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EMBASSY OF THE
UNITED STATES OF AMERICA
Nairobi, Kenya

February 2, 1990

Mr. Walter Bollinger
Acting Assistant Administrator
for Africa
U.S. Agency for International
Development
Washington, D. C.

Dear Mr. Bollinger:

I am pleased to endorse this Country Development Strategy Statement and Action Plan now being submitted by the U.S. Agency for International Development in Kenya. My staff and I have reviewed the document, have discussed it with USAID/Kenya staff, and fully support the strategy outlined in it.

I have been in Kenya for only a short time, but it is already clear to me that the major development problems described in the CDSS are, in fact, the most significant problems the country faces. Without swift, concentrated action to overcome them, they are likely to overwhelm all efforts to achieve sustained, broad-based economic growth.

I believe USAID is correct in focusing U.S. resources on the strategic objectives of:

-- increasing contraceptive prevalence in order to decrease Kenya's very high population;

-- increasing agricultural productivity and farm incomes; and

-- increasing the level and productivity of private investment.

I look forward to working with this program during the next few years.

Sincerely,

Smith Hempstone
Ambassador

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EXECUTIVE SUMMARY

Kenya, one of the best economic performers in Africa, has the potential to break through to sustained, broad-based, export-led growth, based on rapid industrialization and expanded agricultural exports. Success in doing so will depend on how well the Government of Kenya carries out its declared program of structural adjustment and reform, and how efficiently the foreign and domestic private sectors respond to the major improvements these reforms are expected to produce in Kenya's investment climate.

Kenya achieved and maintained a real GDP growth rate of over five percent per year between 1985 and 1988. Inflation averaged under 10 percent, and many economic indicators showed positive gains. The Government of Kenya (GOK) has worked closely with the IMF and the World Bank during the past decade through a series of structural adjustment and stabilization agreements. Although Kenya's record on implementing adjustment measures has been somewhat mixed, the country received a major Enhanced Structural Adjustment Facility (ESAF) loan from the IMF and special funding from A.I.D. through an African Economic Policy Reform Program (AEPRP), both in 1989, to recognise and encourage its adjustment efforts.

As Kenya enters the 1990s, there are signs that the economic growth rate is declining, inflation is increasing, foreign private investment is continuing to decline, there is a growing over-reliance on foreign assistance, revenues from traditional exports are declining, the government budget deficit is increasing, and other economic performance indicators are weakening. A number of measures need to be taken to overcome these trends. Greater economic and fiscal discipline is required. Opportunities for improving the efficiency of domestic markets, particularly in agriculture, and for fostering the growth of non-traditional exports and tourism must be grasped. The environment must be protected. Development and use of improved agricultural technologies and methods must be accelerated. Steps must be taken to encourage foreign investment and to mobilize domestic capital. Successful implementation of policy and administrative reforms should produce a positive private sector response resulting in increased production, employment, income, and foreign exchange earnings. Special efforts will need to be made to ensure that as many Kenyans as possible — particularly current or potential small-scale entrepreneurs and smallholder farmers, a majority of whom are women — participate in and benefit from growth.

An overriding factor in Kenya's efforts to maintain and accelerate economic growth and to improve the lives of its people is its very high population growth rate, which has resulted in severe pressures on land, on food availability and on social services. There is good news about the success of efforts to decrease the population growth rate. For the first time in Kenya (and perhaps for the first time in Africa) there is solid evidence that contraceptive use is increasing dramatically and fertility is beginning to decline. The estimated population growth rate has dropped from 4.1 percent in 1984 to 3.8 percent today. That level is still one of the highest in the world. If this rate of fertility decline is not sustained over the next few years, many of the benefits from progress made in other areas could be wiped out.

USAID and many other donors are helping Kenya progress toward the goal of sustained, broad-based economic growth. USAID is involved to the greatest extent in helping to achieve the development subgoals of: reducing fertility and population growth, and increasing production, employment, income and foreign exchange earnings. USAID resources are concentrated on three strategic objectives:

— increase contraceptive prevalence

— increase agricultural productivity and farm incomes

— increase the level and productivity of private investment

USAID also plans to provide assistance for wildlife management and conservation education, although the strategy for this sector is not clearly defined as yet. Kenya's exceptional wildlife population is endangered by poaching, encroachment by human populations into wildlife preserves, and mismanagement. Immediate assistance is required, and USAID proposes to join with a number of other donors to provide it.

The Development Fund for Africa will be the primary source of funding to carry out the strategy, into which the Food for Peace program is being fully integrated. Centrally and regionally funded projects will continue to be tapped where appropriate, and USAID hopes to be able to take advantage of additional funds offered by the AEPRP at least once during the next five years.

To achieve increased program impact, greater concentration of resources and more efficient use of less staff, the Mission plans to increase use of performance-based disbursement programs, to continue to decrease the number of discrete projects, to rely to an even greater extent on non-governmental organizations to provide services and manage programs, and to draw heavily on the skills of an excellent Foreign Service National staff and personal services contractors.

I. OVERVIEW OF THE ENVIRONMENT FOR SUSTAINABLE, BROAD-BASED, MARKET-ORIENTED GROWTH

Kenya has been a top economic performer in sub-Saharan Africa since Independence in 1963. Kenya's economy grew seven times faster in the 1980s than sub-Saharan Africa as a whole. The country has made impressive progress in many areas and clearly has the potential to do much more. Kenya posted a real GDP growth rate of over five percent per year over the past four years. Significant steps have been taken to reduce the population growth rate, which is now estimated at 3.8 percent. The rate is down from 4.1 percent in 1984, but still is one of the highest in the world. The country has made remarkable advances in expanding educational opportunities, with primary enrollment increasing from 54 percent of school-age children in 1965 to 95 percent in 1986; over the same period secondary enrollment has increased from 4 percent to 20 percent. Kenya has registered impressive declines in mortality and a significant extension of life expectancy. There is a vital private sector and good physical infrastructure.

Kenya is one of very few African countries that could make the leap from good economic performance into rapid development and structural change marked by double digit growth rates and single digit inflation rates. High rates of domestic investment, a favorable geographic location with respect to major world markets, and positive attitudes about private sector growth all combine to give Kenya the potential to become one of Africa's first newly industrialized countries.

However, economic and social pressures continue to mount, slowing or offsetting growth. A rapidly increasing trade deficit and accelerating government expenditures (financed by donor grants and loans) have contributed disproportionately to GDP growth. High levels of population growth have resulted in severe pressures on land, on food availability, and on social services; they are the major factor in urban unemployment/underemployment of 25 to 35 percent. Government policies and bureaucratic procedures continue to hinder expansion of private enterprise and make it difficult for farmers and entrepreneurs to take advantage of opportunities. Improvements in technology, particularly in agriculture, have been slow to develop and even slower to reach the individuals who will put them into effect. Kenya — and the donor agencies assisting the country — must act quickly to reduce these constraints if the country is to accelerate and sustain growth and make it possible for the benefits of growth to be shared more equitably among the people.

This document contains no separate social analysis. However, the topic has been thoroughly described in the social analyses of USAID's three most recent program documents: the Kenya Market Development Program, the Kenya Health Care Financing Program, and the Kenya Fertilizer Pricing and Marketing Program. In addition, the extensive Social and Institutional Profile prepared on Kenya in 1983 remains fundamentally valid. With the exception of the Demographic and Health Survey described elsewhere in the CDSS, little groundbreaking work has been done on social analysis in the recent past. USAID will continue to emphasize social analysis in all project design and evaluation documents. Women in Development aspects of the USAID program are described in Annex D.

A. Political Environment

Kenya's most important political achievement since Independence has been the maintenance of peace and basic civil order. With the exception of a short-lived coup attempt in 1982, Kenya has been an island of stability and progress in a region marked by conflict, instability and economic deterioration. As the experience of most of Kenya's neighbors has shown, without this stability, any successful development is very difficult indeed. Related to peace and civil order is basic institutional continuity and coherence. The maintenance of rural-urban linkages has been especially significant, both in a physical and an institutional sense. As an important payoff from the substantial investments that have been made in education and human resource development, Kenya has succeeded in generating substantial technocratic expertise, both governmental and non-governmental. The value of entrepreneurship is strongly embedded in the nation's political culture.

These positive institutional/political attributes, however, also have a negative side, with implications which are detrimental to economic efficiency and which weaken the commitment to economic reform and a private sector-dominated economy. For example, the problem of entrenched bureaucratic interests, a result of continuity, is one explanation for slow implementation of policy reforms. The very stability and coherence of the institutional arrangements has generated a bias against innovation and change. In addition, these political and institutional attributes have been, and continue to be, the rationale behind large public investment in parastatals and the productive sector more generally. They are the impetus behind the continuing growth in public sector employment. They also contribute to the Government's unwillingness to allow the market to set prices for many key commodities and to the difficulty of reconciling technocratic and political goals within the bureaucracy.

In general, African political systems are marked by nationalism, paternalism and the centrality of personal rule and personal relationships. Kenya is no exception. The raison d'etre of the large public sector role in Kenya is a combination of nationalism and paternalism. The nationalism has two components: the first is the utilization of the public sector as an (1) instrument to regain control over economic life from racial minorities and foreign interests; the second is the use of the public sector to unify the REDISN (2) nation by distributing the benefits of development among regions and ethnic groups. Paternalism is embodied in the notion of top political leaders as father figures for the nation, expected to respond to the needs of their people by actually delivering the goods. The President becomes a special role model in this regard.

In recent years, there has been an unprecedented centralization of power and authority in Kenya. The concept of a civil society with a plural, democratic institutional base has eroded. Sustained, broad-based economic growth needs vital democratic institutions to ensure that a wide range of views are considered and that the largest number of people have an opportunity to participate in the benefits of development. While the situation is far better in Kenya than in many other African nations, there has been steady deterioration over the past few years in both the numbers and the role of democratic institutions. The autonomy of the trade unions, women's organizations, professional associations, the press and the judiciary has been restricted to some degree. Similarly, there is an increasing politicization of economic life, involving both access to market opportunities in the private sector and decision-making in the bureaucracy. These trends need to be reversed.

In all countries, economic management involves the interplay of technocratic and political considerations. The Kenyan scene has long been marked by a tension between market forces, entrepreneurship and technocratic management on the one hand, and paternalism and what has elsewhere been termed "crony capitalism" on the other. The recent World Bank report, Sub-Saharan Africa, From Crisis to Sustainable Growth, analyzing the long-term outlook for economic development in Africa, gives special attention to the creation of an enabling institutional and political environment. This is as relevant for Kenya as it is for other African nations.

In contemporary Kenya, there is an interesting paradox concerning these themes. On the one hand, there is an increased public realization of, and commitment to, the benefits of market efficiency, entrepreneurship and technocratic management. On the other, there are the disturbing trends of centralization of authority and the ensuing lack of confidence in the impartiality of the judicial and the regulatory systems. These tensions become particularly visible in the context of the structural adjustment program and are highlighted in the decision-making process in the interplay between technocrats and politicians. It is the technocrats who undertake the analysis and draw up the policy reforms; it is the politicians who ultimately decide which become actual government policy. If the credibility of the structural adjustment program and its ability to improve the climate for economic growth and development are to be maintained, the GOK must make a stronger commitment to implementing reforms that it has itself articulated.

B. Economic Environment

Since Independence, Kenya's economy has been based on a philosophy of a mixed economy guided by government intervention. Government corporations and parastatals continue to operate in most areas. At the same time the Government of Kenya (GOK) states intentions of greatly increasing the private sector's role in the economy. A World Bank team called this economic system "a pragmatic blend of laissez-faire capitalism and indigenous African socialism."

Kenya's rapid growth period, 1963-80, was quite impressive for Africa. The economy grew by over six percent annually in real terms and by over three percent annually in per capita terms. This commendable level was achieved in large part by increasing land area under production, substantially increasing cash crops (with concurrent improvement in agricultural terms of trade), promoting import substitution-led manufacturing growth, and increasing government expenditures and employment. The benefits of this rapid growth, however, were not as widely diffused as they might have been. Studies of income distribution undertaken in the mid-1970s showed that the top 20 percent of Kenya's population received 60 percent of national income while the bottom 20 percent received less than 3 percent. The World Bank estimated that half of the rural population lived below the poverty line in 1975.

In the late 1970s, the second oil price shock brought worldwide growth to a standstill and severely affected the Kenyan economy. Kenya's exports fell, inflation increased from under 5 percent to over 15 percent per year, and a balance of payments crisis occurred.

As Kenya entered the 1980s, the economy showed further signs of severe weakness, with problems stemming from:

- rapidly increasing population growth overpowering government services and food production;
- slower agricultural growth because of drought, lack of arable land, and limited potential for further increasing productivity on large-scale farms;
- a narrow base of export earnings in coffee and tea; and
- saturated domestic demand, limiting growth in the import-substitution manufacturing sector.

The 1981-84 period was marked by substantial adjustments in the economy, leading to a real per capita growth of minus 0.2 percent per year. A current account deficit of over 12 percent of GDP led to a contraction of imports, decreased government expenditure in real terms and realignment of the exchange rate. These reforms were carried out with assistance from the World Bank and the International Monetary Fund (IMF).

Recent years (1985 to 1989) marked a recovery period, with Kenya's economy achieving a growth rate of about 5 percent per year and a per capita growth unemployment

rate of 1 - 1.5 percent per year. The rate of job creation in the economy has been 3.7 percent per year, while the workforce grew at an annual rate of 4.2 percent. Recent higher levels of economic growth were fueled by (1) strong agricultural growth made possible by highly favorable weather conditions, increased fertilizer utilization, and policy reforms that have improved farmer incentives; 2) increased imports financed by lower oil prices and increased foreign assistance; 3) increased government spending (nearly 20 percent average annual increases) to "prime the pump" of the economy; and 4) strong performances in tourism and horticulture. Also significant is the fact that Kenya's population growth rate has begun to slow, decreasing from 4.1 percent in 1984 to 3.8 percent in 1989. There are no recent studies that have explored income distribution in detail. The World Bank's 1988 Report on Employment and Income in Kenya suggests that income distribution patterns have not changed markedly since the mid-1970s, that real wages have decreased in the 1976-1986 period, and that the level of poverty in the country may have even increased.

As Kenya enters the new decade, however, there are signs that the growth spurt of the late 1980s is weakening. Real economic growth for 1989 is likely to decrease to about three percent, while inflation is re-emerging as a major problem. After averaging under 10 percent for the past five years, the annual inflation rate is presently estimated at over 15 percent. Recent declines in the international coffee market have sharply affected export performance. Also, it is unlikely that tourism can continue to grow at the rate it attained in the latter half of the 1980s.

Kenya's total workforce is expected to double from 7.2 million in 1987 to over 14 million by the turn of the century. Unless the private sector begins to substantially increase its rate of job creation, most secondary school leavers will become unemployed over the next decade. One area for hope is the informal sector, in which employment has been rapidly expanding. In 1988, the informal sector was estimated to provide 22 percent of total employment.

Reforms are necessary in many economic areas if Kenya is to attain broad-based growth during the CDSS period. Section II of this document describes the major constraints facing Kenya and reviews opportunities for eliminating or decreasing their effects.

C. Implementation of Stabilization and Adjustment Measures

The GOK has worked very closely with both the IMF and the World Bank during the last decade. It has had a series of seven stand-by arrangements from the IMF in support of economic stabilization efforts and has, at the same time, entered into five structural adjustment lending agreements with the Bank. These efforts have paid off as Kenya has avoided the sharp external and domestic disequilibria that have plagued many African nations. The latest IMF arrangement is an Enhanced Structural Adjustment Facility (ESAF) of SDR 240 million, ($300 million) disbursing SDR 80 million ($100 million) in 1989. The GOK's record of implementing stabilization and adjustment efforts has been mixed. The Government has undertaken tough stabilization measures, especially during periods when severe economic instability threatened, but these efforts have proven difficult to sustain after the potential crises have subsided. Similarly, while the GOK has proposed an ambitious program of structural adjustment, implementation has been slow in many areas.

Since the early 1980s, Kenya has followed an increasingly active foreign exchange management program in order to attain and sustain economic stabilization. The shilling has been devalued by over 50 percent since 1982, allowing Kenyan exports and tourism to maintain their competitiveness. The Central Bank of Kenya maintains a program of periodic marginal devaluations.

A major focus of stabilization efforts has been the interlinked issues of inflation, monetary growth and the budget deficit. In the early 1980s, inflation averaged over 15 percent per year. During 1984-88, stabilization efforts which improved fiscal and monetary discipline brought this rate to under 10 percent. The budget deficit was reduced from over 7 percent of GDP in 1986/87 to under 4 percent by 1988/89. With the exception of 1986, when high coffee prices and low oil costs generated a terms-of-trade windfall, monetary expansion has been held in check. Between 1984 and 1988 (excluding 1986), growth in money supply (M2) rose at an average annual rate of eleven percent.

In late 1989 there were strong indications that the rate of inflation was sharply rising, fueled by increases in government spending and monetary expansion. An increased rate of inflation will make it more difficult to maintain positive real interest rates and will put pressure on the exchange rate management system. Rationalization of budgetary expenditures is a major focus of the GOK structural adjustment program, and it is progressing much more slowly than planned. Budgetary expenditures as a percentage of GDP are actually higher now than at the beginning of Kenya's structural adjustment program. In the past two years, expenditures have increased substantially more than revenues. The commitment to maintain and expand the nation's education system is putting increasingly heavy pressures on the budget, while recent analyses have found indications of declining quality in the education system as a result of population pressure and budget limitations. Given education's proven role in increasing incomes and improving the quality of life, ways must be found to reconcile maintaining educational quality with a sustainable fiscal balance. cut back on subsidies to Higher Ed.

The public sector has been used in the past as an employer of last resort. In the 1984-1988 period, public sector employment grew at an annual rate of 4.6 percent, increasing to over 50 percent of total wage employment. It is clear that public sector employment cannot continue to absorb such increases and still meet its fiscal policy targets. The Government is beginning to implement "fee-for-service" schemes in health and education, but their impact on the budget will not be felt in the near term.

As part of its adjustment efforts, the GOK has liberalized the import regime, removing quantitative quotas restrictions on the vast majority of imports. Despite this, a recent study of export incentives has found the trade regime still retains a strong anti-export bias. The system of fixed wholesale and retail prices has also been largely dismantled. Plans are on the books for even more price liberalization. The GOK has also begun to restructure the financial sector, creating a Capital Markets Authority and passing a new banking act. The Central Bank has reactivated its rediscount facility and established an informal Open Market Committee. Most observers believe that these efforts will have to be substantially strengthened in order to have the intended effect of stimulating private sector investment and improving productive efficiency.

D. New and Emerging Issues

1. Urbanization

Urban areas and urban populations are increasingly important in Kenya, with urban problems requiring ever larger shares of resources and public attention. Kenya's urbanization rate of over 8 percent per annum is one of the highest in the world. Nearly five million Kenyans now reside in urban areas. That number is expected to double before the turn of the century. One-third of the urban population lives in the capital city of Nairobi. Kenya's nationwide urban "system" now comprises a complex hierarchy of 172 urban places. In addition to the larger cities of Mombasa, Kisumu and Nakuru, there are nearly 100 cities and towns in the 5,000 to 100,000 population range. They are sites for marketing services for agricultural commodities, industrial and informal sector economic activities, and they provide social and educational services for surrounding rural populations. These smaller urban areas provide opportunities for off-farm employment, which is becoming an increasingly important mechanism for absorbing Kenya's rapidly growing labor force.

2. AIDS

As is the case in many African countries, HIV/AIDS is an important and growing health problem in Kenya. Over 6,000 AIDS cases had been reported as of June 1989, and the doubling time is estimated to be 8 - 10 months. These official figures clearly underestimate the real extent of the problem. HIV prevalence among blood donors is in the range of 1.5 to 2.0 percent, while rates among high-risk groups such as persons suffering from sexually-transmitted diseases (12 - 15 percent) and prostitutes (30-90 percent) are much higher. The international donor community and the GOK are cooperating in developing a comprehensive program focused on surveillance, blood screening, and mass media and community-based education, counselling and condom distribution.

