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PAAD

DEPARTMENT OF STATE
AGENCY FOR
INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. 615-K-604
615-0228 AFR/PD/EAP (East Africa)

2. COUNTRY
REPUBLIC OF KENYA

3. CATEGORY
Commodity Financing - Standard Procedure

4. DATE
September 24, 1982

OFFICIAL PROJECT DOCUMENT

5. TO:
Allison B. Herrick
Director, USAID/Kenya

6. OYB CHANGE NO.

7. FROM:
David Lundberg
Ag. Chief, USAID/Kenya

8. OYB INCREASE
$4,400,000
TO BE TAKEN FROM:
ARDN Funds FY 1982

9. APPROVAL REQUESTED FOR COMMITMENT OF:
$ 4,400,000

10. APPROPRIATION - ALLOTMENT 72-1121021.3
Allot:243-61-615-00-59-21

11. TYPE FUNDING
☐ LOAN ☒ GRANT

12. LOCAL CURRENCY ARRANGEMENT
☐ INFORMAL ☒ FORMAL ☐ NONE

13. ESTIMATED DELIVERY PERIOD
Nov,1982-Feb,1983

14. TRANSACTION ELIGIBILITY DATE
September 30, 1982

15. COMMODITIES FINANCED
Manufactured Fertilizer

16. PERMITTED SOURCE
U.S. only: $4,400,000
Limited F.W.:
Free World:
Cash:

17. ESTIMATED SOURCE
U.S.: $4,400,000
Industrialized Countries:
Local:
Other:

18. SUMMARY DESCRIPTION

The 1982 Agriculture Sector Grant will provide assistance to the Government of Kenya for basic balance of payments and budgetary support while financing imports of required agricultural inputs (fertilizer). Local Currency generations will be deposited in a Special Account from which disbursements will be made for jointly agreed activities in support of agricultural production and rural development.

19. CLEARANCES

		DATE
AGR:TWorrick	TJW	9/27/82
PROG:RGreene	RG	9/28/82
PRJ:SShah		9/29/82
PROG:WLefes		9/28/82
RLA:PScott	PMS	9/28/82
D/DIR:CECostello		
REMC:RCHCNRICH	RCH	9/30/82

20. ACTION
☒ APPROVED ☐ DISAPPROVED

Allison B Herrick 30 Sept 1982
AUTHORIZED SIGNATURE DATE

Allison B. Herrick
Director, USAID/Kenya
TITLE

CLASSIFICATION:

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KENYA AGRICULTURE SECTOR GRANT PROJECT 615-0228

I. SUMMARY AND RECOMMENDATIONS

A. Problem:

As early as 1979 foreign exchange shortages had emerged as a key constraint limiting Kenya's growth and restricting the Kenyan Government's ability to implement its development program and structural economic reforms. Strict measures to control balance of payment deficits also resulted in reduced use of industrial capacity and shortfalls in tax revenues which impacted most heavily upon the development budget. The Government's ability to implement its long range policies in both the industrial and agricultural sectors was therefore limited. Basic structural changes in both sectors are essential to achievement of long range improvements in the foreign exchange and budgetary situations and for creation of the basis for sound long-term growth. Kenya's overall balance of payments deficit rose from $194 million in 1980 to a level of $302 million in 1981. Previous estimates of a $300 million deficit in 1982 have risen to $400 million as a direct result of the attempted August 1, 1982 coup d'etat and the attendant looting and property destruction.

A major contributing factor to the balance of payments problem between 1979 and 1981 was the shortfall in food production and the import of large quantities of maize, wheat and rice. Kenya had been largely self sufficient in food until late 1979 but had to import more than 800,000MT in 1980/81. Kenya has regained basic self-sufficiency in cereal production through a combination of incentive policies, improved weather and donor support in the provision of agriculture inputs. Foreign exchange shortages continue to threaten the agriculture sector with a lack of inputs, particularly fertilizer for the 1983 season.

B. U.S. Response

The U.S. response to the Kenyan need for program assistance consists of a $15.0 million PL480 Title I credit, a $10.0 million cash grant from ESF funds and the proposed $4.4 million Agriculture Sector grant.

USAID/Kenya is recommending authorization of a $4.4 million dollar grant from Agriculture, Rural Development and Nutrition funds to be obligated in FY 1982. Local currencies will be generated under the program grant through importation of fertilizer into Kenya. Fertilizer is the commodity identified for this program assistance for the following

reasons: (1) it will have direct effect on sustaining agriculture production; (2) it has potential benefit for smallholders; (3) it is easily procured in the U.S. and distributed in Kenya; and (4) there will otherwise be a substantial shortfall in donor-supplied fertilizer imports.

The proposed $4,400,000 U.S. grant will permit import of approximately 17,000 metric tons of fertilizer, depending on prices at the time of tender. Local currency generations from sales of fertilizer will be deposited in a Special Account in the Central Bank of Kenya. Disbursements from this account will be made for jointly agreed activities in support of programs to increase agricultural production, rural employment and incomes.

