 16.2(c) (2) (ix), which provides an exclusion with respect to IPs when, prior to approval, A.I.D. does not have knowledge of he specific commodities to be financed and when the objective in urnishing such assistance requires neither knowledge, at the time ssistance is authorized, nor control during implementation, of he commodities or their use in the host country. The program ill not provide financing for the procurement or use of pesti- ides.

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

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ANNEX H

Agricultural Sector Analysis: Constraints and Policy Issues

This Annex provides an analysis of the agricultural sector performance in recent years, the major constraints and policy issues in the sector. It is based on a detailed sector analysis in USAID/Kenya Agricultural Sector Strategy Statement, and the World Bank Agricultural Sector Report.

I. The Role of Agriculture in Kenya's Development

Kenya's agricultural sector plays a key role in the country's overall economic growth and development. It is a major source of rural employment, employing more than 80 percent of the population. The sector not only feeds the population, but also contributes more than 50 percent of foreign exchange earnings through exports of coffee, tea, and horticultural products.

The sector contributes significantly to growth and development in other sectors of the economy, notably manufacturing and service sectors. The agricultural sector provides important forward and backward linkages to the manufacturing sector. The manufacturing sector in Kenya is comprised, largely of agro-based industries which depend on the agricultural sector for inputs. Agro-industries (food processing, beverages, tobacco, textiles, and wood products) account for approximately 50 percent of the value added from the manufacturing sector. The sector is also a major consumer of manufactured inputs, such as fertilizers, seeds, fuel, bags, livestock drugs and medicine, feeds, and other agricultural chemicals. The services sector, which includes transportation, power and trade, is also linked to the agricultural growth and development.

With Kenya's rapid population growth and expanding labor force, agricultural linkages to the manufacturing and services sectors become an important strategic element for employment creation. Growth in agricultural production will directly or indirectly help reduce unemployment. These linkages have increasingly been recognized by the government. The focus has broadened to look beyond agricultural production as direct input into agroindustries. It has concentrated on the relationship between the rural areas (as both producers and consumers) and urban centers (as suppliers of agricultural inputs and off-farm employment). With increased agricultural output, the demand for inputs and other services as well as consumption goods increases. This will generate employment in urban centers (mostly small towns), which in turn creates demand for agricultural products.

II. Structure and Performance of Kenya's Agricultural Sector

A. Structure

Out of Kenya's total land area of 575,000 square kilometers, 19% is high and medium potential, 9% is arable landwith periodic drought, and the remaining is desert or land considered suitable only for livestock production. Cropping patterns are influenced considerably by the great diversity of ecological and climatic conditions.

At independence, large-scale, settler farms dominated commercial production, producing most of the country's wheat, dairy products, coffee, tea and horticultural export crops, and the bulk of domestically-marketed maize. At that time the traditional subsistence sector was marked by a pattern of smallholder production with minimal integration into the major commercial channels.

Since independence Kenyan agricultural has developed three major subsectors: subsistence producers (producing primarily for home consumption), a commercially oriented smallholders (producing both food and cash crops), and a large farm sector.

The major agricultural subsectors include food crops - maize, wheat, beans and other legumes, sorghum, millet, and rice, export crops - tea, coffee, and to a minor extent, pyrethrum and sisal; industrial crops - sugarcane and cotton; and livestock production.

There has been increasing commercialization of smallholder agriculture. Subsistence producers, which include both smallhold farmers and pastoralists, have increasingly become commercially oriented. Smallholders produce mainly maize and beans for subsistence, combined with cash crops (depending on the agro-ecological zone) and livestock production. This subsector is dominant in terms of output, land area and employment. It accounts for about 75% of total agricultural output, 66% of land area devoted to arable agriculture, over 85% of total agricultural employment, and about 55% of marketed output. Using labor-intensive production methods, smallholders produce about 60% of the marketed production of coffee, 35% of tea, 45% of sugarcane, and almost all the marketed production of rice, pulses, cotton and pyrethrum. Thus, the emerging importance of smallholder agriculture has been an important impetus to growth, and future performance will hinge largely on removing the constraints blocking expansion in this subsector.

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A substantial proportion of the large farms have, since independence, been redistributed to smallholders. Currently both large farms (over 50 ha.) and medium size farms (20 - 50 ha.) cover about 3.5 million ha. Using mechanized methods of production, they produce mainly grains (maize, wheat and barley), livestock products (meat and milk) and plantation crops (coffee, tea, sugarcane and sisal).

B. Performance

Kenyan agricultural production more than doubled between 1955 and 1977, growing at an average annual rate of 3.6%. Coffee and tea production accounted for 46% of this increase. In the 1963 - 1972 decade, agricultural production grew at an average rate of 4.6 per annum. During this time - the first decade after independence - attention was focused on the African farmer and the high growth was attributed primarily to the expansion of land area under cultivation, major yield increases, and switches to higher value crops. Specifically, crop area increased by 20%, principally on high and medium potential land, as smallholders took over from departing settlers; there were major yield increases in maize due to the introduction in 1964 and rapid adoption of high yielding hybrids; a shift took place toward the production of such high value crops as coffee, tea and dairy products; and smallholder farmers moved increasingly into commercial farming.

Since 1972 there has been a slow and highly variable growth in agricultural production. Between 1972 and 1977 the average annual growth was only 2%, increasing to 3.1% in the period 1972 to 1982. During the 1979-80 period, negative growth was recorded, while 1977 and 1981 recorded impressive growth rates of 10.2% and 6.2% respectively. With the drought in 1984, production again dropped dramatically.

Maize production experienced wide fluctuations throughout the 1970's and into the 80's. The growth of marketed maize averaged 13.2% per year between 1964 and 1972, but fell to -4.6% between 1972 and 1981, largely because of poor incentives, marketing problems in 1978 (a bumper crop year), and droughts in 1979 and 1980. Estimates of total maize production show that increases in 1982 and 1983 were attributable primarily to area increases, although yield increases are also partly responsible. In 1984 production was again down due to severe drought. Production recovered in 1982/83 to 2.3 million tons, due to favorable rains and a large increase in the producer price. During 1985-1987, the annual growth rate of maize production averaged about 6 percent.