Chart I-1

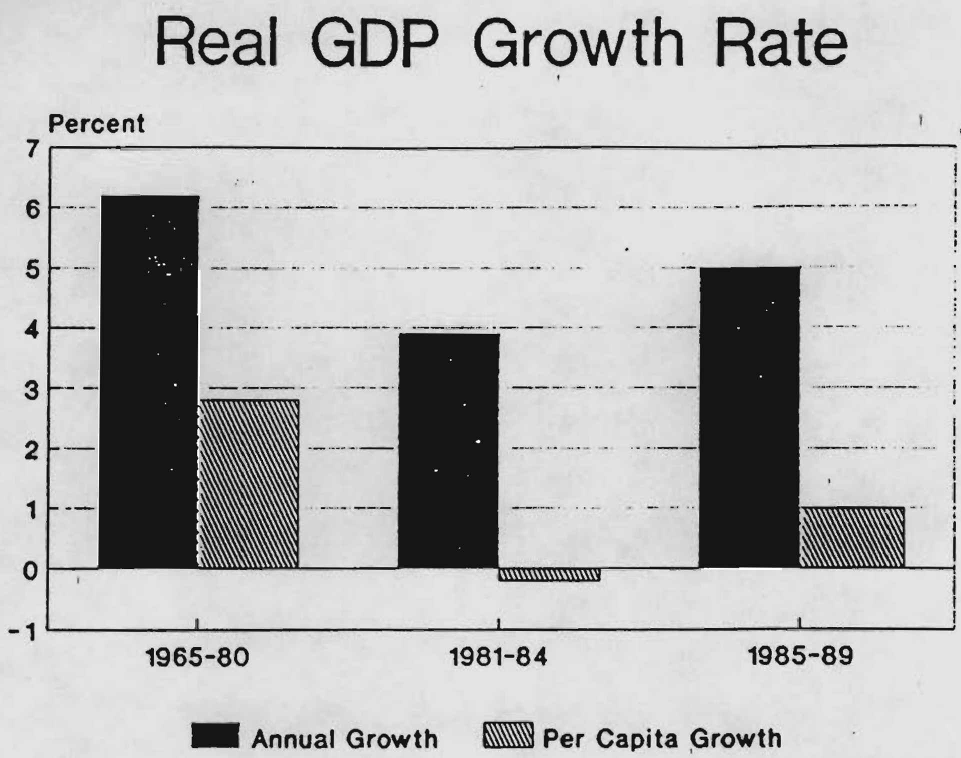


Chart I-2

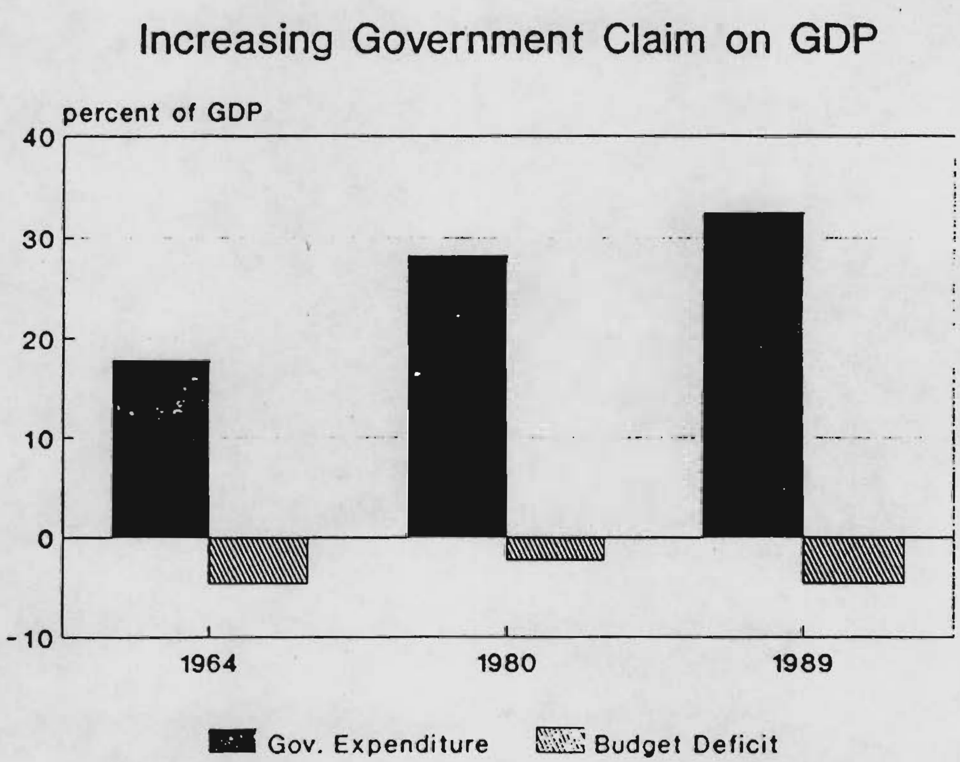
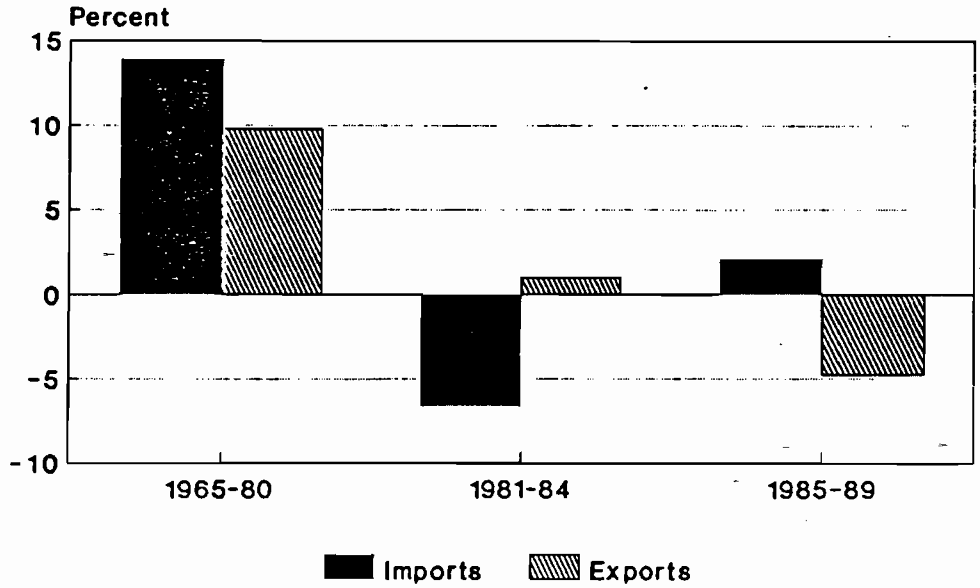


Chart I-3

Declining Exports Can't Pay For Imports
(Rate of Growth of Imports and Exports)



so little growth in imports - lack of FX

Source: IMF (nominal SDR's)

Chart I-4

Current Account Balance
(as a percent of GDP)

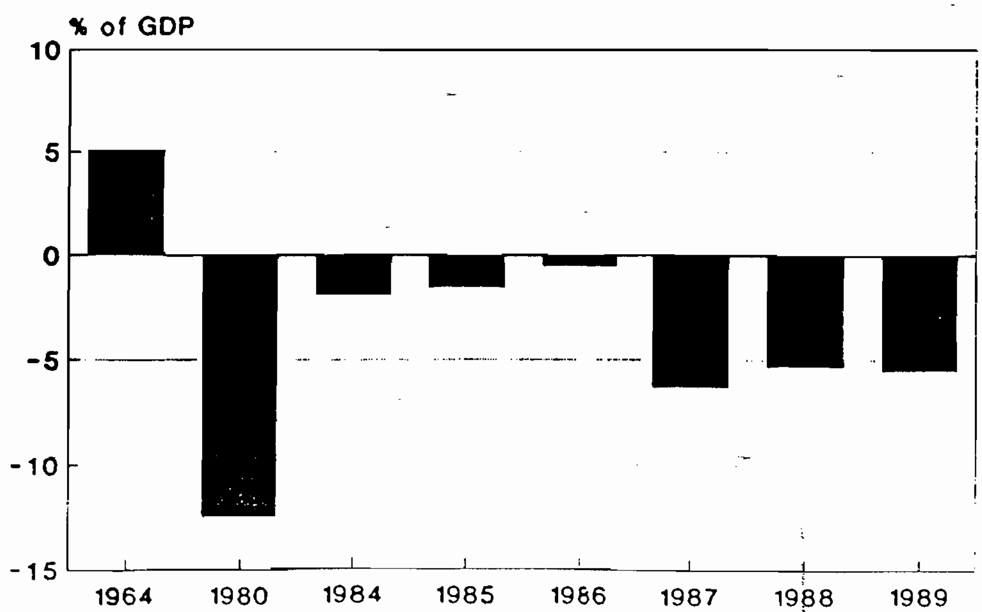
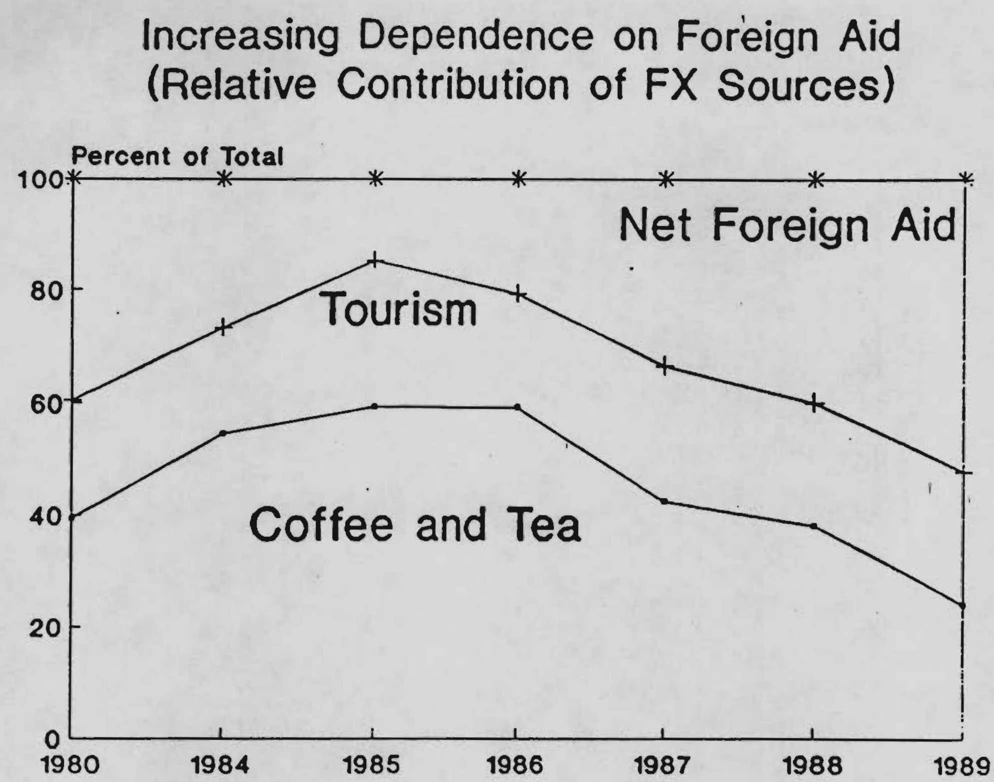


Chart I-5



Note: FX - foreign exchange in SDR's

Chart I-6

II. ANALYSIS OF KEY GROWTH CONSTRAINTS AND OPPORTUNITIES

Kenya is frequently congratulated for doing better at managing its resources and economic development than most countries in sub-Saharan Africa. A legitimate aim of a development assistance program might be to help the country maintain that position among the leaders on the continent. Analysis of constraints and opportunities might be geared to that level, and success might be measured against such comparisons. However, if Kenya is to attain a level of sustainable, broad-based economic growth commensurate with its potential, it must raise its sights. Kenya really should be compared with those developing countries (such as Malaysia and Thailand) which are striving for transformation to industrialized economies. Real growth in East Asia, for example, averaged eight percent in the 1980-87 period, compared with an average of 3.8 percent for Kenya and 0.5 percent for sub-Saharan Africa as a whole. Experiences of the newly industrialized countries suggest that private sector-led, export and market-oriented growth (including strong performances in the agricultural sphere) can lead to increased incomes and a structural transformation of the economy, thereby providing a solid foundation for more rapid and equitable development.

The Government of Kenya's stated development strategy is in line with this philosophy. The 1986 Sessional Paper, "Economic Management for Renewed Growth," outlines policies to be followed to accelerate growth into the 21st Century. It stresses the dominant role that must be played by the private sector in revitalizing the economy and the need for the Government to establish market-based incentives to promote private sector activity. Although implementation has been slower than planned and many proposed actions have not taken place, the strategy is laudable and is one USAID supports throughout its program and throughout this CDSS.

Kenya has the resource base, the infrastructure and the trade links that could propel the transformation to rapid growth. Kenya has a large and trainable low-wage labor pool and an established, though small, industrial base. It is an air and sea transport hub for the East Africa region and has well established trade links with and preferential access to European markets. Kenya's membership in the Preferential Trade Area of African countries provides access to another potentially large and untapped market for its goods and services. There is strong potential for agriculture to expand exports of produce to Europe and other seasonal markets and to provide inputs for agricultural production. However, a number of constraints block the development path and must be overcome.

The overwhelming constraint on rapid growth and development is the high level of population growth, which keeps expanding output from being translated into higher per capita incomes, puts severe strain on the service provision capacity of the economy, and generates powerful political pressures for non-sustainable budgetary expansion. While real progress is being made in reducing the population growth rate, more must be achieved, and soon, if rapid broad-based growth is to become a reality in Kenya.

Population pressure is directly linked to a second major constraint, low agricultural productivity and incomes. While Kenya has achieved what are, by African standards, good levels of agricultural output, it must increase the productivity of agriculture and create a context in which small-scale farmers can shift their production to higher value commercial crops. A rapidly growing agriculture will provide the basis upon which industrial diversification can occur by increasing the levels of demand in the economy and providing foreign exchange and investment resources.

Finally, for rapid growth to ensue, the private sector will have to become the primary engine of growth in the economy. This will necessitate an improvement in both the quantity, and especially, the quality of investment. For that to occur, the Government will have to provide a more favorable environment for both domestic and foreign investors. Appropriate macroeconomic and sectoral policies and effective, efficient administration hold the key.

A. Economic Constraints and Opportunities

Economic constraints to sustained, broad-based growth in the Kenyan economy can be divided into external and internal categories.

1. External Constraints

The major external constraints over the medium-term are: unstable foreign exchange earnings; reliance on high levels of foreign aid; low and diminishing foreign investment; and poor prospects for regional trade.

International prices for Kenya's export commodities have been very unstable. Coffee and tea account for about half of total exports, and agricultural exports account for approximately 70 percent of total exports. For this reason, Kenya's trade and current account balances swing widely from year to year, depending on commodity prices. For example, coffee prices are down 50 percent in 1989 from 1988. In general, export growth has been sluggish. Real export growth has been under one percent per year in the past five years, while real imports have grown at about five percent per year. Kenya's terms of trade have deteriorated markedly since 1984, exacerbating the problem of slow export growth. Kenya must increase and diversify exports if the country is to have much chance of reversing its balance of trade problems during the CDSS period. Horticulture presents an excellent opportunity for rapid expansion over the next decade if export incentives can be developed and if infrastructure constraints such as lack of cold storage and insufficient aircargo space are addressed. Possibilities for expanding manufactured exports also hold great promise.

Tourism has been a vital factor in offsetting the balance of trade problem. Continued tourism expansion can increase foreign exchange earnings. Although it cannot be expected to continue to grow as fast during the next five years as it did the past five, during which the number of tourists visiting Kenya each year doubled, tourism must continue to increase by at least five percent annually, in real terms, just to earn enough foreign exchange to cover rising debt service payments. Publicity about incidents of violence against tourists in the national parks and in the cities, about malaria at the Coast, and about wildlife poaching or limited capacity for visitors at the parks have made tourists more wary about deciding on Kenya as their vacation spot. Those problems must be reduced or eliminated, and measures must be taken to retain a greater percentage of foreign exchange earnings (only 8-13 cents per dollar at present in comparison with about 45 cents in East Asia) in order for Kenya to realize maximum benefits from tourism.

Reliance on increasing foreign aid (about 12 percent of GDP in 1989) is probably not a sound strategy for Kenya over the medium term. Although assistance may remain at current levels, providing that Kenya continues to implement the policy changes promised by the government, there are no assurances. With a debt service ratio presently at 35 percent of exports and services, repayments of loans will continue to decrease net aid flows over the next 10 years even if gross aid flows increase. Donor assistance has represented a temporary infusion of investment to serve as a catalyst for structural change, which, among other benefits, is intended to bring in private foreign investment. Unfortunately, foreign investment continues to decline and significant improvements in the investment climate will be needed to reverse this trend. This is a major challenge for government policy.

Regional trade continues to be constrained by instability in neighboring countries and the lack of purchasing power in those same countries. With domestic demand limited, emphasis on new export production and new export markets is needed. Given Kenya's large and growing structural trade deficit of $1 billion, exports would have to double to match the import bill. While this is possible, it would require a coordinated effort to increase non-traditional exports, tourism receipts and foreign investment. The alternative is to drastically restrict imports which would stifle the possibility for expanded growth.

2. Internal Constraints

Internal economic constraints involve macroeconomic policy restrictions, regulatory and institutional controls, and resource limitations. The first is described here. The second is described throughout this CDSS.

Macroeconomic management policies are of constant concern to the GOK, which is addressing economic difficulties through the use of such tools as interest rates, exchange rates, the money supply, and fiscal deficits to control supply and demand of goods and resources in the economy. The Government has gradually devalued the Kenya shilling in real effective terms over the past several years, thereby ensuring that inflationary tendencies do not make Kenyan products uncompetitive on world markets. Also, while the Government continues to impose ceilings on interest rates, these have been generally positive in real terms, so that the rate of inflation has not overly discouraged domestic saving.

Budget and fiscal policy actions have not been as positive. Government expenditures are nearly one-third of GDP. Government deficits remain high, forcing the GOK to borrow heavily in domestic markets, increasing inflationary pressures and effectively limiting private sector access to credit. The main problem has been government spending, driven up by increased debt service burdens and increased public service wage outlays. In addition, the Government continues to make large investment outlays, the most inappropriate of which consist of investments in parastatal activities that the Government itself has acknowledged are an inefficient use of the country's scarce investment resources.

Regulatory and institutional constraints are a major element of Kenya's economic growth problems. The Government has become much too involved in microeconomic management. That such involvement is to the detriment of the overall economy has been an increasingly frequent subject of high-level policy papers, in-depth analysis, and donor dialogue. Microeconomic controls that are counterproductive to the development of a healthy, thriving, competitive private sector in Kenya include licensing controls, marketing controls, and financial controls. They are described in greater detail in C.3 of this section.