C. Recommendations

USAID/Kenya recommends that a four million four hundred thousand dollars ($4,400,000) grant from Agriculture, Rural Development and Nutrition funds be authorized to the Government of the Republic of Kenya for financing the importation of selected commodities, subject to the following provisions:

- Procurement will be restricted to A.I.D. Geographic Code 000

- Such other terms and conditions as A.I.D. may deem advisable.

D. Environmental Analysis

In accordance with AID Regulation 16, it has been determined that a negative determination is appropriate regarding the environmental impact of this grant.

E. Project Preparation

T. Worrick Agriculture Economist, USAID/Kenya
R. Greene, Economist, USAID/Kenya
J. Wilheim Chief, AFR/DR/PPEEA
S. Shah, Chief, Projects Division, USAID/Kenya
W. Lefes, Program Officer, USAID/Kenya
P. Scott, RLA, REDSO/EA

II. Economic Trends and Prospects

A. Background

By 1979 foreign exchange shortages and budgetary imbalances had emerged as key constraints limiting Kenya's growth to unacceptable levels and restricting Government's ability to carry out its development program and structural economic reforms. During 1979-81 foreign exchange and budgetary constraints acted interdependently to lower the growth rate of the Kenyan economy. Strict measures to control balance of payments deficits also resulted in reduced use of industrial capacity and shortfalls in tax revenues. Reductions in revenue were felt most heavily in the development budget. The Government's ability to implement its long-range policies in both the industrial and agricultural sectors was therefore limited. Basic structural changes in both sectors are essential to achievement of long-range improvements in the foreign exchange and budgetary situations and for creation of the basis for sound long-term growth.

At the Consultative Group meetings of 1979 and 1981, the Government of Kenya asked donors to put increased emphasis on program assistance relative to project assistance. Kenya made it clear that a difficult balance of payments position a growing development assistance pipeline, and a need to control the growth of recurrent expenditure all support the need for program assistance in the short-term. Kenya's requests drew an initial response in 1980 in the form of a World Bank/IDA Structural Adjustment Credit equivalent to $55 million, combined with an EEC Special Action Credit equivalent to $15 million. Agreement was reached in July 1982 on a second World Bank Structural Adjustment at a proposed level of 124 million SDR's ($135 million) with emphasis on the agricultural sector. The International Monetrary Fund (IMF) also provided program assistance. A two-year Stand-By Credit equivalent to $273 million was approved in October 1980, but only $102 million had been drawn by August 1981 when the credit was suspended. Difficult negotiations for a replacement Stand-By totaling 152 million Special Drawing Rights (SDR), equivalent to $165 million, continued through December 1981 and the Arrangement became effective on January 8, 1982. Other donors who have responded to the request for a shift to increased program assistance include the United States, the United Kingdom, the Netherlands, West Germany, Japan, Norway and OPEC.

B) Macro-Economic Trends

Despite a continued high level of commitment to development, Kenya has faced increasing diffuculty in matching the rapid progress experienced during the first ten years after Independence in 1963. From 1964 to 1973 real Gross Domestic Product (GDP) grew at an average rate of 6.6 percent per year, and per capita GDP rose at an average rate of nearly 3 percent. More recent developments are less promising reflecting both internal problems and Kenya's vulnerability to external events: the collapse of the East African Community in 1977, the end of the coffee boom in 1978, international recessions (1974/75, 1979/80); continuing increases in petroleum and other import prices (especially 1974, 1975, 1979, 1980), and periodic drought (1974/75, 1979/80).

GDP growth during the period 1974-81 has averaged only 4.8 percent annually, and the rate for 1982 has been estimated to be under 5 percent. Per capita GDP at market prices stood at $393 in 1981 based on a realistic mid-year population estimate of 17.0 million. The level for 1982 would be somewhat higher if calculated at the 1981 exchange rate. However, the Kenya shilling was devalued against the SDR on two occasions in 1981 for a cumulative adjustment of 23.7 percent. When the average exchange rate of the shilling for 1982 as calculated by the IMF is applied to final GDP data for the year, estimates of Kenya's per capita GDP may be reduced by as much as 20 percent. Government and donor analysts agree that Kenya will be unable to meet the original economic targets of the 1979-83 Development Plan. According to recent Government estimates, growth rates (which were to have averaged 6.3 percent year over the 1979-1983 Plan period) have been revised downward to an average 4.3 percent per year. Moreover, even if the country's terms of trade halt their recent decline, the growth rate of real resources over the period will average only 2.2 percent annually, well below the 4 percent rate of population increase. On average, people will be less well off in Kenya in 1983 than in 1978. (See Table 1.)

Table 1

Annual Rates of Growth of GDP
(at Factor Cost) 1979-83

	1979	1980	1981	1982	1983	1979-83 Average
Development Plan	4.5	7.0	6.5	6.7	6.9	6.3
Sessional Paper No. 4 of 1981	3.5	5.8	5.9	5.9	6.0	5.4
GOK: June 1982	4.2	3.0	4.8	4.5	4.8	4.3
Per Capita GDP Growth	0.2	-1.0	0.8	0.5	0.8	0.3
(Adjusted for Terms of Trade)	(-2.9)	(-3.4)	(-4.0)	(0.5)	(0.8)	(-1.8)

Nearly every major sector of the economy has shared in the general slowdown of activity since the early 1970's. Some sectors have performed better than others, however, and the economy has undergone a slow but steady structural transformation.