The extreme variability of production witnessed in past years make it difficult to plan for marketing, exports or imports, and storage. In the last eight years, maize production fluctuated by 49% around the average, a difference which amounted to about one million tons.

After registering slow growth in the early part of the 1970s (due largely to a decline in large farms), wheat production has grown at an average rate of 4.6% per annum since 1972. Recovery in growth is attributable both to attractive price incentives (wheat prices have been set at or slightly over import parity for a number of years) and yield increases. Wheat is grown by large and medium scale farmers, primarily in areas which are unsuitable for maize production. Kenya is not self-sufficient in wheat; imports have been increasing steadily over the last decade, and are now roughly 200,000 tons per annum. Availability of suitable land area for wheat production will constrain future expansion, and most growth in production will come from yield increases.

Other major food crops include sorghum, millet, rice, various legumes (principally beans), roots and tubers. Sorghum and millet are the second largest commodity in terms of acreage planted, yet have remained primarily a subsistence crop due to the consumer preference for maize and the late emergence of an animal feed industry. Development of highly-yielding, more palatable varieties of sorghums and millet is expected to increase agricultural productivity in the low to medium potential areas and thereby increase national productivity. Increased productivity in these areas will also foster specialization in production and trade which are perceived as key ingredients to a revitalized agricultural sector.

Coffee is the single most important agricultural commodity in Kenya in terms of its contribution to agricultural GDP and to foreign exchange earnings. The volume of coffee production grew 4.1% per annum due to both area and yield increases, while the value grew 3.4% over the same period. Aside from the coffee boom in 1977, when world coffee prices rose sharply, coffee prices have in general been declining since the 1970s and are expected to improve only marginally over the next decade (there will be price fluctuations). Kenya has compensated for declining world coffee prices by expanding exports, but possibilities for a large expansion are limited. Kenya is a party to the International Coffee Agreement, which sets export quotas, though production can be sold on non-quota markets (where prices are normally lower). Kenya coffee is of high quality, however, and certain importers are willing to pay a premium for it; thus, the possibilities of expanding production can not be discounted.

Tea is the second most important earner of foreign exchange among agricultural exports. Over the last 15 years Kenya has expanded tea production largely through a smallholder tea production program run by the Kenya Tea Development Authority (KTDA). In 1982, smallholders accounted for 41% of Kenya's tea production. KTDA's tea expansion program has now come to a close, however, and further increases in tea exports must come about primarily through yield increases unless additional land can be diverted from food commodities. Kenya's tea production is only approximately 5% of the world total and about 13% of tea marketed in international markets. As in the case of coffee, real tea prices are expected to increase only marginally throughout the 1980s. An International Tea Agreement has been under discussion for several years, similar to the coffee agreement, but at present no quotas have been agreed upon. While such an agreement may improve world prices, it would effectively restrict exports from Kenya, which currently exports as much tea as it can handle.

With regard to other export crops, after a decade of declining production pyrethrum output has been expanding since 1979. Deliveries of pyrethrum flowers in 1981 were nearly double those of 1979. Kenya has the major market share for pyrethrum exports, but production problems in the late 1970s, stemming from low producer incentives and poor performance by the Pyrethrum Board, increased competition from synthetic pyrethrum and the concomitant erosion of Kenya's market share. Production has recovered since 1984. Between 1985 and 1987, sales of pyrethrum almost doubled.

Sisal was once an important export, but production fell in the 1970s. Sisal faces competition both from other sisal producing countries and from cheaper synthetic fibers. Sisal production continued to decline in the 1980s. Marketed production declined from 50,000 tons in 1983 to 37,000 tons in 1987.

The performance of industrial crops has been mixed. Sugarcane production averaged an annual growth rate of 18.7% between 1972 and 1981 and was the second largest contributor to agricultural GDP growth. Production, however, stagnated during the 1980's at less than 4 million tons per year since 1982.

Cotton production stagnated throughout the 1970's, after which it registered a sharp increase in 1980, largely due to price increases and expansion of area. Since 1980, however, cotton production has declined to average 1970 levels, largely due to the deterioration of price and to institutional problems of the Cotton Lint and Seed Marketing Board, plus marketing and payment problems of cooperatives. There are, however, opportunities for increased production over the long term through small scale irrigation.

Table 1 through 3 show the recent trends in production and prices of various crops.

Livestock is an important agricultural activity, with nearly 60% of smallholders owning one or more head of cattle. Ranching is a major activity in the semi-arid areas (which are ill-suited for many other productive activities), and livestock provide the means of subsistence for Kenya's pastoral groups. In the past decade, however, the performance of the livestock subsector has been weak. Dairy production registered a declining growth rate for both value and volume of marketed production in the period 1972 - 1982. Since 1983, the trend has been reversed with an annual average growth rate of 10 percent.

Meat production is largely centered in the rangeland areas; marketed beef is produced mainly by ranches, which take a variety of forms of ownership: group ranches, company ranches and privately owned ranches. One of the major problems in beef production is limited rainfall and water supply in the ranching areas. Government sponsored programs to develop water points on ranches have largely failed, due primarily to the poor performance of the Ministry of Water Development. Private initiatives by group and company ranches to develop water have been limited, in part because of their financial situation. While private ranches are on balance more efficient, group and company ranches have faced serious financial problems and cash flow shortages.

Table 4 shows production and sale of livestock and dairy products in recent years.

III. Sectoral Constraints and Issues

Given the population pressure faced by Kenya, agricultural growth has to accelerate. To maintain constant per capita production, will require an annual rate of growth of about 4 percent, and a faster rate of growth will be needed in order to have real increases.