B. Selected Major Areas

1. High Rate of Population Growth

A very high rate of population growth is the overriding constraint to sustained, broad-based economic growth in Kenya. Although the rate has at last begun to come down, decreasing from 4.1 percent in 1984 to 3.8 percent in 1989, it remains one of the highest in the world. If the 3.8 percent rate of growth continues, the population will double in less than 20 years, to 50 million in the year 2010. Even with a successful family planning program and further significant decreases in population growth rates, the population of Kenya is projected to exceed 33 million by the year 2000. Clearly, this

Chart II-1

TOTAL POPULATION
Actual and Projected at 1989 Growth Rate

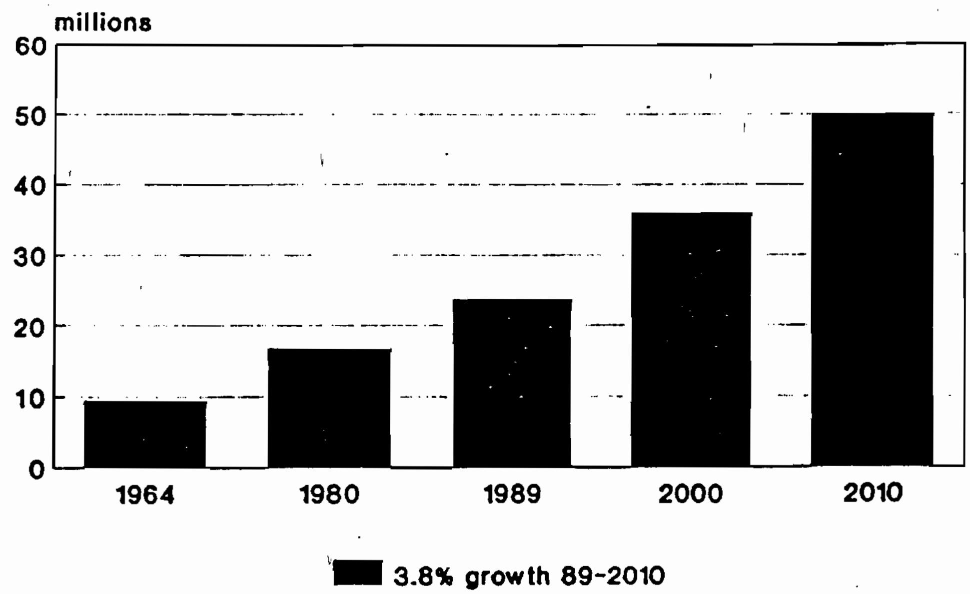
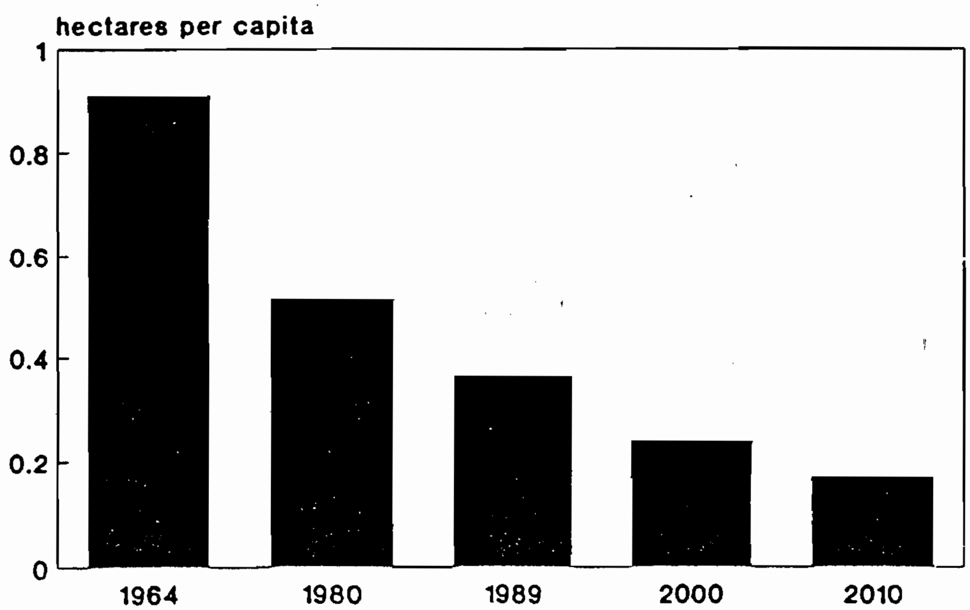


Chart II-2

AVAILABLE ARABLE LAND PER CAPITA**
Actual and Projected



** Projected at 1989 pop. growth rate

situation seriously undermines efforts to attain per capita improvements in a wide range of social and economic areas. The increasing scarcity of arable land and limited employment opportunities present a formidable challenge for Kenya.

Another consequence of this high rate of population growth is that well over 50 percent of the population is less than 15 years old. This extremely high dependency ratio strains the resources of individual families and of public sector programs as both struggle to cope with the needs of children until they can become productive members of the society.

While the situation is serious, there is reason for incipient optimism about the future. Now, for the first time in Kenya (and perhaps for the first time in Africa) there is solid evidence that a difference is being made. The 1989 national Kenya Demographic and Health Survey (KDHS) shows a dramatic increase in contraceptive use and provides the first indication of a decline in the total fertility rate. In comparison with a similar survey in 1984, the 1989 survey shows a 60 percent increase in contraceptive use and a 15 percent decline in the total fertility rate (number of children per woman). Total contraceptive use increased from 17 percent in 1984 to 27 percent in 1989, while use of modern contraceptive methods doubled from 9 percent to 18 percent during the same period. The 1989 survey found a total fertility rate of 6.7 children per woman; the 1984 survey reported 7.7.

Despite this recent success, however, fertility remains at a very high level and will have to decline much further if Kenya's medium and long-term population objectives are to be achieved. To reach the GOK 1995 population growth rate target of 3.5 percent, for example, the total fertility rate will need to decline from the current level of 6.7 to 5.9 -- an ambitious goal. But KDHS data clearly show that rapid change in fertility preferences and attitudes toward childbearing are underway. Nearly 80 percent of women of reproductive age indicate a desire to either delay or stop childbearing. Such a change, combined with a continued expansion of family planning services in the next five years, makes this fertility reduction objective achievable.

A variety of socio-cultural factors, such as early age at marriage, the high value Kenyans place on children, and the relatively low status of women affect the desired number of children and thus the potential demand for family planning services. Notwithstanding these factors, USAID believes that the major constraints to use of family planning in Kenya relate to the limited supply of services and to lack of information about those services. Possibilities for reducing or eliminating those constraints constitute significant opportunities for increasing the prevalence of contraceptive use. Moreover, it is likely that such an increase will result in reduced fertility and then in further reductions in the rate of population growth.

a. Supply

The KDHS suggests that access to quality family planning services is still a major constraint to contraceptive use. While only 27 percent of women of reproductive age are using a method of contraception, and only 18 percent are using a modern method, the proportion of women wanting to delay or stop childbearing is nearly 80 percent. Thus, the potential demand for contraceptives and family planning services is considerable.

Despite major recent progress (such as an increase in the number of MOH service delivery points), it is estimated that 30-40 percent of the population does not have ready access to family planning services. In the public sector, services are probably routinely available at no more than 50 percent of facilities, because of either the absence of trained staff, equipment, medical supplies or contraceptives. For example, while nearly 400 MOH and NGO health personnel are being trained in family planning each year, a backlog of more than 4,000 are still to be trained. Periodic shortages of certain contraceptives and weak internal distribution systems continue to constrain the availability of services at the periphery. Related medical equipment and supplies, such as disposable gloves, examining instruments, and disinfecting solutions, are also frequently in short supply. Less than 25 percent of MOH hospitals routinely offer VSC services.

Within the private sector, clinic-based services are available through the Family Planning Association of Kenya network and, increasingly, through the large national network of mission hospitals and clinics which comprise the Christian Health Association of Kenya (CHAK). Augmenting this are the more than 120 service delivery points established and assisted by the USAID Family

Planning Private Sector Project. Substantial opportunity exists, however, to further expand the availability of family planning services within CHAK and within private firms.

Community-based services (CBS) are a critical component of a broad-based family planning program. Despite a recent expansion in CBS, coverage through CBS or other forms of outreach is still less than 20 percent of the population. In addition, the lack of a full-fledged contraceptive social marketing program, (subsidized commercial sales) continues to seriously limit ready access to contraceptive supplies for lower socio-economic groups in urban and semi-urban areas.

b. Demand

In the KDHS, lack of knowledge about specific methods was the reason cited by the largest number of respondents (23 percent) for non-use of family planning. While many potential users are able to name most methods, both clients and family planning service providers display a great deal of misunderstanding about the safety, effectiveness and use of these methods. Easily understood and accurate print materials are rarely available to counter rumors and misunderstandings and to support efforts by clinic and community-based staff. Another reason cited for non-use was the husband's disapproval. To date, information programs have not been very effective in reaching men.

The KDHS also indicates that contraceptive use is much lower in areas where infant and young child mortality remains high. In Central and Eastern Provinces, for example, where child (under the age of five) mortality is estimated from the KDHS to be less than 50 and 65 per thousand, respectively, 40 percent of married women of reproductive age are using family planning methods. In Nyanza and Western Provinces, where child mortality is estimated to be 148 and 133 per thousand, respectively, less than 15 percent of married women of reproductive age are using family planning methods.

It is evident that substantial opportunity exists to increase the prevalence of contraceptive use through the increased availability of information and services and through continued support to child survival activities, particularly in selected high-mortality areas.

2. Low Level of Agricultural Productivity and Farm Incomes

Improving the productivity of the agricultural sector will be necessary if Kenya is to achieve sustainable, broad-based economic growth. Agriculture continues to be a major source of income and employment in the economy, representing 30 percent of GDP and close to 70 percent of the workforce. Moreover, Kenyan farmers supply nearly all of the nation's food supply and nearly 70 percent of foreign exchange earnings. Given a proper macroeconomic environment and effective sectoral policies and investments, agriculture has the potential to make significant contributions to employment growth and expansion of exports, as well to provide the base upon which industry can rapidly expand.

Since independence, Kenya has had one of the highest rates of agricultural growth in sub-Saharan Africa. But growth performance in the first independence decade (4.6 percent per annum) was markedly better than in the past fifteen years (2.8 percent per annum), during which time the expansion in output failed to keep up with the rate of population increase. In the past five years, however, as a result of highly favorable weather conditions, increased fertilizer utilization, and policy reforms that have improved farmer incentives, the growth of agricultural output has increased to 4.2 percent per annum.

In spite of this recent growth for the sector overall, per capita maize production has decreased since 1985 because of low growth in yields and high population growth. Maize yields are only now returning to levels reached in the late seventies. Charts II.5 and II.6 on the following page highlight declining maize production per capita and stagnant yield production since the late seventies.

extensive The growth in agriculture since independence has resulted largely from increasing the land area under cultivation. But the prospects for further growth through extension of land area under cultivation are now extremely limited. In the future, increasing use of fertilizer, an improved policy intensive enviornment, and improved seed varieties and other production techniques will hold the key to sustaining significant agricultural growth. Per unit production is already high in Kenya's large farm sector, in which some 3,700

Chart II-3

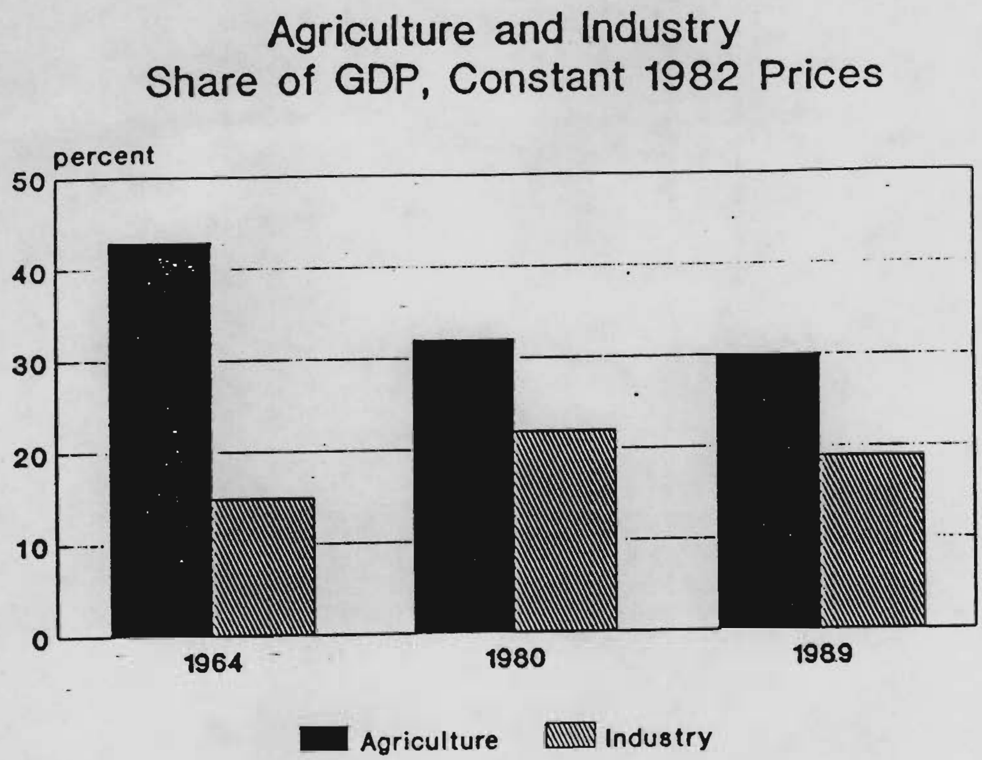


Chart II-4

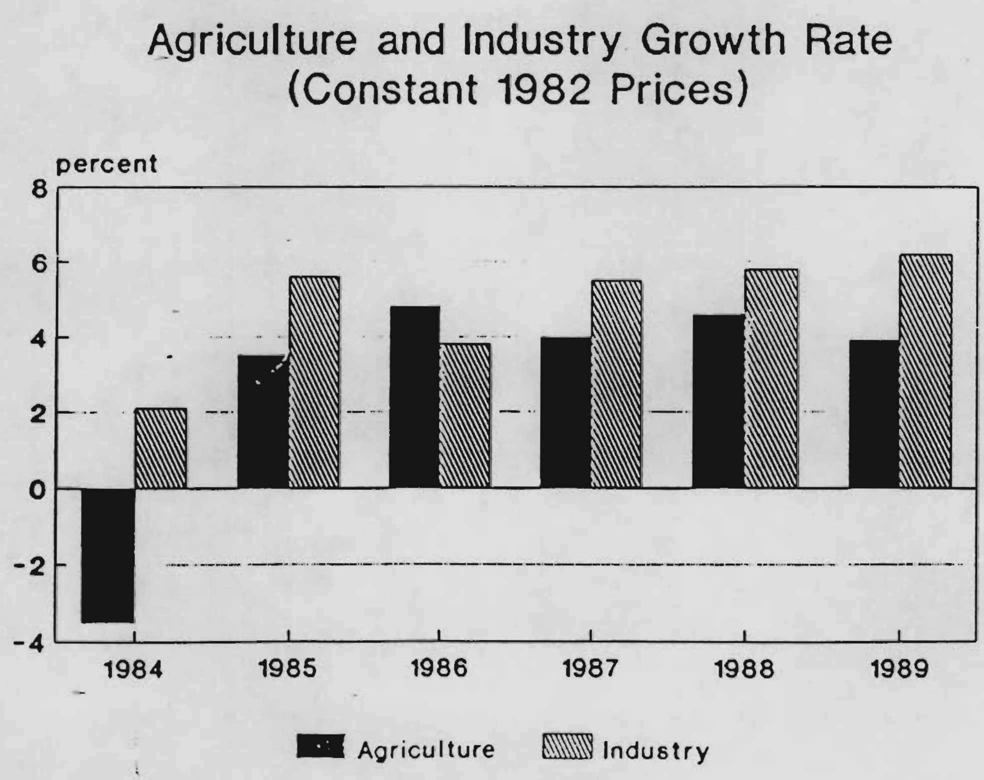


Chart II-5

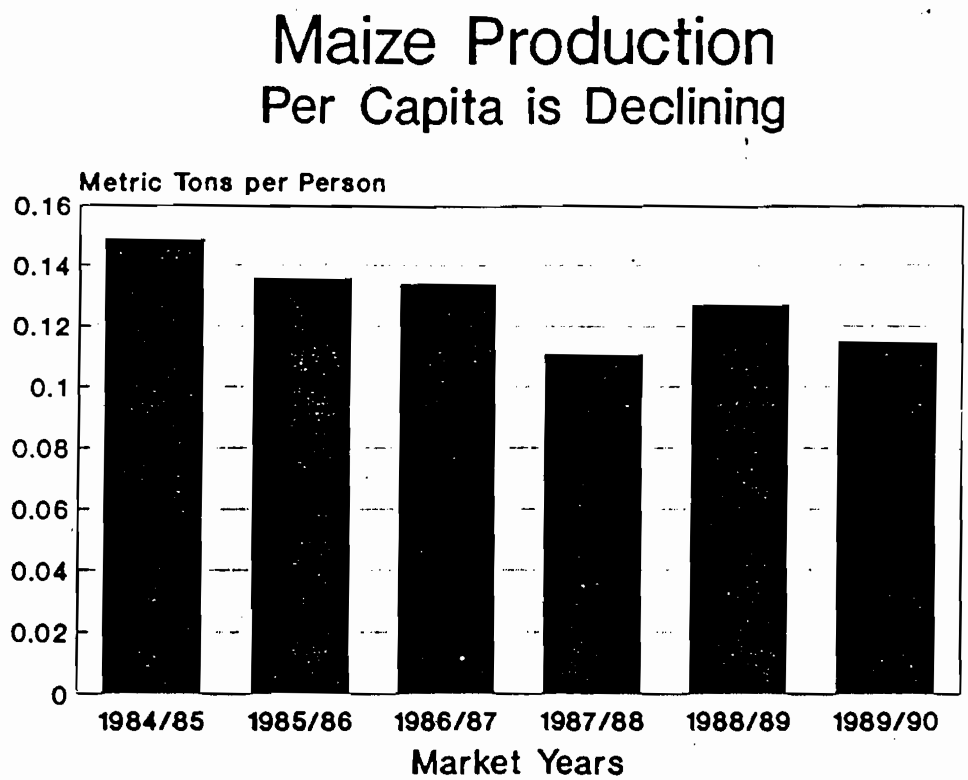
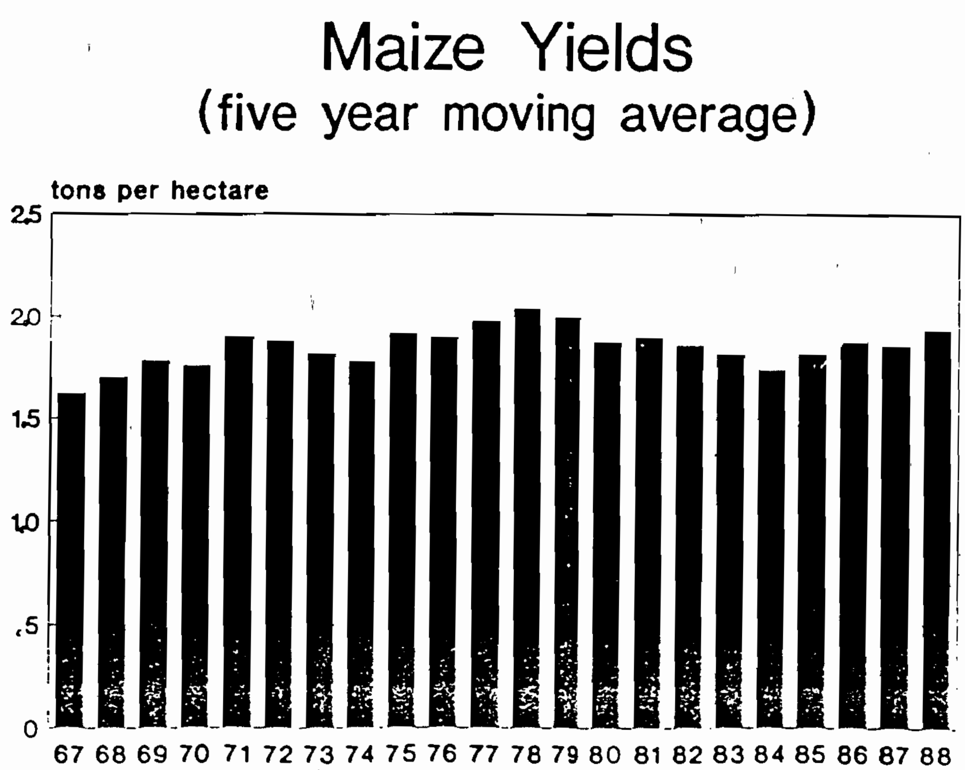


Chart II-6



Source: World Bank

farms account for one-third of the area under crop production. This means that improving productivity in the smallholder sector, in which 1.7 million farms average some two hectares in size, must be the target for agricultural development strategies.