The manufacturing sector in Kenya has performed consistently better than the economy as a whole, growing at an average rate of 8.4 percent per year in the first decade of independence and at a slower but still impressive rate of 6.4 percent since 1974. However, despite its rapid growth the manufacturing sector remains relatively small accounting for 14 percent of wage employment and 13.3 percent of GDP in 1981. Nearly 80 percent of GDP in manufacturing is accounted for by private sector activity and the remainder by majority-owned government corporations or parastatal organizations.

Since Independence, Kenya has fostered the growth of its manufacturing sector primarily by means of a policy of import substitution based on quantitative trade controls and foreign exchange restrictions. Relatively capital-intensive manufacturing has been encouraged and protected. Industry operates with heavy dependence on imported inputs and is therefore vulnerable to limitations on availability of foreign exchange. Most of the easy investments of the import-substitution variety have already been made. High levels of protection, including an overvalued exchange rate, have in the

past resulted in an anti-export bias reducing the availability of foreign exchange. At the same time, the net contribution to foreign exchange savings of many past investments is open to question. The capital-intensive nature of many import-substitution industries has contributed to the relatively slow growth of industrial employment while the poor quality and high prices of many manufactured goods represent an implicit tax on the agricultural sector.

The growth of the agricultural sector has declined from an average annual rate of 4.7 percent during 1964-73 to 3.9 percent during 1974-81. Despite a rate of growth since independence below that of the general economy, the agricultural sector still provides Kenya with 34 percent of inputs into manufacturing, 67 percent of non-petroleum exports and approximately 65 percent of total employment. Agriculture remains overwhelmingly in private hands with 99 percent of total output accounted for by the private sector. Kenya's agriculture is characterized by a wide variety of production systems reflecting different ecological zones, population densities and land holding patterns. Farms of twenty hectares or more cover 3.7 million hectares or just over half of Kenya'srecorded farmland. Included in this total are 2.7 million hectares of so-called "large farms" in the former scheduled areas once reserved for European settlers and 1.0 million hectares of "gap farms" (i.e. farms outside the scheduled areas but too large to be included in the Integrated Rural Survey of small farms). During most of the 1970's, large farms and gap farms together provided approximately 25 percent of the value-added in agriculture and 45 percent of recorded marketed production. When coffee and tea prices were at their highest in 977, large and gap farms increased their share of agricultural value-added to just over one-third of the total. Kenya's large ranches and open grazing lands in pastoral areas provided an additional 2 percent of agricultural value-added on average during the 1970's. The small farm, however, remains the dominant mode of agricultural production in Kenya accounting for 49 percent of recorded farmland, 55 percent of marketed production, 70 percent of value-added in agriculture, and more than 80 percent of agricultural employment.

Problems in Kenya's key agricultural sector were outlined in Kenya's National Food Policy Paper published early in 1981. Producer prices in the past have been inadequate (maize, beef and milk prices in particular), credit services inefficient (late disbursements, unsatisfactory collection programs), and provision of input supplies inadequate and untimely. Marketing services have been poor with parastatal

bodies and cooperatives taking an increasing share of sale proceeds at the expense of the producer. Recently, the Government of Kenya has introduced large increases in producer prices on a number of important agricultural products including maize (44 percent), wheat (21 percent), rice (53 percent), sugar (13 percent), beef (20 percent to 30 percent), and milk (16 percent). Kenya's program of structural adjustment is now being extended to the agricultural sector under the new $135 million agreement with the World Bank. The Bank, USAID and other donors are continuing to discuss necessary actions with the Kenyan Government relating to agricultural pricing, marketing, storage, credit, and financial planning and management. Donor support at the current stage of Kenya's agricultural development will be important both to help finance the costs implicit in implementing some key policy measures, as well as to lend support to policy-makers faced with difficult economic and political decisions during a time of increasingly scarce resources.

C) Public Sector and Budget

The contribution of the public sector to total output has grown only marginally since Independence from 24 percent of GDP in 1964 to 27 percent in 1981. During the same period, Government's share of wage employment rose from 31 percent to 47 percent of the total, and the Government budget rose from 20 percent of GDP to 37 percent. The development account has generally maintained its share of the rapidly increasing budget levels. Although the exact percentage has varied from year to year, the development budget in 1981 accounted for 29 percent of total expenditures, the same level as in 1964. Although an expansion of development spending may have seemed desirable, it is now apparent that the number of donor initiatives has exceeded the Government's ability to manage projects. The requirement to match development expenditures with additional expenditures in the recurrent budget, especially for managerial and administrative personnel, is so great that project implementation has been damaged - seriously in some cases.