The USAID/Kenya Agricultural Sector Strategy Statement and other sector analysis, such as the World Bank agricultural sector report for Kenya, have identified a number of constraints to rapid agricultural growth in Kenya. The major constraints are:

Table 1

RECORDED MARKETED PRODUCTION AT CURRENT PRICES, 1983-1987

KPound Million

	1983	1984	1985	1986	1987 *
CEREALS					
Maize	48.95	49.05	54.56	66.50	68.09
Wheat	26.92	17.84	26.26	32.88	21.88
Others	5.54	4.52	10.19	7.82	11.07
Total	81.41	71.41	91.01	107.20	101.04
TEMPORARY INDUSTRIAL CROPS					
Sugar-cane	34.34	40.99	46.75	52.79	55.47
Pyrethrum	5.03	1.94	2.92	4.48	5.64
Others	11.87	15.53	16.24	35.45	42.26
Total	51.24	58.46	65.91	92.72	103.37
OTHER TEMPORARY CROPS	11.96	9.57	17.27	27.81	18.83
PERMANENT CROPS					
Coffee	166.25	227.67	191.89	288.32	192.16
Tea	130.31	301.12	247.60	242.33	194.76
Sisal	15.54	17.34	15.03	15.42	13.54
Others	4.52	5.62	4.86	4.71	4.34
Total	316.62	551.75	459.38	550.78	404.80
TOTAL CROPS	461.23	691.19	633.57	778.51	628.04
LIVESTOCK AND PRODUCTIONS					
Cattle and Calves	51.81	58.95	70.36	84.26	103.87
Dairy Produce	32.80	25.78	36.26	56.51	62.08
Others	9.64	12.86	15.75	19.03	23.71
Total	94.25	97.59	122.37	159.80	189.66
GRAND TOTAL	555.48	788.78	755.94	938.31	817.70

* Provisional

SOURCE: Republic of Kenya: Economic Survey, 1988

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AVERAGE GROSS COMMODITY PRICES* TO FARMERS, 1983-1987

KSh. per stated unit

PRODUCTS	Unit	1983	1984	1985	1986	1987**
Coffee	100kg	3,488.00	3,844.00	3,972.00	5,020.00	3,662.00
Tea	"	2,184.00	5,184.00	3,366.00	3,382.00	2,500.00
Sisal	"	625.00	674.00	707.00	743.00	705.00
Sugar-cane	tonne	227.00	227.00	270.00	297.00	300.00
Pyrethrum (extra equivalent)	Kg	1,150.00	1,150.00	1,150.00	1,210.00	1,210.00
Seed Cotton	100 Kg	369	448	480	470	482
Maize	"	154.00	175.00	187.00	198.00	209.00
Wheat	"	222.00	269.00	271.00	293.00	295
Rice Paddy	"	178	178	342	348	372
Beef (third grade)	"	1,138.00	1,101.00	1,492	1,857.00	2,115
Bacon Pigs	"	1,459.00	1,482.00	1,394	2,057.00	2,432.00
Milk	100 litres	240	240	285	325	325

* The prices are for calendar year and may differ from those based on crop years. In the case of tea and coffee, the prices are for made tea and processed coffee respectively.

** Provisional.
SOURCE: Republic of Kenya: Economic Survey, 1988

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SALE OF SOME MAJOR CROPS TO MARKETING BOARDS, 1983-1987

CROP	UNIT	1983	1984	1985	1986	1987 *
Maize	000 tonnes	636.0	560.0	582.9	669.5	651.9
Wheat	"	242.3	135.4	193.5	224.7	148.3
Rice Paddy	"	36.6	36.4	39.5	21.3	30.1
Cotton	"	25.8	22.8	38.0	25.4	23.8
Coffee	"	95.3	118.5	96.6	114.9	104.9
Tea	"	119.3	116.2	147.1	143.3	155.8
Sisal	"	49.7	51.4	45.0	41.5	37.0
Sugar-cane	mm tonnes	3.2	3.6	3.5	3.6	3.7
Pyrethrum (Extra Equi-valent)	000 tonnes	87	34	50	74	93

*Provisional
SOURCE: Republic of Kenya: Economic Survey, 1988

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Table 4

PRODUCTION AND SALE OF LIVESTOCK AND DAIRY PRODUCTS, 1983-1987

	UNIT	1983	1984	1985	1986	1987 *
KENYA CO-OPERATIVE CREAMERIES						
Recorded Milk Production**	Mn. Litres	274	190	231	316	347
Milk Processed:						
Wholemilk and cream	Mn. Litres	215	230	249	292	302
Butter and ghee	Tonnes	3,721	2,301	3,424	4,215	4,754
Cheese	"	227	203	252	208	207
Dried wholemilk powder	"	1,693	205	970	3,057	2,346
Dried skim-milk powder	"	1,921	206	766	2,733	2,040
Other products	"	-	71	-	329	1,493
Livestock slaughered***						
Cattle and Calves	'000 Head	384	614	524	427	524
Sheep and Goats	"	293	405	327	300	359
Pigs	"	64	87	65	77	60
KENYA MEAT COMMISSIO						
Intake of:						
Cattle and Calves	'000 Head	84	222	116	24	2
Sheep and Goats	"	7	13	-	-	-

* Provisional
** Including sale licensed by the Kenya Dairy Board
*** Licensed abattoirs only.
SOURCE: Republic of Kenya: Economic Survey, 1988
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1. limited supplies of arable land and distribution of land ownership;

2. inadequate research and extension services;

3. inefficient agricultural input supply systems;

4. marketing and pricing policies; and

5. institutional and financial constraints.

These issues have been analyzed in detail in the USAID/Kenya Agricultural Sector Strategy Statement and in the 1986 World Bank Agricultural Sector Report. The analyses in these two documents remain valid. This section summarizes the analyses of these major constraints and issues.

A. Land Issues

The limited supply of good arable land in Kenya (only 19 percent of the total land area is considered medium and high potential) together with a high population growth rate has been an important factor in explaining slow growth of agricultural output. The squeeze on land in some areas has reduced use of fallow, resulting in declining yields. The increasing intensity of farming also exacerbates soil erosion.

The option of increasing land use under cultivation is not promising for Kenya in the short and medium terms. While considerable potential exists in the long term for small-scale irrigation, it requires significant financial, mamagerial and technical resources which make the economic viability of this option doubtful.

An alternative to increasing land use cultivation is by changing cropping patterns. However, its prospects are constrained by the ecology of various regions (high value crops cannot be grown economically in many areas) and exports of two key high value crops - tea and coffee are limited. Further, farming systems issues need further careful analysis. Because of the predominance of integrated farming, measures to induce changes in cropping patterns must reflect a good understanding of farm level economics, including labor demands and risk, and this knowledge is not now available. There are virtually no good technical packages for high value crops that can be introduced now.