In the past several years, the GOK, the World Bank, USAID and other donors have undertaken a series of in-depth assessments of the agricultural sector. These assessments have examined the constraints and opportunities in agriculture, the costs and benefits of different approaches to agricultural development, and the impact of various donor projects and programs. They have made recommendations to both the GOK and the donors about agricultural sector strategy options. Among the more important of these assessments are:

- "Kenya's Agricultural Growth Prospects and Strategy Options,"World Bank, June 1989;
- "Raising Agricultural Productivity: the Role of Research and Extension," Government of Kenya, January 1989;
- "Increasing Kenyan Agricultural Productivity: Application of the Policy Analysis Matrix - Interim Project Report", prepared for USAID/Kenya November 1989; and
- "Economic and Social Soundness Analysis for the Kenya Market Development Program," prepared for USAID/Kenya, July 1989;

These studies have concluded that there are four key constraints to achieving Kenya's agricultural sector objectives of increasing output and improving productivity, especially in the smallholder sector. These are:

- Limited supply of arable land and insecure land tenure;
- Inefficient marketing and pricing policies;
- Inefficient agricultural input supply systems; and
- Inadequate research and extension services.

In addition, factors outside the agricultural sector such as unfavorable terms-of-trade, a weak balance-of-payments, and inflation have imposed constraints on the performance of agriculture.

a. Arable Land Supply and Land Tenure

Of Kenya's 44.6 million hectares of land, only 8.6 million hectares (19 percent) are medium to high potential agricultural land. Much of the rest is used for extensive livestock grazing or taken up by national parks or forest reserves. Of land not now under production, only 500,000 hectares could conceivably be put into production through irrigation, drainage or flood control. This limited supply of arable land combined with the high population growth rate has generated severe land pressure. Consequently, farming methods, such as reducing fallow periods, have been undertaken which increase soil erosion and decrease per unit productivity.

The land constraint is further complicated by unequal land distribution and insecurity of tenure. Nearly two million small farms occupy less than four million hectares while 3,700 large farms occupy close to three million hectares. Land tenure reform in Kenya has not focused on redistribution; rather it has sought to provide secure tenure to small farmers. Unfortunately, because of complex bureaucratic procedures, tribal politics, and legal difficulties in general and specifically with relation to women, and financial and personnel limitations, the land tenure program has been implemented at a very slow pace. Lack of secure tenure has limited access by small farmers to credit and has limited their incentive to undertake improvements whose pay-offs are longer term. The GOK is working on a framework to address these complex and sensitive issues.

FARMS
2.0 MIL on
4.0 m hectares
3,700 on
3.0 MIL. HECTARES

b. Agricultural Marketing and Pricing Policies

The lack of a well-developed marketing system and the presence of administratively fixed agricultural commodity prices create a disincentive to increased agricultural productivity. The extent of Government intervention in agricultural marketing is high. For most major crops, official prices are set through marketing boards which either exert monopsonistic power or substantially control access to marketing by the private sector. Official price policy does not allow temporal or spatial price variation for most commodities. This discourages private storage, increases marketing costs, and contributes to a misallocation of scarce land resources since prices do not reflect local market conditions. In addition, these government controls decrease agribusiness profitability, inhibiting development of extensive private marketing and processing industries.

While in recent years fixed prices have more nearly reflected import/export parity, the potential incentives resulting from these reasonably high prices have been offset by late payments to farmers by the marketing boards. In many cases, farmers have had to wait up to fifteen months to receive full payment for their output. This has resulted in serious liquidity problems for smallholder farmers.

fixed prices generally reflect parity

The core of the parastatal marketing system is the National Cereals and Produce Board (NCPB), which markets about one-half of the total commercial sales of maize. In addition to absorbing some $60 million of government subsidies per annum, the NCPB controls a complex set of restrictions that substantially increase the cost of the informal sector maize trade (the other half of total marketed production). These policies benefit only large-scale producers while increasing the cost of maize to consumers and lowering the price to smallholder farmers.

Kenya's rural transportation system is at a critical juncture. Poor roads have increased the cost of agricultural marketing and have discouraged economies of scale. A recent USAID study has identified the poor quality of rural roads as the major infrastructure constraint to more efficient marketing. The rural roads system must be improved or it will quickly fall apart, further limiting the likelihood of improving smallholder productivity. The recurrent budget for rural roads has decreased by 22 percent between 1985/86 and 1989/90.

c. Agricultural Input Supply

Agricultural inputs constitute a critical element in the strategy to enhance smallholder. These inputs include fertilizer, improved seed varieties, pest and disease control chemicals, animal feeds, and farm machinery and implements. The structure of the input delivery system is characterized by a wide range of participants including parastatals, cooperatives and private traders.

Of particular importance is fertilizer. Various studies by the GOK and the World Bank have estimated that the potential requirement for all types of fertilizer is 650,000 tons per year, while actual consumption has averaged only 260,000 tons per year in the past three years. Studies suggest that fertilizer investment is highly profitable, providing returns of 3-4 times its value in maize and wheat and 10 times or more for coffee or tea.

Yet the fertilizer subsector has experienced severe problems in recent years. These are the result of official fertilizer price setting and controls, inadequate and untimely imports due to foreign exchange constraints and cumbersome import quota and allocation procedures, and lack of technical knowledge on the proper use of fertilizer and uncertainty about its financial returns.

In December 1989 the GOK decontrolled fertilizer prices as part of its programs with USAID and the World Bank. This will help address the inputs constraint but will need to be accompanied by action in the other areas of constraint.

d. Agricultural Research and Extension

Prior to independence, agricultural research in Kenya responded to the needs of commercial farmers with mechanized operations and marketed inputs. While government policy has long since shifted to a focus on smallholders, changes in research priorities and activities have lagged behind. The result has been a lack of development of improved technologies for smallholders. Unless significant improvements are made in the existing technology base, smallholder agriculture will not be able to make the productivity gains that will be needed to maintain agricultural output growth at a rate faster than the growth of population.

A 1986 study of the agricultural research system in Kenya led to a decision to consolidate all research activities in the Kenya Agricultural Research Institute (KARI). But, KARI has had difficulty in implementing its research plans because of budgetary constraints, a failure to develop linkages with the agribusiness community, and, especially, a lack of skilled researchers and managers. As Chart II.8 shows, nearly 80 percent of the KARI budget is presently allocated to personnel and administration. Operational funds, already a small fraction of the budget, are subject to political pressures and are often held up at the Treasury. While horticulture has grown substantially in recent years as shown in Chart II.7, it could expand even faster with new technologies.

KARI, Egerton University and other institutions involved in agricultural research have highly qualified senior managers and researchers. However, these institutions lack the depth of expertise and program management capability required to sustain agricultural research programs.

Kenya shares the general problem of many developing countries in extending the productivity-enhancing results of research work to its smallholder farmers. This is the result of poor dissemination of information because of weak links between the research and extension systems, lack of appropriate products to extend to smallholders, inadequate resources and support for the extension staff, and weak management and supervision in the extension service.

3. Low Level and Productivity of Private Investment

The Government, donor agencies, and various private consultants have concluded that the current low level and productivity of private investment in Kenya is the most significant factor constraining growth in production, employment, and foreign exchange earnings. Low investment quality makes it difficult, if not impossible, for the country to attain sustained, broad-based economic growth.

While an increased amount of investment is required, enhancing the productivity of investment is as crucial an issue. Kenya's rate of domestic savings in relation to GDP is one of the highest in Africa, and its annual investment rate is on the order of 25 percent of GDP. However, in comparison with other countries at Kenya's level of development, the growth generated by this high investment level is low. With an incremental capital-output ratio (ICOR) of about five, Kenya's economy currently requires five percentage points of investment to produce one additional percentage point increase in GDP. (In industry and manufacturing, the figure is probably a bit higher.) If the ICOR were to drop by one point (to four), GDP growth could be expected to increase by one percentage point per year, a significant gain.

inefficient inv. returns is low.

Chart II-7

Horticultural Exports - Rapidly Increasing From 1984-88

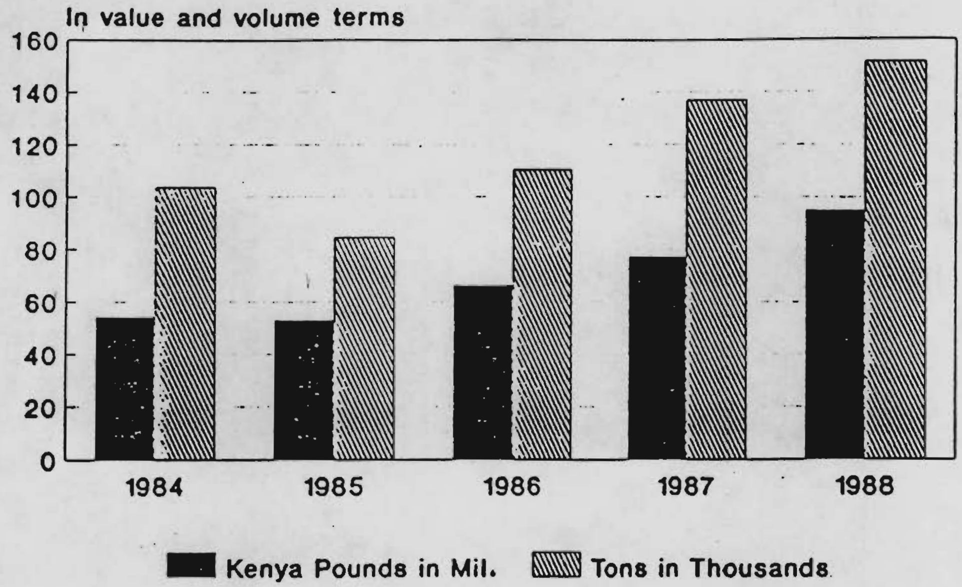
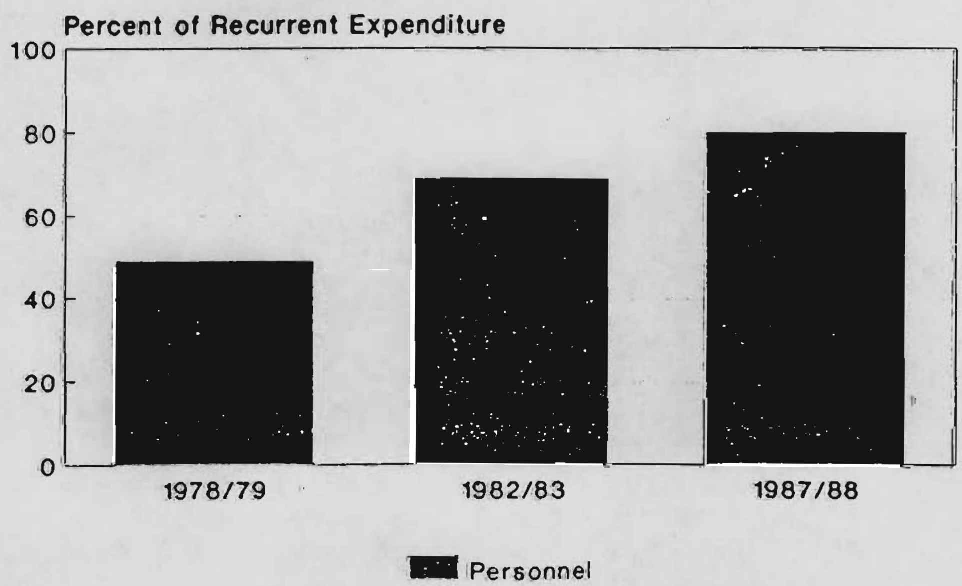


Chart II-8

Increasing Personnel Costs In Agricultural Research



Source: GOK

During the past year, USAID has funded an extensive series of assessments on opportunities and constraints in Kenya's private sector. Drawing from both public and private sector sources, the analyses include a wide range of information about the private enterprise investment and operation climate in Kenya. One of the studies is the largest private sector survey conducted to date in Kenya. Others examined USAID and other donor-funded activities during the last decade and provided recommendations on the most cost-effective, impact-laden interventions for the future. Assessments include:

- "Evaluation of the USAID/Kenya Private Sector Program" (prepared for USAID in July 1989);
- "Export Incentives for Kenyan Industry" (prepared for the Kenya Association of Manufacturers in August 1989);
- "Government Controls and Their Impact on the Manufacturing Sector" (prepared for the Kenya Association of Manufacturers in October 1989);
- "Manual for Action in the Private Sector: Kenya" (prepared for USAID in December 1989); and
- "The Enabling Environment for Kenyan Export Processing Zones" (prepared for the Ministry of Finance in December 1989).

These documents have made a major contribution to understanding the constraints to increased private enterprise activity in Kenya and the opportunities that exist for overcoming those constraints. They have played an important role in shaping USAID's strategy in this sector. The analysis which follows is based on this prodigious body of research and on USAID's extensive experience as the earliest and largest private enterprise donor in Kenya.

Major constraints to increasing the level and productivity of private investment in Kenya include: too many government controls which inhibit investment, especially those which impede expansion and diversification of export production and of foreign private investment; underdeveloped financial markets to make capital available for investment; and insufficient mechanisms to improve the productivity and expand the base of domestic investment and entrepreneurs.

a. Government Controls — The Enabling Environment

Despite numerous pronouncements and some major actions to the contrary, economic policy in Kenya is marked by a long-standing, if now largely discredited, philosophy of development which is suspicious of market forces. Market forces in Kenya have, in too many instances, been superceded by pervasive government intervention. The goals of this intervention were to save scarce foreign exchange by protecting import-substituting enterprises and to ease burdens on the poor — primarily the urban poor — by controlling prices of daily necessities, including food. This philosophy has created a policy environment that now keeps the economy from growing as rapidly as it could and should, and that acts as the major constraint to improving levels and productivity of private investment.

The policy environment is improving gradually, however. With strong encouragement from bilateral and multilateral lenders and donors, Kenya is reexamining its development philosophy. In the groundbreaking Sessional Paper No. 1 of 1986, and in numerous subsequent pronouncements (such as annual budget presentations and speeches by high level officials), the GOK has noted the importance of moving away from direct government intervention and toward liberalization for more efficient resource use in the economy. A number of policy improvements have been implemented in the past four years, but much remains to be done. Over twenty years of inward-looking development philosophy has become entrenched in policies to such an extent that reforms cannot occur overnight. Many groups, both inside and outside government, have benefitted from the protected environment and will fight to maintain the status quo. Kenya's challenge is to overcome the strong resistance to change presented by these "stakeholders," and to fully implement needed policy changes.

Major reforms are needed in many categories of government controls. The most important categories involve:

— licensing restrictions, such as import and export licensing, entry and work permits, and trade licensing, all of which make starting and operating businesses extremely difficult and provide numerous possibilities for corruption;

— financial controls, such as foreign exchange regulations which dictate the allocation and use of scarce foreign exchange and make it hard for foreign investors to repatriate profits; and

— market controls, such as price controls and regulation of trade by means of established marketing boards.

Perhaps the most debilitating constraint on investment (either domestic or foreign) is the unfortunate combined effect of all the foregoing controls. The resulting "investment climate" is larger than the sum of these constraints and often causes potential investors to look elsewhere. The symptoms of a poor investment climate — including successful capital flight despite complex controls to prevent it, severe penalties for illegal foreign exchange transactions and drastically reduced levels of foreign investment — are evident in Kenya. Another characteristic of the current investment climate is the widespread prevalence of corruption that pervades all business transactions in Kenya.

Perseverance in developing and implementing market-oriented private enterprise policies is required if private enterprise is to make the enormous contribution to economic growth that it has the potential to make. Opportunities for reform abound, as do opportunities for providing assistance to encourage and support such reform.

b. Financial Markets and Financial Services

Kenya's capital market is large and diversified by African standards. There are 26 commercial banks, of which 3 are government owned, 14 are branches of foreign banks, and nine are private domestic banks. In addition, there are numerous non-bank financial intermediaries, including 37 insurance companies, 1,700 rural savings institutions, and five development "banks." A stock exchange has existed since 1954. However, the achievement of an advanced, outward-looking economy will require the development of a broader range of institutions and financial services than currently exists. Problems in the financial sector are of three types. First, inadequate macroeconomic policy has its initial impact on the financial sector. Since the Central Bank works for the Government, the Government and its parastatals have first claim on banking system credit. As a result, deficit financing crowds out private sector credit. Second, a series of public sector policies is hindering the further development of a financial system which could adequately serve the needs of an outward looking and rapidly developing economy. The most important of these are exchange controls and interest rate controls. The former prevent the development of financial instruments needed by a modern export sector. The latter prevent the credit needs of small business from being adequately addressed. (The experience of USAID/Kenya's private sector portfolio is that financial institutions are usually willing to carry the credit risk of lending to small enterprise, providing their administrative costs are covered.) Finally, there are a number of institutional constraints which need to be addressed. Chief among these are the development of an adequate regulatory institutional framework for equity markets and foreign investment.

c. Incentives to Encourage, and Services to Support, Domestic Investment and Entrepreneurship

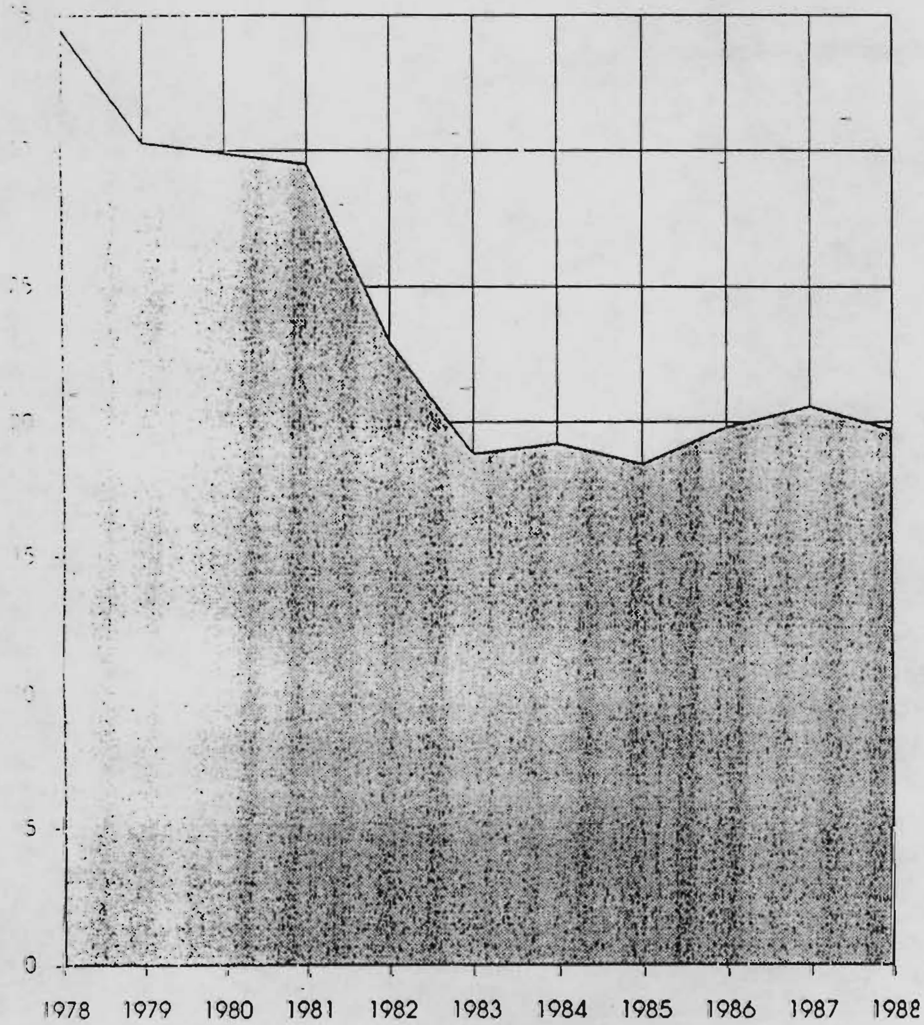
The inhospitable policy environment restricts both foreign and domestic investment. Furthermore, domestic entrepreneurs are constrained by a number of factors. Specifically, given Kenya's very high population growth rate, 400,000 new workers per year are eligible for employment, but the growth in job opportunities does not begin to meet employment demands. Despite strong growth rates recently, the informal sector is also limited in its capacity to employ and to increase productivity. Value added is low, the domestic market is limited, and with greater economic liberalization, outside competition may crowd out today's informal industries. Domestic enterprises have poor access to marketing, technology, and regulatory information, and are also constrained by lack of training in such basic areas as accounting and inventory management.