The share of Central Government expenditures covered by deficit financing has never exceeded the 27 percent recorded in the first year of Independence. By 1969, this deficit had been reduced to 19 percent. Since then the deficit has generally averaged over 20 percent with a level of 20.4 percent in 1979/80 and a peak level of 24.4 percent in 1980/81, the

first year of the structural adjustment. The preliminary data contained in the June 1982 Budget Speech suggest a reduction in the deficit for 1981/82 to less than 22 percent. The deficit for 1982/83 is currently budgeted at just under 17 percent. Such an improvement will require significant additional effort and will be difficult to obtain.

The peak deficit of 1980/81 (10.6 percent of GDP) far exceeded the level foreseen under the IMF program of that year (6.0 percent of GDP). (See Table 2.) Budget deficit levels (like balance of payments targets), are not themselves IMF performance criteria but failure to achieve program objectives often results in a co-ordinate failure to meet quantitative performance criteria with regard to total domestic bank credit, net bank credit to Government, and new external borrowing contracted or guaranteed by Government.

Government's first attempt to prepare a forward budget for 1980/81-82/83 as part of its Structural Adjustment program was not completed satisfactorily. This was due in part to a reorganization of Government and in part to a deterioration in the external terms of trade which caused the macroeconomic planning frame to become rapidly outdated.

During 1980/81 budget deficit targets were exceeded entirely because of a sharp increase in expenditures. Revenue in fact, increased from 30 percent of GDP in 1979/80 to 31.5 percent in 1980/81. Expenditures increased for a variety of reasons including: supplementary allocations to finance Government wage increases of 23-30 percent; increased costs for defense and internal security; accelerated development expenditures; and the chronic breakdown of fiscal controls which results in a large volume of unauthorized and extra budgetary expenditure.

Expansion of the budget deficit prevented Kenya from meeting the IMF ceiling on net bank credit to Government at the end of June 1981, though previous ceilings had been observed. Net bank credit to Government as of June 30, 1981 stood at some 4.9 billion Kenya shillings versus an agreed performance criterion level of 3.7 billion shillings. Compliance with the performance criterion for total net domestic bank credit was narrowly missed as well (17.7 billion shillings actual, versus 17.5 billion shillings agreed upon). The ceiling on new external government borrowing which had been set at $600 million was not exceeded. Given Government's inability to comply sufficiently with agreed upon criteria, drawings under the Stand-By were suspended in August 1981 after the equivalent of $102 million of the total Stand-By credit of $273 million had been drawn.

Protracted negotiations between the IMF and Government continued through December 1981, and a replacement Stand-By Arrangement was approved by the Executive Board of the IMF on January 8, 1982. The Arrangement provides Kenya with the right to draw up to 151.5 million SDR's ($165.8 million) in four tranches through November 1982 upon compliance with certain performance criteria to be periodically reviewed. Import, exchange rate, and interest rate criteria are discussed separately in the section on Government policy reforms below. With regard specifically to budget and fiscal policy the main program objective was a reduction in the Central Government deficit from 10.6 percent of GDP in the fiscal year ending June 30, 1981 to 7.5 percent of GDP in fiscal year 1981/82. Based on preliminary data for 1981/82 contained in the June 1982 Budget Speech, Kenya may have achieved its desired program target especially if estimates of GDP growth rates approaching 5 percent are confirmed when final data are available*. Unless data on the overall budget deficit are significantly revised, or estimates of the GDP growth rate last year prove highly inaccurate, Kenya is unlikely to have approached anything like the budget disaster of 1980/81 during fiscal year 1981/82.

Kenya met its performance criteria ceilings for January 1982 by narrow margins and was able to proceed with the first two scheduled drawings under the new Stand-By (90 million SDR's by June 1982). By January 1982 total domestic bank credit stood at 98.8 percent of the agreed ceiling, and net bank credit to Govenment was at 87.1 percent of the agreed level. New external borrowing contracted or guaranteed by Government (1-12 years maturity) stood at $145 milion as against a ceiling of $160 million. Government was able to meet its targets in part due to extraordinary budget practices (delayed payment of January salaries to some Government workers; non-payment of suppliers credits). Supplementary tax measures voted in April 1982, and severe restrictions on expenditures in the final quarter of the fiscal year, were undertaken to assist in meeting the June targets. A continued shift toward utilization of non-bank financial intermediaries to fund the debt of the Central Government has assisted in meeting bank credit ceilings as well. Although utilization of

* IMF might question GOK's computations for GDP.

such non-bank intermediaries should expand in line with their overall growth, it will become increasingly necessary to take such a shift into account in setting bank credit ceilings in the future in order to avoid over expansion in the money supply. As of the first week of September 1982, Kenya had not drawn the third tranche of the current Stand-By, the IMF assessment of Kenya's performance for the period ending June 30 was incomplete and the final November 1982 drawdown was uncertain. USAID's current assessment is that Kenya will meet or come close to its targets as agreed.