In the short and medium term, land use intensification mainly with existing crops offers the most promising option for increasing production and employment. The scope for increasing yields varies by type and size of farms. As yields are already relatively high on most large farms, it is likely that further increases in yields will come from smallholders. Concentrating on intensifying smallholder production offers the best option for addressing the land constraint.

The land constraint is further complicated by land distribution and tenure problems. Distribution of Kenya's limited arable land is very unequal. This has resulted in a loss of potential output primarily because some large farms are underutilized. There is a pronounced dichotomy between large and small farms in terms of holding size. Small farms average 2 ha in size and make up 56% of cropped area while large farms range in size from 20 to 1,000 ha and occupy 34% of cropped area. Although previously large farms were thought to be more efficient than small farms, analysis has shown that smallholders are at least as efficient as large farmers, and in many instances are more efficient in their use of domestic resources.

Kenya's slow pace in changing land tenure systems has also affected agricultural sector performance. Land tenure systems have been changing over the past three decades, from a communal tenure system to a freehold individual or group-based system. To date, only 13% of land available for adjudication has been registered. Registration has rarely led to increased investment in land development, largely because land title no longer assures access to credit because of political difficulties of foreclosure. The slow pace of tenure reform is due to complex bureaucratic procedures, lack of personnel and equipment, insufficient financial support, and an increase in litigation by farmers dissatisfied with the process. The benefits of tenure change will be difficult to realize unless the process is reformed and links between registration and agricultural services strengthened.

B. Research and Extension

Research:

Kenya's research system includes an extremely diverse body of institutions. Prior to independence considerable investment was made in developing a viable research organization - which was to serve both kenya and the larger East African region. The system which evolved focused largely on the needs of the large commercial farms where purchased inputs were regularly used and many operations were mechanized. The structure of the research system developed during this period has never been fundamentally altered. In recent years, however, the structure of Kenya's agricultural sector has changed, as smallholder production has increased in importance. With but few exceptions (e.g., the development in the 1960's of new hybrid maize varieties), little research has been directly relevant to smallholder problems; for example, issues such as the availability and cost of labor, competition among crops for labor, intercropping, and optimal husbandry and input use have not been seriously addressed. In essence, appropriate improved technology for the smallholder has not been developed. In addition, continued innovative research which addresses the problems/constraints facing the medium and large farm sectors has lagged.

The principal reasons for the failure of Kenya's research organization to respond to the needs of the agricultural sector have been rooted in the basic management and organizational flaws in the system. Principal shortcomings include the following:

a. Proliferation of Research Stations and Programs - From a group of four stations in the early 1940s, Kenya's research station network has now grown to a total of 43 national and regional stations, sub-stations and testing sites. Many of these operations have evolved for reasons other than the need for geographically-specific research outlets. Along with the growth of physical facilities has been the proliferation of research programs, many sponsored by donors. The result is the spreading of existing research resources over too many stations and too many research "priorities".

b. GOK Funding - GOK funding of agriculture as a proportion of total expenditure has declined over the past several years. The share of MOALD's budget devoted to research has also declined proportionately to other activities, especially recurrent expenses. This situation has led to the emergence of inadequate recurrent funding as a major constraint in research.

c. Personnel - Another factor hampering the research system is a lack of sufficiently trained scientists. A recent review of Kenya's research program highlighted this constraint as perhaps the most crucial. In addition, the proper balance of research staff and support staff at stations, the preparation of senior scientists for management responsibilities, and the creation of a scheme of service conducive to productive research are all important problems.

d. Support Services - The inadequacies of research support facilities and their management are high among the major constraints to productive agricultural research. ISNAR found that research scientists spend an inordinate amount of time performing tasks better done by support staff. The infrastructure or support problem is partially a result of the disproportionate amount of recurrent budget devoted to staff salaries.

e. Research Linkages. - The "national" research system as it presently operates is confined to the government's activities through KARI (Kenya Agricultural Research Institute). Linkages between government research entities and university researchers are limited and informal, as are those with private sector agricultural researchers. Also, sharing of information and transfer of technological advances between GOK researchers and the international centers (IARCs) is not institutionalized. These factors, combine to prevent Kenya from having a true "national" research system benefiting from shared information and cooperative efforts.

Addressing these problems is essential to developing new technology necessary to increase agricultural production in the medium and long term.

Extension:

In Kenya, as in many countries, there is a considerable gap between yields achieved experimentally at research stations and average yields realized by farmers - particularly by smallholders. The reasons for this are many (including reluctance to accept new cultural practices or technologies because of the perceived risks involved, inadequate financial incentives, inappropriate technologies being introduced, etc.) One factor, often cited as critical, is poor dissemination of information due to weak research - extension links. In Kenya the agricultural extension service, organized under the Ministry of Agriculture and Livestock Development, is vast - it is staffed by large numbers of individuals with (approximately 8,200 in 1986) at least minimal technical skills and substantial budget resources are devoted to it. Irrespective of this, the discernable impact of extension work on increased agricultural production has been minimal. The central problems in the past revolve around two general issues: a lack of new or appropriate technologies to extend and poor organization/management/supervision of extension activities. With regard to the former, as is emphasized in the sections above, there has been a decided lack of the new available technologies; at the same time, the rate of adoption of known improved inputs and cultural practices is, among increased productivity by their adoption. With regard to organization and management, problems typical of many extension efforts are evident: an inordinant amount of time spent by senior staff on bureaucratic "paper work", while staff and farmer education receive little attention; little or no supervision of junior staff regarding their contacts with farmers; inadequate training of the staff who actually do interact with farmers; information passed which is not relevant to a particular farmer's or group of farmers' conditions, etc.