Like potential entrepreneurs in most other developing countries, prospective

Kenyan entrepreneurs have difficulty locating term funds for investing in productive fixed assets. To blame is a financial system which, though well formed for a country at Kenya's stage of development, still puts most of its term funds into relatively non-productive assets such as residential dwellings and land purchases. Because the financial system is conservative and averse to the risks that more profitable and innovative borrowing might produce, credit provision in general is based on very heavy collateral requirements. As a result, financiers in the formal sector are not skilled in project proposal assessment.

Chart II-9

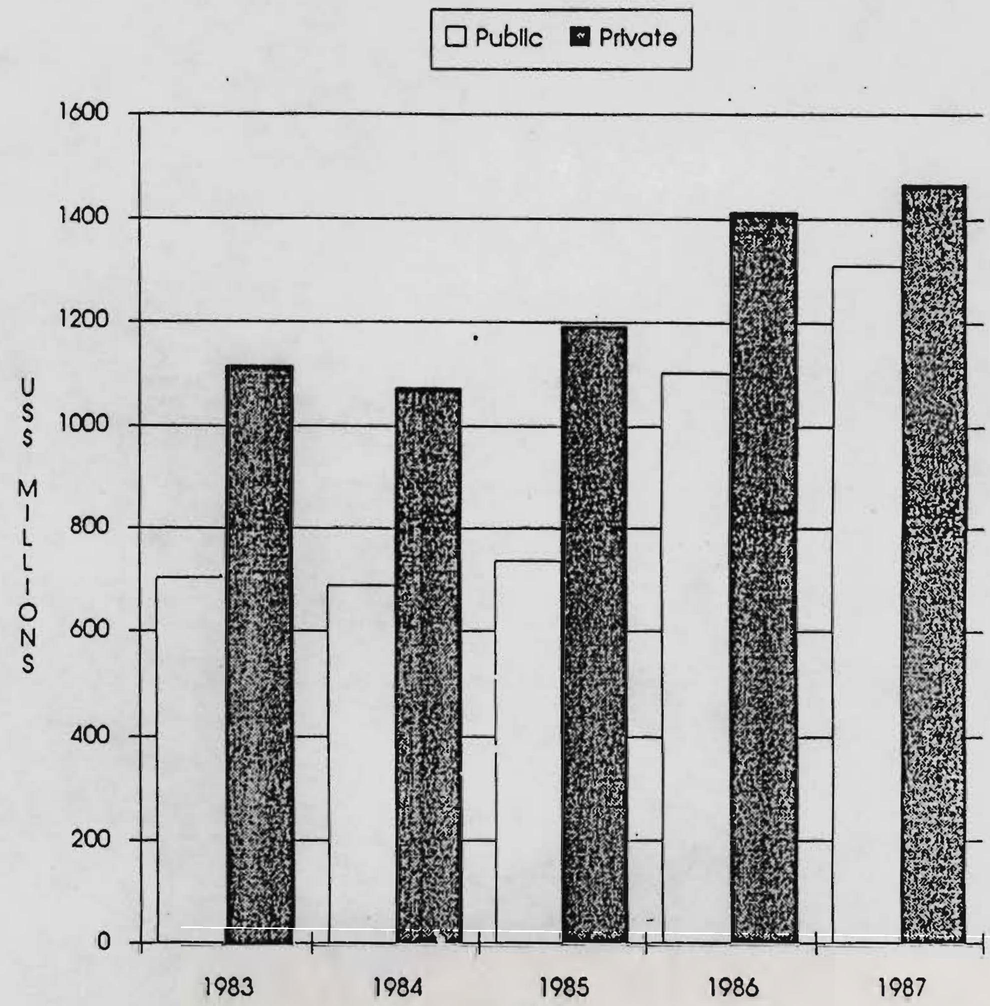
Gross Fixed Capital Formation (Constant 1982 Prices)



: Central Bureau of Statistics   080689-046

Chart II-10

Credit Use 1982-1987



urce: World Bank, Kenya: Recent Economic Developments & Policy Issues 1988   080689-008

Source: Manual for Action in the Private Sector (MAPS) - Kenya, 1989

Table 1. Kenya: Selected External Indicators

RATIOS TO GDP	1964	1980	1984	1985	1986	1987	1988	1989
Merchandise Imports	24.7	36.5	25.5	24.2	23.4	23.6	24.3	25.3
Exports (GNFS)	n.a.	n.a.	20.2	19.3	20.2	15.5	16.1	16.3
Current Account Balance	5.1	-12.5	-1.9	-1.5	-0.5	-6.3	-5.3	-5.5
EXTERNAL TERMS OF TRADE	160.6	110.1	100.0	82.8	94.1	76.9	80.4	74.0
Import Price Index	17.7	101.0	100.0	104.2	112.2	113.7	125.2	n.a.
Export Price Index	28.4	111.2	100.0	86.2	105.6	87.5	100.7	n.a.
FOREIGN INVESTMENT (mn SDR)	n.a.	60	12.0	(22.0)	36.0	(8.0)	(15.0)	10.0

Table 2. Kenya: Selected Internal Indicators

	1964	1980	1984	1985	1986	1987	1988	1989
PER CAPITA INDICATORS								
Population ('000; midyr)	9,444	16,693	19,536	20,315	21,122	21,957	22,822	23,718
GDP/Capita Index	68.3	100.4	100.0	100.9	102.4	103.2	104.4	105.4
Consumption/Capita Index	103.9	121.0	100.0	93.4	108.9	110.8	113.5	114.4
Agriculture/Capita Index	93.4	101.8	100.0	99.6	100.4	100.4	101.1	101.1
PUBLIC SECTOR INDICATORS				(percent of GDP)				
Revenues and Grants	13.3	25.9	23.7	23.2	23.3	23.4	25.1	27.8
Expenditure/Net Lending	17.8	28.2	27.9	28.7	27.3	30.5	28.7	32.1
Fiscal Balance	-4.6	-2.3	-4.1	-5.5	-4.0	-7.1	-3.6	-4.3
Credit Growth				(percent growth)				
Public Sector				8.6	44.6	36.2	-2.1	n.a.
Private Sector				15.0	16.4	6.5	16.2	n.a.
				(percent of total)				
Public Investment	n.a.	n.a.	41.7	39.0	41.2	36.3	41.2	n.a.

III. WHAT OTHER ORGANIZATIONS ARE DOING TO ADDRESS CONSTRAINTS AND TAKE ADVANTAGE OF OPPORTUNITIES

A. Overview

1. Other Donors

Kenya receives a large amount of external assistance, more than $900 million in 1989. About two-thirds of the GOK's 1989/90 development budget is externally funded. Between 1985 and 1989, donor assistance has almost tripled. Kenya has diversified its sources of aid. The United States, once Kenya's leading bilateral donor, was the fourth largest bilateral donor in 1989, providing about nine percent of bilateral funding. The United States is the sixth largest donor overall, with about six percent of total donor funding. Currently, Japan is the largest bilateral donor. The World Bank continues to be the largest multilateral donor, accounting for about 25 percent of total aid flows. Other major donors include the Asian Development Bank, the European Economic Community, France, Britain, Denmark, Germany and the Netherlands.

Table III.1 summarizes major uses of donor assistance. In terms of functional priorities, four areas — agriculture, transport and communications, water supply and sanitation, and energy — continue to command the highest amounts of assistance. Agriculture is clearly the lead sector in donor assistance preferences (accounting for about 18 percent of 1989/90 aid flows). The United States, the World Bank, the Nordic countries, Germany, Italy, the United Kingdom, the EEC, the UNDP and IFAD devote large shares of their assistance budgets to agriculture.

In comparison to other sectors, donors give fairly low priority to education and training (3.4 percent of external resources in 1989/90). For the Government of Kenya, however, education takes an extremely high level (34 percent) of the recurrent budget for all ministries and consumes 24 percent of the total amount budgetted for all ministries.

There is growing donor support for structural adjustment as an essential element of Kenya's development. A substantial amount of aid (31.7 percent in 1989/90 aid flows) is in the form of non-project assistance. Donors are increasingly financing policy-based reforms and essential imports and are providing budget support. There is a relatively large share of such assistance in the programs of the World Bank, the United States, Japan, the United Kingdom, Germany, the Netherlands, the Nordic countries, the AfDB and the ADF.

2. Non-Governmental Organizations/Private Voluntary Organizations

NGO programs are a major feature of development efforts in Kenya. With about 400 registered organizations, three-fourths of which are locally based, Kenya's NGO sector is the most active in sub-Saharan Africa. NGOs carry out large numbers of activities at their own initiative and implement many additional activities with financial assistance from the GOK and from donors.

A recent study financed by the Ford Foundation estimates that about $32 million in donor assistance funds to Kenya is channelled through NGOs. Although this represents a little less than 3.6 percent of total aid flows, such assistance has enormous impact because NGOs operate in most areas of the country, play a disproportionately large role in the provision of social services (particularly health and education services), and usually target the underserved -- the rural poor, nomads, women, and the un- or under-employed. Typical sectors of NGO funding are community water supply, population/family planning, micro-and small-scale enterprises, health and education. Donor support for NGOs is likely to rise as the capacity of local organizations increases. It is estimated that another $150 million per year is channelled to Kenyan NGOs through international religious organizations.

3. Government of Kenya

The GOK's 1989/90 investment program is the equivalent of $922 million (see Table III.2). The Government commits the most resources from its development budget to transport and communications (nearly 18.7 percent), agriculture (about 18 percent) and energy (11 percent). Planning and finance, education and provision of water supply are being accorded roughly equal emphasis, with each targetted to receive about 8 percent of the

1989/90 development budget. Under its budget rationalization program, the GOK is increasing the budget for agricultural research and extension, as well as increasing nonwage operating and maintenance budgets in such sectors as education, health, roads, water supply and agriculture in order to increase the productivity of public investments.

B. Activities of Other Donors, NGOs and the GOK in Major Areas of USAID Concentration

1. Decreasing Population Growth Rates

The United States, the World Bank, UNFPA, the United Kingdom and Sweden devote a large share of their aid to activities designed to decrease population growth rates. USAID is the major donor in this area, with both the largest dollar amount and broadest scope of assistance. New information indicating that a demographic transition is well underway is expected to encourage even greater interest in providing assistance. See Annex E for a summary of other donors' current and planned assistance in this area.

Local NGOs play a major role in the delivery of health and family planning services in Kenya. It is estimated that 30 to 40 percent of rural health services are delivered through the network of hospitals and health centers which comprise the Christian Health Association of Kenya and Kenya Catholic Secretariat. Complementing these programs are clinic-based services provided by the Family Planning Association of Kenya and the health facilities operated by many commercial enterprises. USAID is supporting most of these activities with direct bilateral funding and through U.S. cooperating agencies such as the Association for Voluntary Surgical Contraception, Family Planning International Assistance, and the Pathfinder Fund.

Kenya has an official policy, reflected in a 1984 Sessional Paper, to reduce the rate of population growth. Political commitment, emanating from both the President and senior government officials, is considerable. The President is knowledgeable about and openly supportive of efforts to reduce rapid population growth through voluntary family planning. Kenya's national political party, KANU, has included family planning in its newly re-issued manifesto. Frequent references to the importance of family planning are seen in the popular press.

A National Council for Population and Development was established in 1982 and given responsibility for policy and strategy formulation. It is charged with coordinating all population activities and donor assistance for population in Kenya and with monitoring the implementation of such programs. Instead of directly implementing programs, NCPD serves as an intermediary through which funds flow to implementing organizations, in most cases NGOs. Virtually all of the funding coordinated and managed by the NCPD comes from donors. The GOK now finances most of the operational costs associated with the NCPD secretariat.

In addition to the NCPD, the primary vehicle for implementing the national family planning program is the Ministry of Health. Through the Ministry's extensive network of health facilities, a full range of family planning services is offered. The 1989 Demographic and Health Survey showed that more than 60 percent of current family planning users were served through the MOH system. Because family planning services are thoroughly integrated into the MOH system, the MOH contribution has, and will continue to be, largely in the form of salaries paid to health workers, physical facilities, and minimal levels of equipment and supplies needed to support the program. Most of the direct costs (such as those for training and contraceptive supplies), are financed by donors.

2. Increasing Agricultural Production and Farmer Incomes

All bilateral and multilateral donors in Kenya are involved in the agriculture and/or natural resource management sectors. An increasing amount of donor aid to the sector is in the form of non-project assistance. The multilateral banks, the United States, Japan and European donors are involved with policy-based programs and the provision of essential agricultural inputs. This form of assistance has strong support from the GOK. The World Bank, with probable co-financing from Japan, the Netherlands and Germany, is currently designing a second structural adjustment operation focused on pricing and marketing reforms and on budget rationalization within the sector. Eleven donors, including USAID, the World Bank, EEC and ODA are involved in a well-coordinated program of support to agricultural research through the Kenya Agriculture Research Institute (KARI).

NGOs are very active in the sector, particularly in the areas of natural resource management and community-based sustainable agricultural development systems. The rapidly expanding area of wildlife management -- a particular focus of NGOs -- is now attracting increased attention from the World Bank, USAID, the EEC, Japan and Germany.

The GOK strategy for agriculture is wide-ranging, including agricultural education, research and extension, provision of inputs, crop and livestock improvement, market development and many other activities. The overall thrust of this strategy remains the intensification of production on high to medium potential lands, although the strategy in recent years has been broadened, giving increased emphasis to arid and semi-arid lands (ASAL). This new emphasis responds to the need to bring more land under production and thereby provide opportunities for Kenya's expanding population. IFAD and UNDP have taken the lead role in this area, with other bilateral donors supporting the program in specific geographic areas of the country. Given the relatively limited acreage that can be put into production through this expanded emphasis, the greatest opportunity to increase productivity will remain in the high potential areas which are the focus of the USAID strategy. Through continued support to KARI, university education, and the International Council for Research in Agroforestry, USAID also contributes to the ASAL strategy.

3. Promoting Private Enterprise

Other donors, NGOs and the GOK are placing increasing attention on private enterprise as a key growth sector. USAID has emerged as a clear leader and innovator, and the USAID program is consistently cited as a model. Other principal donors in this area are the World Bank, IMF, UNDP, ILO, UNIDO, Germany, Norway and the Netherlands. The United Kingdom, Sweden, Canada, Belgium, Denmark and the European Community are taking steps to become more involved. Generally, the multilaterals have been involved in macroeconomic and institutional reform efforts. The bilateral agencies have focused on credit and training for micro- and small enterprises, as well as support to parastatals working with the informal sector and in small enterprise promotion. Among the bilateral donors, attention to women's enterprise issues has been particularly strong.

Most NGO/PVO efforts are directed at income generating activities, and training and credit for micro- and small enterprises. The USAID-supported Kenya Rural Enterprise Program is increasingly recognized as the pre-eminent NGO providing technical assistance, training, loans and grants to community-based enterprises and other NGOs.

The importance of private enterprise, and the need to encourage it, figures prominently in GOK pronouncements at the highest levels. Among its efforts in this sector in the past year, the GOK has restructured its Investment Promotion Centre, created a Capital Markets Authority, established an EPZ Steering Committee, and set up a cabinet subcommittee to expedite investment approvals. Also, the informal, or "jua kali," sector is gaining in importance and is expected to figure prominently in government actions during the next five years.

Table III.1: Kenya - Functional Distribution of Donor Assistance (Commitments - 1989/90)

	In U.S. million dollars	As percent of total
Agriculture, Forestry and Fishery	163.6	18.2
Transport and Communications	124.7	13.8
Water Supply and Sanitation	93.7	10.4
Energy	90.0	10.0
Population and Health	51.2	5.7
Industry, Trade and Banking	40.8	4.5
Education and Training	30.6	3.4
Other sectors	20.9	2.3
Non-Project Assistance	285.6	31.7
Total	901.1	100.0

Source: Government of Kenya, Development Estimates, 1989/90

Table III.2: GOK Development Budget by Ministry (1989/90)

	In U.S. million dollars	As percent of total
Transport and Communications (including roads)............	172.9	18.7
Agriculture, Livestock, Supplies and Marketing...........	109.4	11.9*
Energy.........................	101.4	11.0
Planning and Finance.............	76.9	8.3
Education and Training...........	76.5	8.3
Water Supply.....................	75.3	8.2
Office of the President..........	48.7	5.3
Local Government.................	48.1	5.2
Health...........................	46.7	5.1
Others...........................	31.6	3.4
Defence..........................	31.5	3.4
Research, Science and Technology..	30.7	3.3*
Environment and Natural Resources.	25.0	2.7*
Lands and Housing................	18.9	2.1
Regional Development.............	12.9	1.4
Industry and Commerce............	7.4	0.8
Cooperatives.....................	5.9	0.6*
Tourism and Wildlife.............	2.5	0.3
Total..........	922.3	100.0

*Percentage given on page III-3 for agriculture includes these elements as well.

IV. USAID'S ROLE AND EXPERIENCE IN ADDRESSING THESE CONSTRAINTS AND OPPORTUNITIES

During the past decade, USAID has played a major role — along with other donors, NGOs/PVOs and the Government of Kenya — in assisting Kenya to overcome two of the three major constraints described in Section II.

Runaway population growth over the past decade brought with it the necessity of producing an ever greater amount of food on land being rapidly divided and subdivided as generations grew to adulthood. Efforts to increase and improve agricultural productivity, social services, and incomes or to build a solid base for economic growth were severely hampered or negated by the relentless onslaught of population growth. Thus, the need to decrease the rate of population growth and increase agricultural productivity have long been identified as Kenya's most urgent needs. The GOK and assistance agencies were convinced years ago that sustainable economic growth in Kenya was impossible unless significant progress could be made in meeting those needs. No one believed that the problems could be overcome through short-term solutions. And they were right. Long-term solutions were and continue to be required. USAID plans to continue to work toward those solutions.

During the past five years, USAID has also played an important role in assisting Kenya in efforts to increase the role of private enterprise in national economic growth and development.

Continuity of assistance has proved to be an extremely valuable factor in USAID's development effectiveness in Kenya. It has meant that the Mission has been contacted and consulted continually on the full range of issues within the three strategic areas of assistance, even when USAID funding for a given topic is minimal. USAID has therefore had much greater influence and impact than might otherwise have been the case. Access to decisionmakers through activities in the three priority areas has also given USAID a strong voice in influencing macroeconomic policies.

A description of USAID's interventions in its three stategic objective areas over the years could easily fill several volumes this size. For the purposes of this document, however, the segments that follow are brief. Additional information is readily available upon request.

A. <u>To Reduce Population Growth</u>

USAID is the major bilateral donor to the national family planning program in Kenya. The main focus of this support is on expanding and improving family planning services throughout the country.

Under the $46.2 million Family Planning Services and Support Project, financing is provided for in-service training of key health providers; establishment of voluntary surgical contraception (VSC) services; contraceptive supplies (IUDs, condoms, and vaginal foaming tablets); and logistics, community-based family planning services, and information, education and communication (IEC). In FY 1988, the project was amended to include support to the national immunization and diarrheal disease control programs of the Ministry of Health. Augmenting this effort, USAID is financing the Family Planning Private Sector Project ($8.4 million) and a community-based health and family planning activity through the Christian Organizations Research Advisory Trust (CORAT), a local NGO. Under the FPPS Project, USAID has funded the establishment and strengthening of family planning services in commercial firms, mission hospitals, and teacher colleges.

Several A.I.D. centrally-funded cooperating agencies and contractors are intimately involved in the implementation of the program. These include the Association for Voluntary Surgical Contraception (AVSC), The Pathfinder Fund, Family Health International, The Population Council, JHPIEGO, Management Sciences for Health, and John Snow, Inc. In each case, a combination of central and bilateral funding is being used to implement program activities. USAID also receives centrally-funded support from Family Planning International Assistance to strengthen/expand family planning services and from MEDEX to assist with the design and implementation of pre-service training curricula for key health workers.

Under the $15 million Health Care Financing Program, USAID supports government efforts to generate additional revenue for preventive and primary health care, both through user fees and reallocation within existing budgets.

B. To Increase Agricultural Productivity

Over the years USAID has been involved in many aspects of efforts to help Kenya increase agricultural productivity. There have been a number of major accomplishments, but much remains to be done.