Table 2

Kenya: Central Government Finance, 1978/79-1981/82

	1979/80	1980/81 Program Outturn	1980/81 Estimated	1981/82 Budget	1981/82 Program	1981/82 Projected Outturn
	(In millions of Kenya Shillings)					
Total revenue and grants	12,193	14,411	14,892	16,244	16,832	16,403
Recurrent revenue	11,884	13,819	14,234	15,610	16,054	15,861
Foreign Grants	309	592	658	634	778	542
Total expenditure	15,543	16,779	19,618	19,106	20,784	20,575
Recurrent expenditure	10,684	11,692	12,940	13,468	14,220	14,230
Development expenditure	4,859	5,087	6,254	5,638	6,164	6,345 1/
Suspense and other 2/	--	--	424	--	400	--
Adjustment (- expenditure) 3/	179	--	62	--	--	--
Overall deficit (-)	-3,171	-2,368	- 4,788	- 2,862	- 3,952	- 4,172
Financing	3,171	2,368	4,788	2,862	3,952	4,172
Foreign (net)	2,198	1,278	2,202	2,026	2,798	1,667
Gross borrowing	(2,602)	(1,875)	(3,144)	(3,160)	(4,082)	(2,963)
Repayments	(-404)	(-597)	(-942)	(-1,134)	(-1,284)	- 1,296)
Domestic (net)	973	1,090	2,586	836	1,154	2,505
Nonbank (net)	(811)	(412)	(1,026)	(782)	(800)	(1,476)
Bank and CSFC	(162)	(678)	(1,560)	(54)	(354)	(1,029)
Bank, CSFC, and Eurocurrency financing	906	678 to 1,000	2,294	54	1,413	2,053
Of which: Eurocurrency financing	744	...	735	--	1,059	1,024
			(In percent of GDP)			
Memorandum items:						
Reccurent revenue	30.1	30.4	31.5	30.2	30.6	29.7
Of Which: tax revenue	(26.1)	(26.5)	(26.7)	(26.1)	...	(...)
Total expenditure	39.3	36.9	43.4	36.9	39.6	38.5
Overall deficit	8.0	6.0	10.6	5.5	7.5	7.8
Bank, CSFC, and Eurocurrency financing	2.3	2.2	5.0	0.1	2.7	3.8

Sources: IMF. Economic Survey, 1981; The Appropriation Accounts; Other Public Accounts and the Accounts of the Funds, 1979/80; Financial Statement, 1981/82; and data provided by the Kenyan authorities.

1/ Includes a KSh 400 million loan to Cereals and Sugar Finance Corporation.

2/ For 1980/81 represents expenditure incurred against deposit accounts: for 1981/82 represents a provision for unpaid vouchers from 1980/81.

3/ Reflects the fact that budget is not strictly on a cash basis.

D) External Trade and Balance of Payments

The external sector has become increasingly important to Kenya since Independence. The value of imported goods and services rose from 29 percent of GDP in 1964 to as much as 40 percent in 1980. The level for 1981 is estimated at 35 percent despite substantial restrictions on import licensing. Imported inputs have become important to the growth of Kenyan industry and to a lesser extent of commercial agriculture. Machinery and transport equipment accounted for 26 percent of the value of goods imported in 1981, while industrial supplies represented 25 percent, fuels 39 percent, (two-fifths for re-export), food and beverages 5 percent, and other consumer goods only 5 percent. Kenya's Social Accounting Matrix for 1976 shows that in the overall economy 35 percent of primary and intermediate inputs were accounted for by imports. In the manufacturing sector, imports accounted for 33 percent of gross output. By comparison 3 percent of gross output in agriculture was directly accounted for by imports.

Exports of goods and services have not kept pace with the rapid growth of imports in Kenya. The value of exports has fallen from more than 33 percent of GDP in both 1964 and 1974, to 28 percent in 1980, and to an estimated 26 percent in 1981. The volume of Kenya's worldwide exports was only 12 percent higher in 1981 than in 1972, the year when Kenya's program of industrial protection and import substitution began in earnest. Given a decrease of 35 percent in the external terms of trade, the purchasing power of Kenya's exports was 27 percent lower in 1981 than in 1972. By 1981, the volume of Kenya's manufactured exports had fallen to 70 percent of its 1972 level. Such decreases occurred despite (or perhaps because of) an increase in the price index of Kenya's manufactured exports by about 350 percent during the same 9-year period.

Kenya has attempted to develop new export markets in the Middle East, but little tangible evidence of success can be noted and no major breakthroughs are expected. The 1977 closing of the Tanzanian border resulted in a major market loss for Kenya. Exports to Tanzania fell from 10 percent of total exports in 1976 to 1 percent in 1980 and 1981. The Ugandan export market similarly dropped from 10 percent of total exports in 1976 to 1 percent in 1979. The Ugandan market rebounded to 13 percent of the total in 1980, but fell again in 1981 to only 8 percent, indicating that prospects remain uncertain.