In order to address these problems, in 1983 the MOALD introduced, with the assistance of the IBRD, the Training and Visitation (T & V) extension program. The thrust of this effort was to (a) develop an effective method of extension staff supervision, (b) disseminate technology which is appropriate to a given areas, (c) introduce a method of farmer/staff interaction and farmer education that has proven far more effective in many countries than the traditional one-on-one staff/farmer approach, and (d) carry-out extensive staff training. The approach involves organizing farmers into groups, and having extension field staff work with a "contact farmer" who represents each group (i.e., a farmer who is relatively progressive and who is respected by others in the group). The contact farmer in turn assists in the dissemination of information to others in his/her group. While this approach has improved the organization of extension work, it is confronting difficultues. The principal problem revolves around the effectiveness of the contact farmers; often those in the groups with whom the contact farmers work are sceptical of the advice/information being disseminated (in part because, in some instances, the contact farmer is viewed as an employee of Government and is resented). This problem likely results largely from the process of selection of contact farmers and their inadequate integration into the groups. As more is learned through the implementation of the system, this problem will likely become less serious.

A further problem has been the lack of effective research-extension-farmer linkages capable of identifying and addressing constraints experienced by the producer. This lack of a farmer feedback mechanism, which is most pronoumced with women farmers, results in inappropriate research and the development and delivery of technological packages which often do not address farm-level constraints and/or are not economically viable. A final concern with extension is that in the past year, extension workers have increased by more than 250% to approximately 8,200. This has resulted in a 59% increase in the recurrent cost of the extension program (which presently costs $18 million per year). It is currently planned that the GOK and IBRD will have a joint evaluation of the T & V Program in mid-1987. The focus of this evaluacion will be to assess its 1) cost effectiveness, 2) management and supervision, and 3) research-extension linkages. It is expected that the result of this evaluation will result in modifications of the T & V system which permit the extension served to be more responsive to farmer's needs.

While there is room for improvement in the public sector extension, a more promising avenue is the development of private sector extension as it relates to agricultural input market development. The rapid dissemination and acceptance of maize hybrids was accomplished to a large degree through the efforts of local stockists.

C. Agricultural Input Supply

Improved agricultural productivity and growth will also depend significantly on the availability and delivery system of key agricultural inputs. Of particular importance for land intensification by smallholder farmers are: fertilizer and agricultural chemicals, improved seeds, and agricultural credit. Major issues include: (a) the type of inputs available, (b) the capacity and efficiency of input delivery systems, and (c) incentives for input use. A thorough analysis of these issues and recommendations have been under taken by the World Bank in its Kenya Agricultural Inputs Review (June 1985). The results are highlighted below.

Use of improved inputs is widespread in Kenya, and compared to many other countries, Kenya's input delivery systems function well in most areas for most inputs. The structure of inputs marketing is marked by the participation of a range of large and small parastatals, cooperatives, private companies and small-scale traders. This rich diversity of participants is the key to future development of an efficient and competitive input market. But there are problems: disruptions in national supplies of fertilizer, localized shortages, slow development of infrastructure to serve smallholders, late arrivals of fertilizer and confusion in pricing policy. The Government has taken an active role in promoting input use and regulating input delivery through pricing and import control policies.

Fertilizer has particular importance for intensification of production. Although statistics are weak, estimates show that total growth of demand for fertilizer averaged only 2.5% since the early 1970s. Kenya presently uses between 160,000 and 200,000 tons of fertilizer per year, but consumption could potentially increase to about 300,000 tons by 1990. These aggregated projections conceal almost stagnant demand for some crops (sugar, wheat and cotton), slowly rising demand for

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coffee and tea, and huge growth in demand for maize (20% to 30% per annum) over the decade. No accurate statistics exist on fertilizer consumption or demand factors, but a general picture of patterns of use can be pieced together. Patterns are marked by a concentration on major cash crops and in certain geographical areas; there is also a clear divergence in use between large and small farmers. Three major cash crops (coffee, tea and sugar) account for nearly two-thirds of total fertilizer use, and only a small share goes to maize (19%) and even less to other food crops. Large farms and estates consume 58% of total fertilizer, out of proportion to their share of farmed land (30%) and total output (2.5%). Even so, smallholder use has grown dramatically since the early 1970s, but a significant gap between recommended and actual rates of use exists for most crops.

Problems in increasing fertilizer use occur in three areas: financial returns, technical knowledge and availability of fertilizers. Low incentives are evident for fertilizer use for many food crops, especially maize; in comparison, for most cash crops, incentives are strong and marketing networks exist to supply fertilizer on time. On the technical side, levels of husbandry are important in realizing the full benefits from fertilizer. On the supply side, Government interventions in fertilizer marketing (through import licenses and allocations) and pricing have discouraged the development of rural supply networks, have constrained overall supplies and have led to chronic problems of late arrival of supplies.

Kenya has established a successful seed multiplication enterprise, the Kenya Seed Company (KSC), with Government and private participation. KSC provides hybrid seeds for maize, beans, wheat and a variety of other crops. The impact of hybrid seeds on agricultural growth has been profound, in part attributable to an excellent seed distribution network which boosted maize seed sales 82% since 1973. KSC also exports minor volumes of seeds to other East African countries. Agricultural machinery is mainly used by large and medium scale farmers, although there is a growing demand among smallholders for land preparation services. An estimated 1,000 to 1,500 private contractors provide tractors and land preparation services, and the Government offers a Tractor Hire Service, though neither operates extensively enough to service all farmers during planting and harvesting seasons. This has contributed to problems of late planting, which reduces crop yields.

Improving the distribution of agricultural inputs is vital for intensification of smallholder production. The Government is aware of problems in input supply and distribution, and

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improving existing systems is a major stated policy goal. Past achievements have been mixed: the experience of introducing hybrid maize seed particularly to smallholders was highly successful in contrast to the stagnant consumption of fertilizer and recurrent problems of late input deliveries. The problems for fertilizer illustrate the overall problems of input supply well. Irregular supplies can be traced to the cumbersome import licensing system, price margins which discourage distribution of smaller lots in smallholder areas, and inefficiencies in cooperative operations. Government initiatives in the past have concentrated largely on improving infrastructure for input distribution. There has been heavy reliance on parastatals and cooperatives to supply inputs in smallholder areas.

Promotion of agricultural credit has played a prominent role over the last two decades as one of the central themes of the Government's agricultural development strategy. Credit is widely seen as a necessary condition for the adoption of improved technologies, especially for encouraging the use of such inputs as fertilizer and chemicals.