USAID has had a relationship with Egerton University, Kenya's foremost agricultural university, on and off since the 1960's through a variety of technical assistance, participant training, and construction activities. The current project, Institutional Development for Agricultural Training, emphasizes curriculum development, staff training, and administrative management. A new activity during the CDSS period will assist Egerton to develop as a center of excellence, contributing to increased agricultural productivity. A fully integrated research, teaching and extension program will be developed; linkages with Kenyan and international research organizations will be strengthened; and a stronger partnership will be developed between Egerton and Kenya's private sector.

USAID has maintained a leadership role in the provision of fertilizer and the liberalization of fertilizer markets since 1984. A 1989 evaluation concluded that the availability, timeliness, and awareness of benefits of fertilizer use had significantly increased. The percentage of farmers purchasing fertilizer from private distributors has increased from 15 percent in 1984 to 53 percent by 1989. The other major donors in fertilizer (particularly IBRD and the Nordic countries) have adjusted their strategies and directly support USAID initiatives in this area. In late 1989, Kenya announced the total decontrol of fertilizer pricing, an important step but one which must be complemented by increased transparency of foreign exchange licensing procedures.

In coordination with 10 other donor agencies, USAID has supported the Kenya Agricultural Research Institute for the past few years, focusing on management and planning systems and on developing linkages with other research organizations. KARI has made tremendous progress in the past year in developing institutional systems and performing research activities, including the release of three new maize varieties.

Grain marketing reform has been a major focus of attention during the 1980's by the GOK with assistance from the EEC, IBRD and more recently USAID. The strategy of the EEC and IBRD efforts has been to develop a lower cost marketing system relying increasingly on the private sector within a national food security system regulated by the National Cereals and Produce Board (NCPB). Initial efforts have concentrated on efficiency improvements by NCPB. USAID and the GOK are presently negotiating a major cereals reform program for an early 1990 start which will focus on the informal marketing of cereals, while complementing continued efforts to improve NCPB's role in managing a strategic grain reserves and price stabilization role. In addition, USAID has supported the On-Farm Grain Storage project for the past six years which has developed, and demonstrated the economic advantages of adopting, new simple, low-cost technologies for storing grain on the farm rather than selling it at unfavorable prices to the NCPB.

Kenya's agricultural strategy, as detailed in Sessional Paper No.1 of 1986, gives prominence to increasing the role of the private sector in serving the agricultural sector. Progress has been slow in this area. USAID is the only donor that is providing support for strengthening management and operational efficiency of agribusiness firms. Within the past year, 24 firms have received direct support.

In additional efforts to work with and support the private sector in the agricultural field, KARI and Egerton (with encouragement from USAID) are beginning to carry out contract research and cost-sharing with private firms. For example, KARI is negotiating with a private U.S. seed company for joint research efforts on new maize varieties in Kenya. KARI's development of high yielding horticultural crops, particularly french beans, was an important factor in rapidly increasing exports of the commodity to European markets.

C. To increase Private Enterprise Development

For several years USAID Kenya has been implementing a wide-ranging private enterprise development strategy. This strategy consists of 20 distinct activities under five projects and accounts for over $100 million in USAID funding. It is one of the most ambitious private enterprise strategies yet implemented by A.I.D. in Africa and includes significant efforts in the areas of finance and equity market development, technical assistance, and training for management and policy reform.

Since 1983 the USAID program has provided credit to all levels of the private sector — small loans for informal and micro/small enterprises, medium term credit for rural enterprises, and loans to match equity investments. The program has fostered managerial and entrepreneurial development and has introduced new technology.

On the policy front, USAID has enabled key Kenyan institutions to conduct studies on issues of vital concern to the private sector and to engage their colleagues and the GOK in dialogue on policy changes and new policy implementation. In 1989 the Mission conducted a program evaluation of all private enterprise projects and activities to date — over $111 million in funding — which was the largest evaluation of private enterprise activities conducted by any USAID Mission. The results of the evaluation were used in a comprehensive sector assessment and strategy revision exercise using an Agencywide instrument, the Manual for Action in the Private Sector.

This first phase of USAID's private enterprise program activity has been referred to as a "targets of opportunity" approach. It is actually a complex set of interventions that are designed to test and demonstrate a variety of new, previously untried approaches in Kenya, and it is in various stages of implementation. For example, two credit programs can show the variation in the timing of interventions: one, Rural Private Enterprise, is completing its sixth year; another, Kenya Equity Management, is just making its first investments. Two other programs illustrate the use of a single implementing agency in multiple elements of the portfolio: the Kenya Association of Manufacturers implements both policy studies and a series of training seminars, while the Informal Sector (Jua Kali) Loan Program implements both credit and training programs. Some of the implementing agencies in all three elements are also targets of institutional development activities.

Moving into the 1990s, a new USAID program, Accelerated Investment and Market Support, will be developed to increase the rate and economic impact of private investment in Kenya.

D. Additional Areas of Support

1. Training

Through training, USAID ensures that Kenya has the technical, managerial, and leadership capacity to guide and implement national development, particularly through programs that support USAID's strategic objectives in agriculture, population and private sector development. Women represented 40 percent, and private sector participants, 45 percent, of all Kenyans supported by the Training for Development Project in 1989. Approximately $4,000,000 is spent each year for all training in the U.S., Kenya, and third countries.

Four thousand Kenyans, including many of Kenya's current leaders, have been trained in the United States since the 1950's, beginning with the Kennedy-Mboya airlift. Taking advantage of U.S. historical experience and comparative advantage, and of the importance of U.S. training for transferring technology and leadership skills, USAID is working to identify and train Kenya's future leaders in all fields. This focus on leadership, along with the emphasis on women, the private sector, and support for strategic objectives, will continue during the CDSS period.

2. Support to Non-Governmental Organizations/Private Voluntary Organizations

USAID supports NGOs/PVOs in the full range of the Mission's activities, particularly in the population, private enterprise, and biodiversity programs. In addition to delivering services under USAID projects, NGOs present opportunities for flexibility and experimentation with new ideas and approaches to development that help keep USAID's assistance current and responsive. Annual USAID support to NGOs/PVOs amounts to about $6.4 million.

3. AIDS

A.I.D. is a major donor to the National AIDS Control Control Programme, both through the WHO Global Programme on AIDS, AIDSTECH, and the Africa Bureau's HIV/AIDS Prevention in Africa (HAPA) Project. Through these three mechanisms, USAID has provided broad program support in the area of IEC and surveillance, improved diagnostics, and community-based education, counselling, and condom distribution.

4. Housing and Urban Development

The Regional Housing and Urban Development Office for East and Southern Africa (RHUDO/ESA) has been active in Kenya since 1972. Its programs have evolved over the years to meet changing development needs and USAID priorities. Emphasis has shifted from financing shelter provided by government agencies to working with private developers, financial institutions and the informal sector. In collaboration with USAID, RHUDO/ESA has substantially increased its attention to policy dialogue, training and institution building in support of its capital assistance. Efforts have broadened from shelter and service provision to concerns with urban development, especially in the context of developing agricultural market towns.

Three Housing Guaranty (HG) projects with an aggregate value of nearly $30 million have been implemented by the Nairobi City Commission. Another $30 million in authorized HG financing is currently available under the Private Sector Project and the associated Cooperative Housing Project, which will support privately produced and financed low-cost shelter in cities and towns throughout the country.

Outside Nairobi, RHUDO/ESA's Secondary Cities HG program financed low-cost shelter in 11 towns, and the more recent Small Towns Shelter and Community Development Project has financed shelter and urban infrastructure in 26 small towns. These projects have provided $20 million in capital assistance. The related technical assistance and training has focused on improving local government management and operations.

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V. PROPOSED COUNTRY DEVELOPMENT ASSISTANCE STRATEGY

USAID's strategy concentrates assistance in three key areas which are vital to the nation's development, where there is a demonstrated development need not being adequately addressed through other resources, and where U.S. assistance is believed to be able to make a significant difference. USAID also proposes to provide small amounts of assistance to a few selected target areas or organizations which have strong potential for positive development impact, are expected to be able to benefit significantly from limited support, are key factors in Kenya's long-term development, and/or address special Congressional concerns.

A. Goal and Subgoals

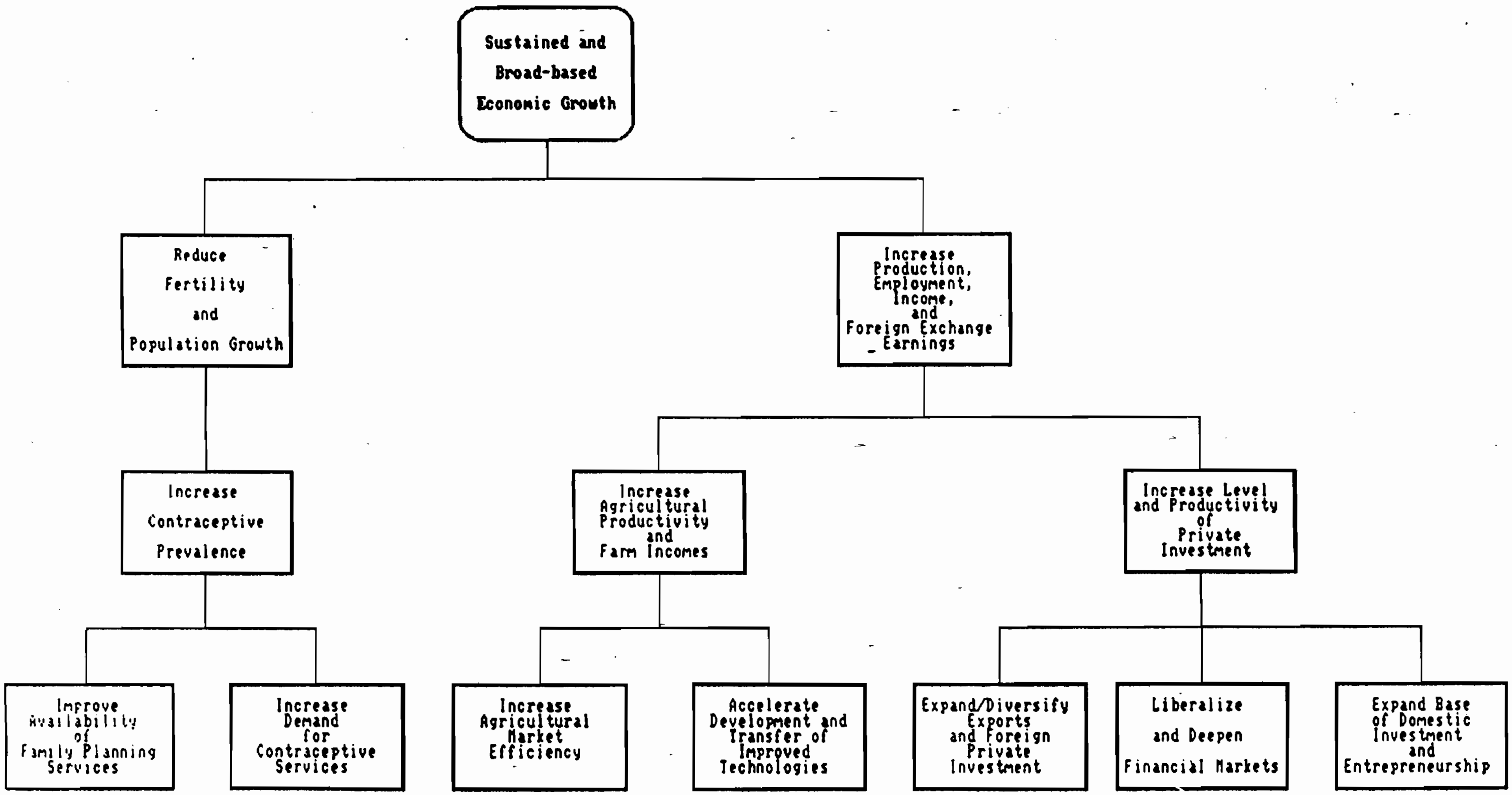
USAID/Kenya's goal for assistance in the FY 1990-95 period is to promote sustained and broad-based economic growth. In USAID's view and in the opinion of numerous assessments commissioned or reviewed in developing this document, Kenya clearly has the potential to achieve this goal. Success will depend on how well the GOK keeps its structural adjustment program on track, how effectively reforms are made and programs implemented to address issues and constraints discussed in Sections I and II, and how quickly the domestic and foreign private sectors respond to the improved investment climate the GOK intends to foster. Another major determinant of success or failure in meeting the goal will be the extent to which a recent declines in population growth can be accelerated. Accordingly, USAID proposes to focus assistance efforts on objectives within two subgoals which are the most critical components for sustained and broad-based economic growth in Kenya. Those subgoals are:

— reduce fertility and population growth; and
— increase production, employment, income, and foreign exchange earnings.

Without significant progress toward the achievement of these two subgoals, achievement of the overarching goal would be impossible. Conversely, the subgoals occupy such an important position at the heart of Kenyan development that substantial successes in these areas are expected to

USAID/KENYA

Program Objective Tree



have a positive impact on goal achievement even if some other key elements of the nation's development program are less than successful.

B. Strategic Objectives

The most direct, most cost-effective, and surest way of reducing fertility and population growth is to increase contraceptive prevalence. This linkage is clear in development literature and in the experience of Kenya and other countries making progress toward the same objective. While there are many other factors which affect fertility and population growth to some degree, USAID has no doubt that concentrating financial assistance and experience on achieving this strategic objective will have the highest impact on achieving the objective.

Strategic objectives that could be pursued to increase private production, employment, income, and foreign exchange earnings are broader and generally less demonstrably linked to the sub-goal by development literature and A.I.D.'s experiences in other developing countries. Over the past several years, partially in preparation for this CDSS, the Mission carried out a series of studies to assist in defining the most appropriate strategic objectives, given Kenya's development experience and potential, to meet this subgoal.

Although their purposes, analytical bases and methodologies differ greatly, there is a common core of recommendations, which are supported by USAID staff perceptions and experiences in Kenya and elsewhere and by development objectives of the Government of Kenya. They have led to the conclusion that: (1) increasing agricultural productivity and farm incomes is critical for national development and for the majority of Kenyans who depend on farming for all or part of their livelihood and (2) increasing the productivity of private investment is essential to moving Kenya to a higher level of economic growth and development.

Therefore, three strategic objectives are proposed as the foundation of the USAID/Kenya program. They are to:

— increase contraceptive prevalence,
— increase agricultural productivity and farm incomes, and
— increase the level and productivity of private investment.

Linkages between the objectives are evident at many points, and progress toward (or backsliding from) one objective is likely to lead to progress (or deterioration) in the others. For example, an increase in contraceptive prevalence that leads to a reduction in fertility, and hence a reduction in the population growth rate, would have a major positive effect on the employment situation and on income levels and would enhance the positive effects of increases in agricultural and industrial productivity. Alternatively, low contraceptive use and resulting higher fertility rates would be expected to severely limit or nullify increases in food production, lead to lower per capita incomes, and greatly decrease the effects of any improvements in private investment or industrial productivity.

1. Objective: Increase Contraceptive Prevalence

USAID's long-term goal is to assist Kenya in reducing its very high rate of population growth. Specifically, USAID supports the GOK's effort to reduce the rate of population growth from 3.8 percent in 1989 to 2.8 percent by the year 2000. By the end of the CDSS period in 1995, the rate is expected to have decreased to no more than 3.2 percent. To reach this goal, USAID plans to focus on increasing contraceptive use in Kenya through continuation and improvement of highly successful, comprehensive family planning activities. Assistance will help to increase the number of service delivery points, both for clinical and non-clinical services, and improve the quality of care delivered at these sites.

Through increased access to quality services, USAID expects contraceptive use among married couples of reproductive age to increase from the current level of 27 percent to 35 percent by the end of 1995. Use of the most effective methods of contraception by that group is expected to increase from 18 percent to 24 percent during the same period.

On the basis of data collected through the USAID-funded 1989 Demographic and

Health Survey, it is clear that substantial regional variation in contraceptive use levels exists, ranging from 40 percent of married women of reproductive age in Central and Eastern Provinces to less than 20 percent in Coast Province and less than 15 percent in Nyanza and Western Provinces. A variety of factors -- cultural beliefs and practices, women's status, educational levels, and others -- contribute to these lower rates. In addition, the relative weakness of family planning services and relatively high infant/young child mortality rates in those areas are also important factors. A refinement of the USAID objective of increasing contraceptive use nationally, therefore, will be to focus increased attention, both for family planning and child survival, on these low prevalence areas. Specifically, USAID will aim to increase contraceptive prevalence to 25 percent in Coast Province and 22 percent in Nyanza and Western Provinces by the end of 1995.

Ultimately, the success of health and family planning service programs in Kenya will depend on the ability of the GOK and NGOs to finance them, but more funds need to be generated and allocated to preventive/primary care before this can happen. USAID is assisting the GOK with the implementation of policy and program changes designed to institute a cost-sharing program for health services and to encourage increased efficiency in the health sector (see Section V.C.1).

a. Target: Improve the Availability of Family Planning Services

The timely availability of adequate supplies of all contraceptive methods is critical to the achievement of planned improvements in service delivery and increases in contraceptive use. USAID has provided technical and financial assistance to the Ministry of Health, and more recently to NGOs, to improve planning, procurement, and distribution of contraceptives. A system for monitoring supplies is central to this effort, and such a system has been designed and instituted in 22 of Kenya's 42 districts. In close collaboration with the World Bank and SIDA, USAID will continue to expand and improve contraceptive logistics and supply systems throughout the CDSS period.

Improving clinic-based services will be an important means of attaining the target. Despite recent gains, large numbers of public and private health facilities do not routinely offer family planning services. The primary constraints are lack of trained staff and lack of equipment and supplies needed to support those who have been trained. To address these problems, USAID will accelerate in-service training of key family planning service providers; expand the number of private sector service delivery points, focusing on strengthening and/or introducing family planning in existing health facilities; and continue the expansion of voluntary surgical contraceptive (VSC) services in both the public and private sectors.

A significant portion of Kenya's rural population does not have ready access to a health facility. For that reason, it is essential that clinic-based services be supplemented with community-based information and services. USAID is now providing and proposes to continue to provide technical and financial support to enable several indigenous NGOs to introduce and/or expand community-based health and family planning services. While both large and small NGOs are encouraged, the strategy is to focus on those NGOs that represent (at least potentially) large service delivery networks. These include the Family Planning Association of Kenya; the Christian Health Association of Kenya; the Christian Organizations Research Advisory Trust; and Maendeleo ya Wanawake, the national women's organization.

USAID will also continue to encourage increases in the numbers of private sector family planning service delivery points in order to expand coverage to the largest number of potential contraceptive users and to reduce the burden on public facilities. In addition, supporting retail sales of contraceptives is an important means of improving access to services, particularly in urban and semi-urban areas. Contraceptives need to be readily available at affordable prices through retail outlets. Though this has been a key element of USAID's strategy for several years, USAID has not been able to pursue this initiative under the aegis of an official GOK institution. USAID has been advised, however, that such an activity may be undertaken as a purely private sector initiative, using resources outside the bilateral project. USAID intends to work with local private entrepreneurs to build on modest efforts undertaken to date to make condoms, and eventually oral contraceptives, available through retail outlets at reasonable prices.

Benchmarks

By the end of FY 1993

- Couple years of protection (CYP) associated with community-based services (CBS) increases by at least 15 percent over 1990 levels.
- Percentage of population with access to CBS increases by at least 15 percent over 1990 levels.
- Improved logistics system is operational in all 42 districts (22 operational now), and at least 12 months supply of contraceptives is in Kenya at all times.
- CYP associated with MOH clinic-based services increases by 15 percent over 1990 levels.
- The number of retail outlets selling contraceptives at subsidized prices increases from 150 to 400, and sales volume increases from 700,000 to 2,000,000 condoms per year.