In contrast with the above trends, real GDP has grown by more than 4 percent annually since 1972. The failure of the export sector to expand or diversify has implied increasing relative shortages of imports as overall GDP continues to rise. The current account deficit rose from 3 percent of GDP in 1972 to 13 percent of GDP in 1980, although this was reduced to an estimated 10 percent in 1981. In absolute terms, Kenya's current account deficit (expressed in U.S. dollars) peaked in calendar year 1980 at a level of $873 million. (See Table 3A.) Provisional Government data of September 1982 indicate a reduction in the current account deficit for 1981 to a level of $693 million. The current account deficit for 1982 is now estimated by Government to be on the order of $677 million. As indicated by a comparison between Tables 3A and 3B, Government's current estimation of the 1982 current account deficit now falls $17 million above the level previously projected by the World Bank, and nearly $246 million above the level once projected under the IMF Stand-By program.

Table 3A

Kenya: GOK Balance of Payments Projections, 1979-1984
(Millions of U.S. dollars)[a]

	1979 Actual	1980 Actual	1981 Provis.	1982 Est.	1983 Proj.	1984 Proj.	
Exports	1031	1238	1067	1111	1252	1380	Exports
Imports	-1832	-2624	-2200	-2180	-2224	-2375	Imports
Trade Balance	- 801	-1386	-1133	-1069	972	- 995	Trade Balance
Non-Factor Services, Net	422	513	540	537	688	779	Non-Factor Services, Net
Resource Balance	- 379	- 873	- 592	- 532	- 284	- 216	Resource Balance
Factor Services, Net	- 211	- 156	189	- 226	- 252	- 289	Factor Services, Net
Transfers, Net	91	139	89	804	88	98	Transfers, Net
Current Account Balance	- 498	- 889	- 693	- 677	- 448	- 408	Current Account Balance
Private Long Term Cap., Net[b]	207	191	139	121	146	137	Private Long Term Cap., Net [b]
Public Long Term Cap., Net	300	387	164	135	126	126	Public Long Term Cap., Net
Other Capital [c]	180	118	87	14	36	42	Other Public Capital [c]
Capital Account Balance	687	696	391	270	308	304	Capital Account Balance
Overall Balance	189	- 194	- 302	- 407	- 139	- 103	Overall Balance
Monetary Movements	- 189	194	302	407	139	103	Financing
Transactions with IMF, Net	- 10	147	69	212	...	...	IMF, Net
Other Changes in Assets, Liabilities	- 178	47	-	79	43	...	IBRD, Program
			)	15	...	...	Commercial Loans
			100)	152	...	...	Bilateral Program
			134	- 51	...	...	Reduction in Reserves

Sources: 1979, 1980. Economic Survey, 1982. 1981-1984. GOK: July, September 1982, (draft documents).

Notes: a/ Final digits may not add due to rounding and exchange conversion. Exchange rates: 1 KSh = $.13376 (1977); 1 KSh = $.13431 (1980); 1 KSh = $.11052 (1981); 1 KSh = $.091324 (1982 ff).

b/ Includes parastatals.

c/ Includes errors and omissions.

PROG:9/6/82

Table 3B

Kenya Balance of Payments Projections FY 1982 - 84
(Millions of U.S. dollars)[a/]

	IMF (MAY 1982)		IBRD (APRIL 1982)			
	1982 PROG	1982 PROJ	1982	1983	1984	
Export	915	909	1115	1259	1424	Exports
Imports	- 1739	-1714	-2261	-2574	-2910	Imports
Trade Balance	- 824	- 805	-1146	-1314	-1486	Trade Balance
Non-Factor Services	...	...	508	577	655	Non-Factor Services
Resource Balance	...	...	- 638	- 737	- 831	Resource Balance
Factor Services	...	...	- 191	- 209	- 237	Factor Services
Transfers	119	123	169	186	204	Transfers
Current Account Balance	- 397	- 431	- 660	- 761	- 863	Current Account Balar
Private LTC	129	114[b/]	73	80	88	Private Direct. Cap.
Public LTC	128	87	553	580	680	Public & Pub. Guar.
Othe Capital	-	-	10	56	60	Short Term Cap.
Capital Account Balance	257	201	...	...	...	
Overall Balance	- 140	- 230	...	...	...	
Financing	140	230[c/]	...	...	...	
IMF, Net	124	179	89	85	85	IMF
IBRD, Program	103	64	...	...	...	
Commercial Loans	41	- 20	...	...	...	
Required Bilateral	26	31	...	...	...	
Reduction in Reserves	- 153	- 24	- 65	- 40	- 50	Reduction in Reserves
Gross Reserves	350	221	357	397	447	
Months of Imports	2.4	1.5	1.9	1.9	1.8	

Source: IMF - Review of Standby Arrangements, May 11, 1982.

IBRD - Report - For a Second Structural Adjustment, P - 3322-KE, June 1982.

Notes: a/ Final digits may not add due to rounding and exchange conversion. Exchange rates: 11.95 KShs = 1 SDR = 1.09133 US$ (at mid-year July 1, 1982); 1 KSh = $ .091324.

b/ Includes parastatals

c/ Excludes exceptional financing included above the line in original IMF presentation.