Over the past decade agricultural credit has evolved significantly. Its market structure has changed with the share of government-funded credit declined from more than 60 percent of the total credit to less than 40 percent in recent years. Large input suppliers and various crop marketing and processing parastatals have recently played a more limited role in provision of suppliers' and seasonal credit for commercial farmers than had been the case previously.

There are a number of troubling trends, both with regard to commercial lending to the agricultural sector and the performance of public sector credit programs. There is, first, a reluctance of commercial banks and non-bank financial institutions to lend in the agricultural sector, a concentration of loan funds to larger farmers and established clientele; second, the financial performance of the Agricultural Finance Corporation and the Commercial Bank of Kenya is deteriorating; third, there is a significant diversion of agricultural loan funds to non-agricultural purposes and declining real levels of capital formation in the sector. And finally, the access of small farmers to credit institutions continues to be limited.

These trends are explained by a number of factors. With regard to private sector lending (both from commercial banks and from non-bank financial institutions), probably the most pervasive issue relates to the low profitability and high risk of many agricultural investments relative to investments in other sectors. Furthermore, there are a range of government policy and regulations, such as interest rate guidelines which set minimum deposit rates and maximum lending rate, licensing conditions, and restrictions on unsecured lending.

Public sector lending is plagued by a related - but even more extensive - set of difficulties. The disappointing performance of many of the government supported agricultural credit programs and the present precariously weak financial positions of AFC and CMK argue for a reassessment of their lending objectives, policy framework and institutional/management capabilities. The major problems faced by both AFC and CBK include the absence of clear lending objectives, and a consequent lack of operational lending programs and strategies for meeting these objectives. They have a low level of institutional capability in terms of experienced and technically qualified staff and lack clear procedures for loan appraisal, administration, accounting and reporting.

In order for the agricultural credit systems to become viable the above issues need to be addressed.

D. Pricing and Marketing Policies

Intensification of production is closely linked to the structure of incentives in the economy, of which pricing and marketing policies and marketing services are a major part. The level of government intervention in pricing and marketing in Kenya is high. Official prices are set through marketing boards for several crops, such as maize, wheat, and milk. In general, restrictive price and market controls apply more for domestically consumed food and industrial crops than for export crops. Pricing and marketing arrangements are summarized in Table 5 below. An extensive review of these issues are given in the World Bank Kenya Agricultural Sector Report.

Four issues should be emphasized in pricing and marketing policies:

a. the level and flexibility of price controls;

b. the role of marketing boards and the impact of their operations;

c. the use of market controls and appropriate forms of market regulation; and

d. the need for market development in both the public and private sector.

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Table V

SUMMARY OF PRICING AND MARKETING ARRANGEMENTS

Commodity	Pricing System	Marketing System	Major Problems
FOODCROPS			
Maize	Producer price, distribution and milling margins, and retail price for maizemeal set by Government.	Government monopoly established by law and held by NCPB except for legal intra-district trade on a limited basis (less than 2 bags).	Low official price levels in some years and erratic price adjustments. Panterritorial pricing decreases incentives.
	Enforcement good in commercial market channels, sporadic but growing in rural markets (especially during 1980/81, 1984 shortage periods).	NCPB handles up to 30% of marketed production. Parallel market operates extensively in rural areas, but has increasingly been constrained. KGGCU play increased role in primary marketing.	Price controls benefit mainly urban dwellers at expense of rural Insufficient price margins for NCPB. Market controls introduce distortions and costs, and adversely affect smallholders. Role and capacity of KGGCU unclear.
Wheat	Producer prices, margins, and retail price for flour set by Government Enforcement is good, as wheat grown mainly by large and medium scale farmers on commercial basis.	Government Monopoly established by law and held by NCPB, who controls entire market. KFA formerly acted as agent, may be replaced by KGGCU.	Inefficiencies in NCPB. Role of KGGCU unclear.
Beans	Incentive price set by NCPB, but prices otherwise not controlled	NCPB handles small amounts, except for 1982, when high incentive price resulted in large purchases.	High prices led to large NCPB purchases with result of storage problems. Significant exports, in 1983, some at a loss.
Rice	Producer prices, margins, and	Government monopoly established by law and	Low producer prices in some years

	retail prices set by Government. Enforcement is good, although there is a parallel market in rice in urban areas.	heldby NCPB.	required subsidies to producers on irrigated schemes. Demand greater than supply but partially met through food donations. Inefficiency of NCPB.
Other foodcrops (millet, sorghum, fruits, vegetables etc.)	Prices market determined	Largely sold on local markets. NCPB handles small amounts of some crops.	Marketing services need improvement. Some problems in supply and quality. especially for fruits and vegetables.
INDUSTRIAL CROPS			
Sugarcane	Producer prices, factory and distribution margins, and retail prices set by Government. Enforcement is good.	Cane marketed through cooperatives or directly to factories. Government has wholesale sugar distribution monopoly, operated through KNTC. Many private retail distributors.	Policy of low consumer prices resulted in insufficient producer prices and factory margins, and subsidization of producers. High rates of taxation Industry in financial crisis due to pricing and resultant supply problems. Improvements in cane marketing needed.
Cotton	Producer prices & ginning margins set by Government. Enforcement is good.	Government has monopoly through Cottton Board. All cotton handled by cooperatives.	Weak cooperatives and financial management of Cotton Board. Late producer payments, high deductions. Issue of differential payments for cotton grown on irrigated schemes.
Oilseeds	Prices market determined. NCPB sets incentive prices for own purchases.	Free market. NCPB and cooperatives handle oilseeds as well.	Improved market information and market channels needed.