By the end of FY 1995

- CYP associated with community-based services increases by at least 25 percent between 1990 and 1995.
- Percentage of population with access to CBS increases by at least 25 percent over 1990 levels.
- Percentage of MOH facilities routinely offering family planning services increases from 50 percent to 80 percent.
- The number of private sector (to include private practitioners trained through the Kenya Medical Association) service delivery points routinely offering family planning services increases from 150 to 200.
- The number of sites delivering Voluntary Surgical Contraception (minilaparotomy) services increases from 52 to 100.

b. Target: Increase Demand for Contraceptive Services

There is substantial unmet demand for family planning services in Kenya. Therefore, USAID does not plan to make large investments to further stimulate demand but will work to influence demand directly through the provision of information on contraceptive methods and indirectly through efforts to further reduce infant and young child mortality. It has been well documented in Kenya that providers and clients are often poorly informed about contraceptive methods and about where family planning services can be obtained. USAID will intensify efforts both with the Ministry of Health and NGOs to ensure that complete and accurate information is available on all contraceptive methods offered by the program. USAID recognizes the important impact of female education on contraceptive use and on fertility. Other donors, particularly the World Bank, provide large amounts of support to educational assistance; USAID may help in some small way, such as funding studies of female education in Kenya, with particular emphasis on the impact of education on fertility.

Improving child health and reducing infant and child mortality is important to Kenya for humanitarian and economic reasons. It is also believed to be an important factor influencing demand for family planning services. Data from the KDHS show much lower rates of contraceptive use where infant and young child mortality remain high. USAID plans to continue support for immunization and Oral Rehydration Therapy (ORT) programs over the next few years, giving special attention to these high mortality areas. USAID is reluctant to propose a mortality benchmark given the lack of reliable data to serve as a baseline. It is proposed, therefore, that no benchmark for infant and child mortality be established until the 1989 Census data are available.

<u>Benchmarks</u>

<u>By the end of FY 1993</u>

— proportion of women citing lack of knowledge of contraceptive methods as a constraint to contraceptive use decreased from 23 percent to 15 percent.

<u>By the end of FY 1995</u>

— proportion of women citing lack of knowledge of contraceptive methods as a constraints to contraceptive use decreases from 23 to 10 percent.

— proportion of women knowing where IUD and female sterilization services can be obtained increases from 60 and 66 percent, respectively, to 85 and 90, respectively.

2. Objective: Increase Agricultural Productivity and Farm Incomes

With its substantial contribution to gross domestic product, export earnings and employment, the agricultural sector occupies a central place in Kenya's economy. Analysis of the economy shows that growth targets for the economy as a whole are unobtainable without rapid growth in the agricultural sector.. Significant improvements in the performance of the sector will increase incomes and improve the quality of life for a large majority of the population.

USAID's agricultural sector strategy focuses on increasing smallholder productivity in the high potential areas. Research has indicated that it is in these areas that policy reforms, improved marketing systems, and investments in infrastructure, research, and human resource development will have the greatest impact. Emphasis on smallholders is appropriate. Approximately 70 percent of current output is produced by small farms. Also, large farms are already achieving high yields for major commodities and analysis shows that during the next decade a projected 85 percent of increased production will come from the smallholder sector. The majority of smallholders are women.

Despite relatively high rates of agricultural growth in recent years (estimated at 4.2 percent for the past five years), future growth in the sector is constrained by a shortage of arable land, high population growth rates, inefficient domestic agricultural markets, unstable international markets for Kenya's agricultural exports, and a policy/institutional environment which requires considerable adjustment and development. During the CDSS period, USAID plans to devote significant amounts of financial and personnel resources throughout the program to efforts to relieve some of these constraints.

A continuing emphasis on productivity increases for basic food grains is essential to meet GOK food security objectives. Significant yield increases by smallholders in the near term (for maize, 1.5 metric tons per hectare to 3.3 metric tons per hectare) will allow food security targets to be met and will allow smallholders to use at least some of their land for high-value commodities. Increases in market efficiency and the availability of improved technology over the longer term will facilitate the shift to high-value commodities.Several development themes will be important in carrying out activities under this objective. Encouraging greater private sector involvement in both input and output marketing and in development of agribusinesses is a key element of several planned interventions under both this strategic objective and the objective described in V.B.3. The important role women play in managing farms and in making agricultural decisions will be encouraged and supported in all USAID program interventions.

Another recurrent theme is the recognition that sustainable economic development depends on preservation of the country's natural resource base. Natural resources issues will be addressed through agricultural research, university education, and support to government and PVO/NGO environmental activities. Wildlife protection and management is scheduled to receive special attention (See Section V.C.2).

a. Target: Improve Agricultural Market Efficiency

The lack of a well-developed marketing system which stimulates a high level of private sector participation has been identified as a fundamental constraint to increasing agricultural productivity and incomes in Kenya. During the first few years of the CDSS period, USAID, in collaboration with other donors, will continue to encourage the commercial importation and distribution of fertilizer. Shifting this important input from GOK control to private sector marketing is expected both to improve the fertilizer program and to strengthen GOK confidence in the ability of private firms to provide critical inputs to small and large farmers in a cost-effective manner. This will be a major contribution to the target of improving market efficiency.

Throughout the CDSS period, USAID will assist the GOK to improve its marketing policies and to develop the capacity to analyze and predict the impact of those policies. The maize market will be the focus of marketing improvements, with a longer-term goal of developing a rationalized marketing system for all commodities. Such a system would promote efficient allocation of investment by farmers and traders based on clear market signals and the principles of comparative advantage. USAID will encourage and support major reforms such as the elimination of commodity movement controls in the maize market during the next few years. Concentrating initial marketing development efforts on maize, the central commodity in the marketing system, is expected to increase GOK confidence in potential private sector contributions to market development. Since the vast majority of Kenyan farmers produce maize both for consumption and sale, the economic and policy signals emanating from the maize marketing system can have a major effect on farmer incomes and affect the decisions of producers and private traders in other commodity systems as well.

Improvements in maize marketing should also facilitate a shift toward higher-income crops by clarifying market signals and fostering the establishment of a reliable and low-cost distribution system which would make maize more readily available for sale in many parts of the country. Some of the Kenyan farmers who produce maize (and nearly all of the smallholders do) could increase their net farm incomes by producing other higher-value crops (either in combination with or instead of maize) in line with their natural comparative production advantages.

During the next few years, the Regional Housing and Urban Development Office proposes to initiate a market town development program which would be complementary to and highly supportive of USAID market interventions. The efficient functioning of agricultural market towns is an important element in the economic development of Kenya and in the improved operation of the market system. Market towns provide inputs and services to the farmers in the surrounding area; they are markets for and processors of agricultural commodities; and they provide off-farm employment. Several recent studies have confirmed the interdependence of the rural and urban economic systems in Kenya and have clearly demonstrated the direct relationship between stable sources of non-farm household income and increases in agricultural investment and productivity. Economic rates of return of 14 percent to 17 percent per annum attributable to market infrastructure were found in one Kenyan market town.

As another element in improving market efficiency and in achieving private enterprise targets described in Section V.B.3 below, USAID plans to encourage the development of agribusiness firms. This will include supplying management assistance to agribusiness firms which provide input, marketing and processing services to producers; supporting organizations and individuals who work to improve regulations and procedures; and offering credit to give selected firms needed capital to further develop their businesses and expand into new markets. As the investment environment improves, these firms are expected to expand their operations and play an increasingly important role in Kenya's economic development.

Benchmarks

By the end of FY 1993

— Reduce marketing costs for maize and beans by 15 percent.
— Increase smallholder farm gate prices for maize and beans by 10 percent.
— Reduce regional and seasonal maize pre-milling price variations, reflecting increased arbitrage activity.
— Increase private sector share of commercial fertilizer imports from 10 percent to 35 percent.

By end of FY 1995

— Reduce marketing costs for maize and beans by 30 percent.
— Increase smallholder farm gate prices for maize and beans by 20 percent.
— Further reduce regional and seasonal maize pre-milling price variations, reflecting further increases in arbitrage activity.
— Increase private sector share of fertilizer imports from 10 percent to 60 percent

b. Target: Accelerate Development and Transfer of Improved Technologies

Development and transfer of improved technologies within a positive incentive structure for producers is a critical factor for increasing productivity and farmer incomes in Kenya. In the short run, increased input use and improved , husbandry practices can achieve production gains. In the longer term research efforts must focus increased attention on developing and disseminating technologies and sustainable farming systems appropriate to the resource constraints of the majority of smallholders. The adoption of yield-increasing technology must be accelerated to achieve significantly higher levels of output.

Several analyses and evaluations have concluded that the most critical element in increasing yields is the availability and use of agricultural inputs, particularly fertilizer. Although significant progress has been made and important policy and systems reforms have taken place during the past few years (in large measure because of USAID actions), there remains potential for higher levels of fertilizer consumption resulting in increased productivity. More rapid dissemination of improved technologies combined with increased efficiency in marketing systems is expected to address major constraints to increased fertilizer use. For the next few years, USAID plans to continue a successful program which promotes the commercial importation, distribution and use of fertilizer.

Improving the quality and efficiency of Kenya's system of agricultural research, technology development, and technology transfer is the central, long-term strategy for this target area. In the CDSS period, USAID's agricultural research activities will focus on strengthening research management and coordination and supporting specific commodity research programs. Sustaining the current commodity focus on basic grains (maize, sorghum/millet) can lead to major productivity gains, an important contribution to facilitating the shift to higher value commodities -- the longer term objective. USAID will also be evaluating the potential for more direct research assistance to high value food and non-food crops (particularly horticultural commodities) to complement the present research focus. Emphasis will be placed on strengthening linkages between research institutions and agribusiness firms for the dissemination of new technologies. USAID will promote policy reforms and provide management assistance to enable private businesses to market improved products and inputs directly to farmers.

Specifically, USAID will continue to provide technical and financial resources for development of the Kenya Agricultural Research Institute (KARI);

provide selected investments in training and applied research at Egerton University; encourage technology transfer through both institutions; and foster the linkages of both institutions to agribusinesses, to private research organizations, and to international research organizations.

Support to Egerton University will focus on programs to improve training in extension and applied research for three distinct groups: technicians who will own or manage private agricultural or agro-industrial enterprises, personnel who will staff the research and extension services, and graduates of Egerton who will assume high-level roles in agricultural research and policy making.

The combination of the above activities will result in a more rapid development and transfer of improved technologies and is expected to lead directly to increased agricultural productivity and farmer incomes.

Benchmarks

By the end of FY 1993

- Increase fertilizer use by small farmers by 15 percent.
- Increase ratio of operations and maintenance expenditures to salary expenditures in KARI budget from 20:80 to 30:70.
- Increase the rate of developing technological packages for specific agro-ecological conditions -- 10 by 1993.
- Increase the rate of release of new technological packages -- 4 by 1993.
- Increase food grain output per hectare by 10 percent for smallholders.

By the end of FY 1995

- Increase fertilizer use by small farmers by 25 percent.
- Increase ratio of operations and maintenance expenditures to salary expenditures in KARI budget from 20:80 to 40:60.
- Increase the rate of developing technological packages for specific agro-ecological conditions -- 15 by 1995.
- Increase the rate of release of new technological packages -- 7 by 1995.
- Increase food grain output per hectare by 20 percent for smallholders.

3. Objective: Increase Level and Productivity of Private Investment

The greatest opportunity for achieving high levels of sustainable economic growth and development in Kenya during the next five years is through increased production of a range of private sector goods and services. This increased production can only be accomplished through increased and more productive private investment, both foreign and domestic. As explained in Section II.B.3 of this document, the level of domestic savings and investment mobilization is high in Kenya. However, the prevailing import substitution trade regime, government controls and lack of incentives have adversely affected the quality and magnitude of both domestic and foreign investment. As a result, a large proportion of investment is currently directed to low productivity and/or speculative activity, such as state-owned enterprises and land and real estate development. GDP growth rates in Kenya are therefore lower than rates achieved in other countries with the same overall level of investment.

Increasing the level and productivity of private investment will result in greater value added to the society at large over the medium and long terms, sustained employment generation, higher productivity of capital and labor, and increased foreign exchange earnings from productive investments (e.g., agro-processing and manufacturing). Creation of new jobs will allow more Kenyans to contribute to and benefit from the growth taking place. To the degree that private investment is focused on agribusiness and rural enterprise, the country's largest economic sector and thus the majority of Kenyan workers will be directly involved. In addition, planned improvements in capital markets and financial systems should better spread the advantages of productive investment to segments of the society often excluded from the benefits of economic growth.

To measure performance in increasing the productivity of private investment, USAID will monitor decreases in the incremental capital-output ratios for the manufacturing sector and for the economy as a whole; increases in the ratio of private fixed investment to total fixed investment in the economy; and increases in the ratio of gross domestic savings (both public and private) to gross domestic product. The Kenyan economy has nearly exhausted the per capita growth potential inherent in the import-substitution, public sector-led development strategy it has pursued since Independence. Recognizing this fact, USAID has played a key role in encouraging and implementing attitudinal, operational and legal changes with respect to the private sector. During the CDSS period, USAID proposes to build on this foundation, concentrating activities in areas determined by experience and recent extensive analysis to have the greatest impact on the achievement of the Mission's goals and objectives. Creation of an improved enabling environment for private enterprise growth is an overarching theme of the strategy and is a prerequisite to achievement of all three of the specific target areas described below.

a. Target: Expand/Diversify Exports and Foreign Private Investment

With a limited domestic market, Kenya's greatest opportunity for a substantial leap in economic growth lies in expansion and diversification of export production. This will require major changes in the anti-export bias embodied in current policies and regulations as well as the development of industries capable of competing in markets outside Kenya. Current GOK policy statements assert that the expansion and diversification of exports is a key element in a high growth strategy. Recent studies have concluded that Kenya has good potential for increasing exports of horticultural and other fresh agricultural products and for becoming a successful exporter of manufactured goods in a number of sectors, particularly those which involve labor-intensive operations such as garment manufacturing and processing of local agricultural products. Agro-processing also links directly to the USAID strategic objective of increasing agricultural productivity and farm incomes.

The Government of Kenya, impressed by the success of the newly industrialized countries and following the recommendations of a USAID-funded policy study on Export Processing Zone (EPZ) development in Kenya, is committed to establishing several EPZs over the next five years. The EPZs should attract new investment through comprehensive and automatic incentive programs for export manufacturers. Continued encouragement by donors to liberalize government controls, along with actual experience in doing so through

EPZs, should result in deregulation of offshore investment and manufacturing being extended throughout the economy.

In concert with other donors, particularly the World Bank, USAID proposes to play an active role in export development. USAID will assist in the planning, management and promotion of privately managed EPZs and will support establishment of an Export Processing Zone Authority which will provide regulatory oversight and expedite government approvals for activity within the Zones. Additional support might strengthen a restructured external trade authority to promote exports of new goods to new markets, increase the volume of non-agricultural exports, and encourage greater transparency and more automatic procedures in the export process.

The Mission will also conduct studies and carry on a continuing dialogue with the GOK regarding policies that encourage export and investment growth. USAID will support policies which reduce or eliminate trade regulations, particularly import restrictions; reduce institutional controls affecting access to foreign exchange, export licenses and customs clearances; and expedite approvals for travel and currency exchange in support of marketing activities. Assistance will be provided to the GOK tax reform and budget rationalization efforts to ensure that tax policy encourages private investment.

Increasing foreign private investment is a necessary complement to export promotion as most new foreign investment will probably be export-oriented. By working simultaneously to expand and diversify exports and to increase foreign private investment, maximum impact on employment and economic growth will be achieved. Foreign private investment has stagnated in recent years and must be revitalized in order to attract needed foreign exchange, generate employment, introduce new technology, promote production practices which will help Kenyan enterprises move into export production, and link domestic resources with world markets. To encourage foreign private investment, USAID will work at the policy level to improve the investment climate and create an enabling environment for investment growth. The Mission will also assist in implementing revised policies and streamlined procedures in concert with GOK export promotion efforts. During the CDSS period, the Mission will support agribusiness trade groups, the chamber of commerce, the manufacturers association and other institutions which can effectively represent key elements of the Kenyan private sector in lobbying the Government of Kenya, introduce new technology and management practices to local industry, and assist in matching joint venture partners and linking Kenyan producers with overseas markets. Additional support from USAID will strengthen the Investment Promotion Centre as a "one-stop shop" for both offshore and local investors.

Benchmarks

By the end of FY 1993

— EPZ Authority fully operational; one EPZ established.
  Export earnings from non traditional exports (value-added from EPZs, manufactured exports and horticulture) increased by 50 percent in nominal dollar terms over 1989 figure.
— 20,000 jobs created directly through establishment of export oriented enterprises.
— New foreign private investments worth between \$25 and \$50 million (an estimated \$3.5 million in new investment was made in 1988/89).

By the end of FY 1995

— Two EPZs fully operational.
— Export earnings from non traditional exports increased by 100 percent in nominal dollar terms over 1989 figure.
— 50,000 new jobs created directly through new foreign private investment and export-oriented enterprises.
— New foreign private investments worth between \$50 and \$100 million.

b. Target: Liberalize and Deepen Financial Markets

Growth in Kenya's financial markets will directly contribute to increasing the level and productivity of private investment in Kenya by providing new financing options for enterprises, new instruments through which savings can be invested for productive activities, incentives for privatization of parastatals, exit options for current equity holders, and a level of confidence essential to attract both foreign and domestic private investment.With USAID support, the Government of Kenya recently enacted legislation which created a Capital Markets Authority to provide regulatory oversight to the security and money markets in Kenya. This statutory body, modeled after the U.S. Securities and Exchange Commission, will facilitate introduction of new financial instruments and oversee marketplace activities. Decreased government involvement and resultant increased investor confidence are expected to help energize the Nairobi Stock Exchange, which has been dormant for much of its 35-year history. Policy analysis and implementation assistance to the Capital Markets Authority, the Nairobi Stock Exchange, the Central Bank, and selected financial institutions during the planning period will enable them to contribute to strengthening Kenyan financial markets.

Two venture capital companies now exist in Kenya, and both receive USAID assistance. Venture capital is still a relatively new and foreign concept in the Kenyan context. However, there is growing investor interest in equity investments as an opportunity for portfolio diversification, with third party management and potential for high yields. Project sponsors are increasingly interested in equity participation as an attractive non-debt option for securing needed resources for startup and/or expansion, particularly when management expertise can be offered as part of the package. USAID will continue to support the growth of venture capital companies/funds in Kenya through provision of credit lines and technical assistance.

In addition to enhancing the regulatory environment and introducing equity options and other new financial instruments for productive investment, much needs to be done to increase access to available credit. USAID has been working with the GOK for several years to introduce medium-term lending for fully collateralized rural borrowers. The effort has not been wholly successful, in large measure because interest rates have been controlled which has provided a disincentive to commercial banks to extend this type of credit. The GOK recently has amended the program's interest rate structure, an action which should help to institutionalize access to term credit for productive investment. USAID continues to encourage further interest rate deregulation by pointing out the negative impact that interest rate-ceilings have on credit availability for small businesses.

To address the issue of collateral, which currently limits access to credit for many borrowers, particularly women, USAID will provide limited training and technical assistance on project-based lending techniques and extend guarantees and targeted medium-term credit through new financial intermediaries. These interventions will improve access to credit for productive private investment, provide experience to banks and non-bank financial institutions in using new appraisal techniques to deliver new services to a different client group, and offer a demonstration model to the rest of the Kenyan financial sector.

<u>Benchmarks</u>

<u>By the end of FY 1993</u>

- Interest rates deregulated.
- Regulatory framework in place for launch of secondary market for T-bills and mortgages, money market instruments, and mutual funds.
- Total equity raised through venture capital companies increases to 60 million Ksh.
- 200 percent increase in number of new issues floated on the Nairobi Stock Exchange (one new issue in 1989); 30 percent increase in volume of trading (average volume of trading for 1989 was 13 million Ksh).
- Medium-term credit extension increased as a percentage of total lending by financial intermediaries.

<u>By the end of FY 1995</u>

- At least one issue of a money market and mutual fund instrument: activity in the secondary market for T-bills and mortgages.
- Volume of trading increased by 50 percent, and new issues on Nairobi Stock Exchange further increased.
- Total equity available through venture capital funds increased to 80 million Ksh.
- Medium-term lending further increased relative to short-term lending by financial intermediaries.

c. <u>Target: Expand the Base of Domestic Investment and Entrepreneurship</u>

An increasing amount of manufacturing activity in Kenya is based in small and informal sector firms. In fact, small business has contributed most to private sector growth in recent years, while large businesses were stagnant. The small/informal sector is also the area in which uptake potential for employment is highest. This was the only sector in which employment grew in the 1980s. This trend is expected to continue, at least until structural changes occur in the economy. Thus, mobilization of local investment, increased productivity, and expansion of the number and skills of Kenyan entrepreneurs have significant potential to fuel broad-based economic growth. These factors provide important linkages with new export initiatives, increased foreign investment and financial market development. Targeted assistance to Kenyan investors and entrepreneurs also complements and provides a strong demonstration effect for key macro-level and institutional reform efforts.