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Despite the large improvement in Kenya's current account balance between 1980 and 1981, Kenya's overall balance of payments deficit rose from $194 million in 1980 to a level of $302 million in 1981 due to a shortfall in the capital account. Net private long-term capital inflows fell by more than $50 million between the two years. More importantly, net public long-term capital flows decreased by nearly $225 million, and net short-term flows fell by more than $30 million. For 1982 the Government of Kenya had projected a modest reduction in the overall balance of payments deficit with larger improvements for 1983 and beyond as the structural adjustment began to take effect. Following the recent coup attempt, however, Government's estimate is that the overall balance of payments deficit for 1982 will be $407 million rather than the $287 million that was orginally projected (see Table 3A). Embassy and USAID estimates are in the same range. Government's past projections for improvements in 1983 and beyond are now rendered very uncertain as well. Additional analysis of the balance of payments and subsequent coordination with donors will be called for.

Kenya's immediate requirement (before the end of calendar 1982) is to find additional financing for about KSh. 1,100 (approximately $100 million) to cover the negative impact of the August coup attempt on the overall balance of payments. The increased need due to the coup attempt is estimated as follows:

A) Imports - Assume a total import coefficient of 25 percent on the estimated KSh. 1.2 billion losses during the rioting on August 1 (a generous estimate since many of the looted items consisted of foodstuffs, clothing, jewelry, shoes, etc., which were locally made). Even high-cost items such as television sets are often locally assembled and contain locally made components. Total increase in import bill: KShs 300 million.

B) Tourism Earnings. Assume a small shortfall in tourism of up to 25 percent during August and a decline in earnings of fully one-half in the fourth quarter. Local tour operators, hotel managers and airline executives can provide no better estimate, but most would hold that an estimated total shortfall of KSh 300 million is probably high.

C) Capital Flight. There obviously is no single line item to which illegal capital movement can be attributed. Yet there is little doubt that many entrepreneurs and individuals will attempt to move liquid assets abroad. Most such transfers take place via under-invoicing of exports and over-invoicing of imports, and through collection of tourism receipts abroad which are not remitted. However, tourism will not present much opportunity for increased outflow in 1982. Neither do many opportunities exist in the export sector which tends to be dominated by big ticket items such as petroleum, coffee, tea, pineapples, etc. Assuming that Kenya's imports already are fully 10 percent over-invoiced by importers attempting to circumvent exchange controls and avoid the overvalued shilling, a maximum of an additional five percent of the value of imports could be removed from the country during the five months of 1982 following the coup attempt. At current values, that total would come to approximately KSh 500 million.

Estimates of a total overall deficit by the Government, Embassy and USAID are all tentative, and are based on very flexible interpretations of the effects of the August events. Resulting estimates are similar. Addition of our estimate of the effect of recent events, to the overall deficit forecast by Government before the coup attempt produces a total overall deficit to be financed of some KSh 4.2 billion ($395 million), as compared with the $400 million suggested in President Moi's letter to President Reagan. Although estimates of the coup effect encompass considerable margin for error in regard to total imports (especially potential Government imports), analysts are agreed on a reasonable working number. Additional financing of about $100 million must be found from bilateral donors, commercial borrowing abroad, or a further reduction in already limited reserves if the required financing of some $400 millions is to be achieved. The Government could finance approximately $50 million by foregoing an anticipated improvement in gross reserves of KSh 562 million. It is more likely, however, that the Central Bank of Kenya would restrict imports more severely since Central Bank officials become extremely nervous when reserves account for barely five weeks' worth of imports. Additional problems would therefore arise. The official anticipated growth rate of imports in 1982 is approximately 22 percent and the unweighted average increase in

prices is about the same. A volume increase in imports of zero would not be consistent with Government's projected growth of real GDP of almost five percent. Given the pressure which the Central Bank is exerting on imports, therefore, it is likely that economic activity which is already being severely restricted in 1982 is in serious danger of being similarly constricted in 1983 as well.

The high level of current account deficits since 1978 has necessitated a major increase in external borrowing resulting in a sharp rise in the debt service level. External debt outstanding and disbursed rose from $701 million at the end of 1977 to $1,744 million at the end of 1980; an increasing portion was contracted on relatively hard commercial terms. (See Table 4.) The debt service ratio has risen from 4.8 percent of exports of goods and services in 1977, to 9.2 percent in 1980. Projected ratios for 1981 and 1982 are 12.2 percent and 14.9 percent respectively. The ratio is expected to continue to rise to a peak of 22 percent by the early 1990s, even assuming a considerable growth in external assistance levels.

Table 4

Kenya: External Debt and Debt Service 1977-1995
(Millions of U.S. Dollars)

	1977	1978	1979	1980
Undisbursed	780.7	1056.6	1252.8	1304.5
Disbursed	917.2	1083.7	1433.2	1743.8
Debt Service*	74.6	121.6	120.2	183.0
Principal	(35.0)	(69.2)	(49.6)	(78.5)
Interest	(39.6)	(52.4)	(70.6)	(104.5)
Ratio to Exports of Goods, NFS	4.8	7.9	7.6	9.2

(Projected)

	1981	1982	1986	1991	1995
Undisbursed	1383.7	1323.0	1584.2	2518.1	3319.7
Disbursed	2336.3	2888.9	5817.3	10873.3	14359.5
Debt Service*	201.8	271.2	531.3	1193.7	1652.1
Principal	(105.8)	(136.9)	(285.4)	(671.4)	983.2
Interest	(96.0)	(134.3)	(245.9)	(522.3)	668.9
Ratio to Exports of Goods, NFS	12.2	14.9	18.1	21.9	18.3
16.9					

Note: *Includes Kenya's notional 45 percent share of EAC debt.