EXPORT CROPS			
Coffee	Prices determined in reference to world price, less export taxes and marketing board and cooperative charges. Producer price about 70% of world price.	Producers market through cooperatives. KPCU handles all cooperative and estate coffee on behalf of the Coffee Marketing Board. Auctions are held in Nairobi.	Marketing system is fairly efficient. Need to improve quality of small-holder coffee during processing to raise returns. High and variable cooperative levels reflect variable efficiency. Late payouts reduce value of prices received.
Tea	Prices set by Government and related to ontent. Prices have been as low as 25% of world. price.	Pyrethrum Board has monopoly on marketing and exports. marketing board.	Low producer prices leading to production declines. Pyrethrum Late payments to farmers
LIVESTOCK AND DAIRY			
Livestock and beef	Retail beef prices set, but only enforced for lowest grades.	Market competition. KMC has monopoly on exports. Livestock Marketing Branch (LMB) of MOALD buys livestock in distress sales.	Low retail beef prices appear to have encouraged demand, led to drop in carcass weights. KMC in financial difficulties as it cannot compete. High costs of LMB operations.
Milk	Producer prices set by Government with dry season price differential. Enforcement only in commercial channels. Prices in rural markets seasonally determined.	KCC has monopoly on milk collection and processing in certain areas. Seasonal rural markets.	Low and sporadically adjusted milk prices have decreased supplies. Local market prices often more attractive. Improved collection systems for small-holders needed. High costs of KCC.

The diversity of agriculture conditions in Kenya makes it nearly impossible to determine a single "right price" for agricultural commodities. The use of panterritorial and panseasonal prices introduces distortions, especially resource allocation. A flexible pricing system which would meet the government's concerns about price stability and adequate incentive to producers, should be adopted. In recent years, the Government of Kenya has been moving in this direction and producer prices reflect closely international prices.

The operational policies of agricultural parastatals, particularly with respect to their financial implications on the national budget are major financial drains. In the case of maize marketing, the restructuring of the National Cereals and Produce Board (NCPB), which the government has initiated recently, is an important step towards addressing maize marketing problems. This is also an important reform because of the size of NCPB's financial loss.

The longer term problem of market development is also important. Marketing systems in economies which are still largely subsistence oriented must be flexible. The amount of surplus which farmers market from year to year may vary substantially, especially when weather reduces output or when price incentives are inadequate. In addition, since many sales are made by a relatively small proportion of producers, there is a temptation to concentrate market services on this group, rather than on all producers wishing to make sales. Cost is also a major consideration and benefits of improved market infrastructure, standard weights and measures, hygiene standards, and similar legislation must be weighted against the costs, which are often translated into higher food prices for consumers when traders pay for these market services. However, some improvements could reduce marketing costs; examples are price information systems and investments designed to decrease market congestion. Finally, related services, especially transportation and communications, affect market development and marketing costs.

IV. A.I.D. Agricultural Development Strategy

To achieve its goals in agricultural development, the Kenyan Government pursued a strategy focused on intensification of both domestic and export-crop commodities. The GOK plans to increase coffee exports from 96,000 MT to 350,000 MT and tea from 90,000 MT to 255,000 MT, both by the year 2000. At the same time the country will remain self-sufficient in food commodities, except for wheat and rice which are readily available on international markets. Given the limited potential for land area expansion, this strategy requires the doubling of food production on existing acreage in the next 15 years.

A.I.D. strategy is designed to support the Kenyan Government strategy. The strategy focuses on the following areas:

a. improving GOK policies, including the processes decision makers use to determine policy and make public investment;

b. strengthening human resources and institutional capacity with special emphasis on management, science, and technology; and

c. strengthening the role and performance of the Kenyan private sector.

The strategy is based on four broad operational concepts. First, it focuses agricultural development assistance on a limited number of high-priority programs. The intent is to concentrate assistance to address key development constraints and limit the efforts to selected major, long-term programs rather than on a proliferation of short-term projects which attempt to address all problems. Second, emphasis is upon activities which will maximize development impact and for which AID has a comparative advantage in assisting. Again, we recognize that it is not possible to address all constraints, but that emphasis needs to be on high impact efforts to maximize the effectiveness of our assistance. Third, the program takes cognizance of and is coordinated with the development activities of other donors. Finally, efforts will be made to fully integrate all available assistance instruments which support USAID/Kenya's general agricultural development strategy and the specific elements of that strategy, i.e. the integration of ESF, PL 480 and Development Assistance resources.

The National Agricultural Research Project is the centerpiece of the USAID/Kenya long-term strategy. This project will focus on the institutional capabilities of the research system, the prioritization of public investment in research activities, and strengthening public/private sector linkages. This institution-building project is complemented by ongoing and proposed activities that strengthen private sector performance, e.g. ESF Fertilizer Market Development, Private Enterprise Development, On-Farm Grain Storage; strengthened human resources through the Institutional Development for Agricultural Training and Agriculture Management Projects and strengthening public policies through ESF-Conditionality, PL 480 Title I, and Food for Progress.

V. A.I.D. Structural Adjustment Assistance Program

Several of the constraints described above have been addressed by A.I.D.-supported projects (e.g. agricultural research, institutional building and training) as well as by other donors. The sectoral focus of A.I.D. Structural Adjustment Assistance Program has been fertilizer pricing and marketing policies. The policy changes are intended to reduce the constraint of fertilizer pricing and distribution and the longer term development of fertilizer market which is composed of mostly private traders.

The chosen sectoral emphasis on fertilizer market development is consistent with the strategy to achieve agricultural growth through intensification of cultivation. The availability and use of agricultural inputs plays a central role in this strategy. The greatest potential in this regard will come from increased use of fertilizer by smallholder farmers. Estates and large farmers have already received adequate supplies of fertilizer. The largest gap between present and recommended levels in is maize where present levels of use vary between 5% and 43% of recommended nutrient levels. Smallholder tea and coffee is at about 33% and 35% of recommended levels respectively. Thus, the targeting of increased fertilizer use by smallholder farmers, and efforts to improve the distribution and services by input distributors to smallholder farmers will greatly increase on agricultural production in Kenya.

Fertilizer Marketing and Pricing Policies

The basic policy objective is to increase availability and use of fertilizer, particularly by smallholders, which will contribute to increased productivity in agriculture. Prior to 1983, fertilizer marketing and pricing were in disarray. The supply of fertilizer imports was very unreliable, with an oligopolistic market structure. Fertilizer imports and distribution were concentrated in the hands of a few importers. The largest distributor was the government-controlled Kenya Farmers Association (now changed to Kenya Grain Growers Cooperative Union). In addition, there were a few private importers who sold fertilizer mainly to large estate farms. Imports of fertilizer usually arrived late for the planting season due to poor planning. The pricing system and the import allocation and administration procedures were inefficient and cumbersome. It encouraged importers to over-invoice and did not provide incentives for finding less expensive supply sources.