As described in Section II, domestic investment has not been directed to productive activity and this has severely limited economic growth in the 1980s. Further, a concentration of wealth in relatively few hands poses serious political and equity problems. Although only one-half of one percent of the country's population is of Asian (ethnic Indian/Pakistani) origin, this minority controls at least 70 percent of private industry and commerce in Kenya. The GOK is therefore concerned that Asians stand to benefit disproportionately, at least initially, from economic liberalization.

As the primary effort under this target area, USAID proposes to support and promote activities which increase the presence and skills of Kenyans of African origin as enterprise managers and owners. In keeping with efforts to achieve growth both in the short and the longer term, USAID's aim will be to promote greater participation of the indigenous population in the economy, not to exclude participation of others. Through USAID programs, disadvantaged individuals such as women and rural entrepreneurs will benefit from direct interventions in training, technical assistance and credit to which they normally would not have access.During the CDSS period, USAID plans to provide assistance to make businesses more productive, enable them to benefit from divestiture of state-owned enterprises, help them adjust to a changing economic environment and remove barriers to entry into the formal sector. Such interventions will address the increasingly critical employment problem in Kenya. Assistance might include training, credit for small and medium enterprises, and increasing entrepreneurs' access to information on joint ventures, marketing opportunities, credit sources and government regulations.

Local advocacy groups play an important role in encouraging policy reform and promoting investment. USAID proposes to continue efforts to strengthen business organizations such as the chamber of commerce, the manufacturers association and the agribusiness consortium, which have fairly broad-based membership and provide increasingly useful facilitative services to members.

Benchmarks

By the end of FY 1993

-- Number of Kenyans of African origin and women as a percentage of entrepreneurs increased by 20 percent for each group, as measured by the number of new formal businesses registered per year.
-- Increase the percentage of small enterprises receiving more than half of their capital from commercial services to 30 percent (from less than 25 percent in 1989).
-- Membership of small and micro enterprises and owner-operated firms in business organizations increased by 30 percent.

By the end of FY 1995

-- The number of Kenyans of African origin and women as a percentage of all entrepreneurs increased by 40 percent for each group from 1990 baseline.
-- Increase the percentage of small enterprises receiving more than half of their capital from commercial services to 35 percent.
-- Membership of business organizations increased by 50 percent.

C. Additional Contributions to Goal Achievement

USAID contemplates some assistance for activities which, while not primarily directed toward achieving the strategic objectives and targets outlined above, are strongly supportive of them and are important factors in movement toward achievement of the goal and subgoals. Such interventions can leverage additional assistance, can fill small but vital gaps in strategic objectives of the GOK and other donors, can respond to Congressional concerns, can test innovative ideas, and can explore possibilities and assist in specific areas where longer-term commitments are not warranted.

Under these criteria, USAID plans to provide small amounts of highly focused assistance to help the GOK develop and carry out its macroeconomic stabilization and structural adjustment program and to preserve and manage Kenya's unique wildlife population. In addition, USAID expects to take advantage of special opportunities to fund small, discrete activities to identify and support future leaders, to encourage the development of democratic institutions and human rights, to prevent AIDS, and to support basic education. The first two areas will receive the greatest attention and are described in greater detail below.

1. <u>Economic Stabilization and Structural Adjustment</u>

A solid, progressive economic stabilization and structural adjustment program is fundamental to the achievement of broad-based economic growth and to the achievement of the objectives which contribute to such growth. With the support and encouragement of numerous donor organizations, Kenya's macroeconomic policy agenda has been established with the World Bank and the IMF which take the lead in monitoring progress indicators and providing assistance to implement various aspects of the agenda. USAID's programs and policy dialogue agenda have been instrumental in some key areas of macroeconomic policy reform, are strongly supportive of the structural adjustment program today, and are expected to remain so throughout the CDSS period. In addition, USAID proposes to continue to assist the GOK to improve its economic management systems and practices. Securing additional resources and making efficient use of those available are critical to effective economic management. The Health Care Financing program under the African Economic Policy Reform Program (AEPRP) is an example of an intervention that helps to do both. Although no new USAID funding is planned, USAID will be intimately involved in program implementation and related policy dialogue with the GOK during the first few years of the CDSS. This activity will generate additional resources for the health sector through the implementation of cost sharing in selected Ministry of Health facilities. It encourages the more effective use of resources by indicating the portion of the budget allocated to primary and preventive care. These additional resources for the sector as a whole, and for preventive/primary care in particular, will enable the quality of health services to be expanded and improved. The World Bank plans to continue this initiative under a health sector adjustment operation scheduled for FY 1991. Building on USAID's sector program, this assistance will support a broad-based reform program in the health sector designed to improve both the efficiency and effectiveness of public sector health programs.

The achievement of substantial success in GOK economic management is well beyond USAID's own manageable interest in the development strategy, but small interventions can result in major improvements and A.I.D. often has a predominant capability in providing such assistance. Such assistance often offers opportunities for removing constraints to the achievement of specific strategic objectives and for strengthening donor cooperation. A.I.D. has a strong record in providing training, technical and management assistance, and equipment to these ends. In Kenya, such assistance has been provided for budget and tax systems analysis, agriculture and health planning, all in the context of project implementation. USAID proposes to continue those initiatives in the first few years of the CDSS and to remain open to additional similar initiatives throughout the period.

2. Wildlife Preservation and Management

Kenya contains one of the richest varieties of wildlife in the world, boasting both larger numbers and more species than almost any other country. Primarily because of this, tourism is one of the country's major sources of foreign exchange ($320 million in 1988) and is a key element in the nation's plans for future economic growth. Wildlife is legally protected throughout the country and there is a well-established system of national parks and reserves occupying more than 50,000 hectares.

However, this system and the country's wildlife are being endangered by poaching, by the encroachment of humans who need more land, and by lack of resources and institutional capacity to effectively manage them. The most glaring example of major problems — one which has drawn worldwide attention and concern during the past 18 months — is the precipitous decline in rhinoceros and elephant populations due to poaching. Since 1973, the number of elephants in Kenya has decreased by 85 percent, from more than 130,000 to less than 20,000. Rhino numbers have declined even more drastically, from 20,000 in 1973 to just 350 in 1987.

Less dramatic, but just as important to preservation of biodiversity and promotion of tourism, is the fact that many other wild animal species are declining and perhaps disappearing because humans, their farms and their livestock are occupying wildlife habitats and migratory routes. Without the support of the people who live in close proximity to Kenya's parks and reserves, it will be virtually impossible to preserve wildlife. To give that support, those people must share in the benefits that result from tourism and from maintaining biodiversity. Halting the poaching, building support among Kenyans most directly affected by wildlife, and overcoming a number of other problems will require much better management and education than has previously been the case in Kenya.

The GOK, a large number of international PVOs/NGOs, and many bilateral and multilateral donors are mobilizing to deal with issues of preserving and managing Kenya's wildlife. A new Kenya Wildlife Service (KWS) was established in 1989 under the direction of internationally known Kenyan paleontologist and conservationist Dr. Richard Leakey. The KWS is in the process of defining its role and setting parameters for a nationwide program for which it expects to secure a large amount of donor support.

With these activities underway, it is too soon to specify a long-term plan or level of U.S. assistance to the sector. However, the needs of the sector are so important and so immediate, the potential benefits of successfully preserving Kenyan wildlife are so great, the linkages with USAID's population and private investment objectives are so evident, and the possibilities of securing real progress with relatively small amounts of assistance are so good that the Mission proposes to help Kenya in this area. Specific interventions are still to be determined. Early plans call for helping the KWS develop its planning and management capabilities and for supporting government and NGO community conservation activities in research, education and training. Longer-range plans might include a focus on preserving and managing wildlife in a single, important national park, possibly Tsavo.

VI. PLANS FOR IMPLEMENTATION

A. Level and Use of Resources

1. Level of Resources

In developing this strategy, USAID assumes a financial resource level of $28 - $30 million per year from the Development Fund for Africa, $5 - $7 million in Economic Support Funds, and $10 - $15 million in PL 480 commodities. This would be a decrease of about 20 percent from average annual total A.I.D. levels in FY 1985 through FY 89. An assumption is also made that there will be a gradual reduction in U.S. direct hire staff from 25 to about 18 during the CDSS period.

Assistance levels might be increased in several ways during the period. Although not an actual resource transfer, U.S. debt relief provides very real assistance to Kenya. This makes it possible for the Government of Kenya to reduce its budget deficit and reprogram funds it would otherwise have had to devote every year for the next several decades to making payments on U.S. economic development assistance loans. The first of a proposed series of three annual debt forgiveness agreements was signed in January 1990. If the GOK remains on track with its structural adjustment program with the World Bank and IMF, the total amount of principal and interest written off by the end of January 1992 will be $174.8 million.

USAID plans to continue to draw on centrally and regionally financed activities both to increase available resources and to take advantage of the special expertise such activities offer, particularly for family planning and natural resources/wildlife activities. In addition, at least one African Economic Policy Reform Program (AEPRP) grant may be requested during the next five years to reward and reinforce significant policy initiatives contributing to the achievement of one or more development objectives.

The Regional Housing and Urban Development Office (RHUDO) in Kenya provides resources for some activities that are complementary to USAID targets and objectives and that address other development constraints. During the next five years, the RHUDO program plans to focus on development of market towns, slum and community upgrading (carried out by the private sector), and involvement of the private sector in financing shelters for low income housing groups.

2. Use of Resources

The A.I.D. program in Kenya is taking full advantage of the Development Fund for Africa to focus resources on the development objectives described in Section V and to initiate performance-based disbursement programs for health care financing and for fertilizer pricing and marketing reform. Additional non-project assistance activities are being planned during the CDSS period for agricultural market development, for investment and export promotion, and possibly for family planning. Flexibility provided by the DFA is making it easier to channel resources when and where they are needed without rigid adherence to artificial appropriation categories and limits.

USAID plans to take advantage of the flexibility of PL-480 resources and increase their effectiveness by implementing a multi-year Food for Progress (FFPR) program tied to agricultural sector policy reforms. Integrated with the DFA-funded Kenya Market Development Program and supported by host government resources, the $40 million FFPR program will provide added leverage to policy initiatives agreed upon over the 1990-94 period. In addition, USAID will continue to provide support to U.S. PVOs for food-assisted development projects through P.L. 480 Title II during the CDSS period.

Drawing on experience in Kenya over the past 25 years and on A.I.D. worldwide and Africa Bureau strategies and guidance, USAID will employ a variety of methods in implementing its strategy. Policy dialogue, institutional strengthening, technical assistance, training, PVO/NGO cooperation, and donor coordination play important roles throughout the USAID program. Women in Development issues and concerns are also considered and addressed throughout the program (see Annex B for a project by project review).

a. Policy Dialogue

Policy dialogue is critical to the attainment of development targets and objectives. USAID is very pleased with efforts and accomplishments in this area during the past few years and intends to increase both during the CDSS period. The Mission has excellent access to and rapport with many key Kenyans who shape policies and guide opinions affecting the development objectives with which USAID is most directly concerned.

In securing these relationships and carrying out successful policy dialogue, continuity of development assistance has proven to be extremely important in the past and is expected to be even more so in the future. For example, USAID is consulted often and has frequent opportunities to express views on policies affecting population/family planning/health issues, even for activities in which the Mission is not directly involved. The same is true in agriculture where significant policy issues have been addressed in agricultural research and the fertilizer sub-sector. The latter, for example, includes elimination of monopoly marketing of fertilizer, complete decontrol of fertilizer prices, and substantial movement toward private sector markets. Despite the modest level of assistance given for macroeconomic policy reform, the Mission's views are frequently sought because the GOK has come to value USAID opinions on such key issues as export promotion, tax reform, and budget deficit reduction. A higher level of confidence, credibility and influence is now being developed with regard to private investment policies and to agricultural pricing and marketing issues.

Every ongoing and planned USAID activity has policy elements and, in an increasing number of activities during the CDSS period, a large and increasing proportion of USAID financial resources will be disbursed on the basis of performance against an agreed upon series of benchmarks designed to achieve and sustain policy objectives.

b. Institutional Strengthening, Technical Assistance, Training

In beginning to design non-project assistance activities several years ago, USAID believed that some traditional aspects of a development assistance program — institutional strengthening, technical assistance and training, for example — might become progressively less important or less necessary. Experience has clearly shown that such is not the case. These elements play a crucial role in designing, implementing, supporting, monitoring, and sustaining programs and reforms. Without them, strategic objectives cannot be met. They will therefore continue to be important means of accomplishing objectives throughout the program and will continue to require significant amounts of financial and personnel resources.For the most part, these elements will be integral parts of the major USAID activities, but there are instances in which central themes, economies of scale, or specific technical office expertise call for coordination. Therefore, the Mission plans to continue to fund umbrella projects to be able to provide leadership training in the United States, some special in-country training activities not financed through other projects, and institutional strengthening of selected Kenyan training organizations.

c. PVO/NGO Cooperation and Donor Coordination

Time, effort and small, but important, amounts of financial resources will be provided to develop and sustain PVO/NGO and other donor cooperation in support of the strategic objectives of this CDSS and to assist them in accomplishing their own strategic development objectives. Such coordination is always important for a successful development program. As USAID resource levels decrease, it becomes even more important. PVOs/NGOs are a major development force in Kenya, working in every geographical and functional area of the country and reaching vast numbers of people.

USAID already relies on PVOs/NGOs to implement many of its activities and, occasionally, to test new ideas in development implementation. During the CDSS period, USAID plans to continue efforts to improve PVO/NGO institutional capacities and the quantity and quality of services they provide, particularly in areas directly related to USAID strategic objectives. The Mission also proposes to continue to maintain flexibility to support and strengthen NGOs working in important areas that may be outside the scope of specific USAID targets but are still supportive of strategic objectives and development goals.

The interests and contributions of other donors (see Section III) in the areas of greatest importance to USAID provide a far greater likelihood that objectives will be accomplished. In addition, closer cooperation with both PVOs/NGOs and other donors offers opportunities for USAID to influence and make a contribution to development in areas in which the Mission is not directly involved but which greatly affect the accomplishment of the goals and objectives described in Section V.B.

Monitoring, Evaluation and Reporting

Over the past several years, USAID/Kenya has played a leadership role in Africa by placing strong and continuing emphasis on improving the evaluation of program and project performance and improving the use of program performance information in planning and decision-making. In addition to the several impact evaluations the Mission has carried out, this emphasis on evaluation has included numerous discussions and planning sessions to define goals, objectives, targets and performance indicators and to develop systems for measuring them. It has involved a major evaluation workshop attended by a large number of USAID staff, two Mission-wide retreats and several smaller office-specific retreats, a decision by AID/W and the Mission to make USAID/Kenya a Program Management and Evaluation Pilot site, and a September/October 1989 in-depth review and system planning exercise directed by a five-person team of evaluation experts.

That team concluded that USAID/Kenya "represents one of the most successful examples of the DFA Action Plan in practical application" and has made good progress in positioning itself and its programs to develop and use performance information. The challenge now is to actually do so. As basic criteria for its overall evaluation and monitoring system, USAID will:

— Incorporate program performance information into existing reporting, review, and decision-making systems.

— Only collect performance information that is likely to be used and only collect it when the costs of data collection and analysis are exceeded by the expected benefits. Keep Program Performance Evaluation as simple as possible.

— Use existing information sources as much as possible.

— Use project mechanisms to collect and analyze most additional program performance information. Annex F describes in much greater detail, including suggested indicators by objective, a USAID/Kenya plan for improving the collection and use of program performance data. There have been a number of refinements, deletions and additions since the plan was prepared in October 1989, but it forms the foundation for Mission monitoring, evaluation, and reporting.

C. Management Implications

USAID proposes to address the same objectives and implement essentially the same basic strategy outlined in Section V if the level of financial resources is no more than 20 percent higher or lower than the $30 - $35 million DFA/ESF plus $10 - $15 million PL 480 assumed in developing this CDSS and Action Plan. The same is true if personnel resources are marginally higher or lower than the level of 18 U.S. Direct Hire staff assumed at the end of FY 1995. If financial and personnel resources are less than 20 percent lower, however, targets and objectives would take appreciably longer to accomplish.

If dollar amounts are more than 20 percent lower than the base levels cited above, USAID would simultaneously consider cutting such inter-sectoral support activities as the umbrella training and PVO programs and discrete activities within the major focus areas. The latter would imply developing less ambitious targets to meet objectives outlined in Section V.

Carrying out the strategy will require heavy reliance on an ability to recruit and retain a very high quality Foreign Service National staff, both contract and direct hire. USAID is extremely pleased with the caliber of its FSN staff at present and FSNs are directly involved in all aspects of program planning, implementation, evaluation, financial management, and administration throughout the Mission. Recent salary adjustments in Kenya have greatly improved the salary scale USAID is able to offer and we believe that salaries are now competitive with those given by government, the private sector, and other donors.

USAID will continue to look to both program and OE-funded USDH personal services contractors to fill major direct hire gaps, particularly in implementation. A greatly improved monitoring, evaluation and reporting system is expected to play an important role in decision-making and in directing priorities. Implementing the strategy with reduced personnel levels will also require that A.I.D./Washington make special arrangements to eliminate and/or to fund and manage some of the extraordinary requirements that currently fall to USAID/Kenya. For example, USAID provides administrative, contract management, office and residential support and other services to three regional A.I.D. offices located in Nairobi. In addition, exceptionally large amounts of staff time are consumed in hosting conferences and meeting with large numbers of official and non-official visitors who come to Nairobi. These responsibilities must be reduced to allow greater concentration of staff efforts on high priority actions that directly assist in meeting strategic objectives.

As USDH staff numbers decrease during the CDSS period, the organization will be restructured to make optimal use of personnel resources and eliminate office redundancies. A number of different configurations are possible but no alternative organizational structure is proposed in this document because that prerogative should be reserved for the new Mission Director, who is expected to arrive in Kenya in mid-1990.

LIST OF ABBREVIATIONS AND ACRONYMS

A.I.D..............Agency for International Development
AfDB...............African Development Bank
ADF................African Development Fund
AEPRP..............African Economic Policy Reform Program
AIDS...............Acquired Immunodeficiency Syndrome
ASAL...............arid and semi-arid lands
CBS................Community Based Services
CDSS...............Country Development Strategy Statement
CHAK...............Christian Health Association of Kenya
CRSP...............Collaborative Research Support Program
CYP................Couple years of protection
DFA................Development Fund for Africa
DHS................Demographic and Health Survey
EEC................European Economic Community
EPZ................Export Processing Zone
ESAF...............Enhanced Structural Adjustment Facility
FFP................Food for Peace
FY.................Fiscal Year
GDP................Gross Domestic Product
GOK................Government of Kenya
ICOR...............incremental capital-output ratio
IEC................International Executive Corps
IFAD...............International Fund for Agricultural Development
ILO................International Labor Organization
IMF................International Monetary Fund
JSI................John Snow, Inc.
KAM................Kenya Association of Manufacturers
KANU...............Kenya African National Union
KARI...............Kenya Agricultural Research Institute
KDHS...............Kenya Demographic and Health Survey
KMAP...............Kenya Management Assistance Programme
KWS................Kenya Wildlife Services
MOA................Ministry of Agriculture
MOH................Ministry of Health

NCPB...............National Cereals and Produce Board
NCPD...............National Council for Population & Development
NGO................Non-governmental Organizations
ODA................Overseas Development Assistance
ORT................Oral Rehydration Therapy
PVO................Private Voluntary Organization
RHUDO..............Regional Housing and Urban Development Office
SIDA...............Swedish International Development Agency
UNDP...............United Nations Development Program
UNFPA..............United Nations Fund for Population Activities
UNIDO..............United Nations Industrial Development Organization
USAID..............United States Agency for International Development
VSC................Voluntary Surgical Contraception