A.I.D.-supported reform objectives fall broadly into four areas:

(a) improving planning and liberalizing import licensing and allocations in order to ensure timely availability of right types of fertilizer in adequate quantities and at reasonable prices;

(b) increasing the number of private fertilizer distributors and strengthening private sector marketing and distribution networks which include extension services to promote proper use of fertilizer by smallholder farmers;

(c) changing the pricing structure to ensure adequate incentives for finding cheaper sources of supply and for promoting retail distribution of fertilizer in affordably small quantities for smallholder farmers;

(d) improving coordination of donor-financed fertilizer imports so that aid fertilizer will not undermine commercially imported fertilizer.

These policy reform objectives are to be accomplished over a number of years. Considerable progress has been made since 1983. The impact of the reform is described below. Reform in fertilizer pricing and marketing should continue, particularly in bringing about further progress in fertilizer import allocation policy.

Impact to Date

USAID has made considerable progress towards achieving the goal of instituting a marketing system driven by the private sector. The first significant policy change was fully implemented in 1985 with the GOK cancellation of its agreement with the KFA for the exclusive distribution of GOK fertilizer. In March 1985 AID financed the importation of 20,500 tons of DAP which was distributed by 16 private sector distributors. In October 1985 another 28,000 tons of AID financed DAP imported by the GOK was distributed by a total of 24 private sector distributors. To date, more than 35 private sector firms have distributed government fertilizer as opposed to only 1 prior to USAID's program. The effects of this policy change have been to expand the geographical distribution of fertilizer in rural areas through a greater number of distributors, thereby making it more available to smallholder farmers, and to encourage price competition at the wholesale and retail levels.

There has been an increase in total fertilizer supply through expanded commercial fertilizer import allocations and allocations to cooperatives. The number of private sector firms receiving allocations from the GOK to import fertilizer commercially has increased from 13 in the 1983/84 cropping year to 44 in the current year. During the same period the total amount of fertilizer allocated for commercial importation by these firms has increased from 183,205 tons to 209,102 tons. Amounts of donor financed fertilizer imports have increased as well from 33,000 tons in the 1983/84 cropping year to 128,000 tons in the current year.

In March of 1986 the Ministry of Agriculture (MOA) established a Fertilizer Inputs Unit to collect and analyze data on the fertilizer sector. Data is collected on quantities and types imported, consumption requirements, local and world market prices and carry over stocks. This information is used by the Ministry to prepare an annual fertilizer import plan so that arrangements can be made to import fertilizer of the proper types, in correct amounts, at the required time and at competitive prices. Since 1985 the MOA has prepared annual fertilizer import plans according to the requirements of the USAID program. This import plan has helped to improve the supply of fertilizer tremendously. The Input Unit has also monitored the performance of commercial importers to make sure quantities allocated for import are in fact being imported and to make timely adjustments in the import plan.

Starting the 1986 long rain season, DAP fertilizer financed by USAID was offered for sale in 10, 25 and 50 kilo bags. Prior to this all fertilizer was sold in 50 kg bags. This enabled farmers to purchase quantities of fertilizer at affordable prices and in convenient sizes for transportation. Popularity of the smaller sized bags is extremely high and it has increased the use of fertilizer by smallholder farmers as a result.

Beginning in 1986 import allocations have been given to cooperative unions and other end users. This has provided a very significant portion of smallholder farmers better access to fertilizer at very competitive prices.

In December 1986 USAID carried out a study to identify the agricultural imput distributors in Kenya who are interested in expanding their retail distribution network, and investing in marketing programs for fertilizer. USAID liaised with the International Fertilizer Development Center (IFDC) to conduct a course in Kenya on retail marketing of fertilizer. USAID financed the participation of individuals from 6 private sector firms to attend this course. Thus, further assistance was given to private sector firms to help them to develop marketing strategies and to implement these strategies through better planning and understanding of fertilizer marketing concepts.

Through donor coordination there has developed a better understanding of the necessary changes in the fertilizer sector to improve fertilizer use and distribution. The problems affecting the fertilizer sector have been discussed in detail at these meetings, and some donors are now developing programs to implement changes. One donor is financing a research program on crop responses to fertilizer use and the economics of fertilizer use. The results of this research will enable planners to better determine the appropriate types of fertilizer to be imported to Kenya and assist the extension service to disseminate information on proper fertilizer use. Donor coordination also resulted in the completion of the fertilizer pricing study as required under the 1984 ADP. The results of this study have lead to the development of policy recommendatiions which are now being considered by the GOK.

Beginning last year the GOK applied the basic theory behind the recommendations to establish prices based on a Benchmark International Price (BIP). Full implementation of the BIP is expected next year as the staff of the Fertilizer Inputs Unit becomes trained and fully operational. In the absence of world market price information the GOK analyzed actual C&F prices paid by Kenyan importers for fertilizers delivered to Kenya in the three month period preceeding the announcement of prices. A BIP was then calculated using the average of the three lowest prices. The scrutiny of the import documents by the GOK indicates an increased interest in finding out how importers operate and to improve the planning and administration of its own functions. The effect of basing the BIP on the average of the lowest three submitted invoices encouraged importers to search for the lowest prices and to adopt efficient import practices.

The establishment of the Fertilizer Committee under the 1984 ADP has developed a technical expertise in the GOK to analyze and develop fertilizer policies. Fertilizer policies are recommended to senior GOK policy makers from their technical officers. These recommendations are first developed through discussions at the technical level of the GOK and USAID. In this manner, GOK policy makers are advised by their own officers rather than a donor promoting policy changes. The GOK is moving in the direction of less decision making at the top and relying more on technical officers to guide the formulation of policies and procedures. This is a welcome change which supports USAID efforts to reduce GOK involvement in the fertilizer sector. Import allocations are now influenced by technical officers which has helped to reduce the approval time for allocations. During the last 2 years, the GOK has developed commercial import allocations and announced them prior to the established deadlines.