Source: World Bank, EAIDA, April 7, 1982.

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Although the Government has in the past shown itself willing to apply orthodox methods to reestablish balance in the external accounts, the consistent application of such methods over the next few years would not permit the external trade liberalization and internal structural changes required to achieve either long-term improvements in the balance of payments, or desirable rates of long-term growth. Additional balance of payments support from major bilateral donors will be required to supplement that already being provided by the World Bank and the IMF, especially in light of the coup attempt of August 1982 and its likely aftermath. Government now projects a requirement for program assistance from bilateral donors alone in 1982 of up to $152 million (see Table 3A). All the major bilateral donors have been approached recently including the U.S., U.K, Germany, France, Norway, Japan, Sweden, Denmark, the Netherlands, Saudi Arabia, and Kuwait. Few if any appear to be in a position to respond favorably at least in the short run at levels beyond those already programmed. In addition to the assistance being provided by the IMF and the World Bank, program assistance in the following amounts is currently budgeted during Kenya's 1982/83 fiscal year: Netherlands ($3.7 million); Japan ($3.7 million); U.K. ($900 thousand); Germany ($900 thousand); European Economic Community ($1.6 million) and the World Food Program ($5.4 million). In line with its 10 percent share of Kenya's gross official development assistance in recent years, the U.S. response to Government's request for assistance this year might logically be in the range of $15 million, a major part of which will be provided under the program proposed in this paper. Given the inability of most donors to react to Government's request in time to provide significant help this calendar year, the ability of the U.S. to respond with a contribution beyond the $15 million level would be of special significance to Government.

E. Status of Non-project U.S. Assistance

Kenya has been provided with $20.0 million in ESF for Commodity Impact Programs and $30.0 million in PL480 Title I credits in FY 1980 and 1981. These programs are fully disbursed. The PL480 Title I credit of $15.0 million in FY 1982 has also recently been disbursed.

III. POLICY OVERVIEW AND STRATEGY

Although external factors such as the price of oil, a deterioration in the terms of trade and a generally soft international marketplace have had a substantial impact upon the Kenyan economy, they cannot be viewed as the root cause of the current economic crisis. They merely contributed to it, and hastened the day of reckoning.

The combination of monetary, fiscal, foreign exchange, trade, industrial, and agricultural policies in Kenya is such that the very structure of the economy and the incentives driving it must be reordered if significant recovery and renewed dynamism are to be hoped for. While the United States agrees with the IBRD that energy and population policies are also essential components of a long-term economic strategy, those issues are beyond the scope of this exercise.

The IMF and IBRD share our view that the Kenyan economy must be restructured and reoriented and are both working with the GOK to find a solution. The Embassy and USAID Kenya believe that the efforts of the IMF and IBRD are generally well directed and that the Government has embarked upon general economic reform consistent with their efforts.

Since 1979 Kenya has reacted to the deterioration of the economy and the balance of payments in a relatively ad hoc fashion by limiting import licenses and borrowing, both external and internal. This resulted in a mounting internal debt, a rising external debt service ratio and an overvalued exchange rate. This over-valued exchange rate together with controlled interest rates encouraged imports, consumption and capital flight and discouraged exports, savings and investment. The IMF has entered into two Stand-By agreements with Kenya in an effort to remedy the problem. The objective has been to begin to redress the fiscal imbalance and correct the balance of payments deficit in the short-term. The IMF Stand-By agreements have been complemented by two IBRD Structural Adjustment Loans.

The first IMF stand-by effort was only partially successful. The GOK exceeded its budget and credit limitations and the foreign exchange reserves continued to erode.

A 23.7% devaluation 5% had already taken place before approval of the second Stand-By. The agreement included a reform and simplification of the import system, a freeze on public sector wages and hiring except for vacancies in "absolutely necessary" posts, monetary and fiscal limitations, an agreement to raise interest rates and increase credit to the private sector, and limits on external borrowing.

The IBRD structural adjustment loans facilitate a rationalization of the industrial structure and to orient it toward exports; this necessarily includes reform of the import regime. Agriculture is similarly to be restructured. Management of the budget, external debt and internal credit are also covered, as are energy and population.

A. The Import Regime and Exchange Rate

1) Foreign Exchange

Despite the two devaluations and certain reforms in the import regime, the foreign exchange position of the GOK continues to deterioriate and a black market for the currency offering premia of 40% to 100% exists. Overvaluation of the shilling brings all of the economic dislocation and disincentives associated with that condition. An estimate of the degree of overvaluation is beyond the analytical scope of this paper, but knowledgeable sources estimate the degree of overvaluation as high as 100%. While that may be excessive, it is not beyond credibility, given the relatively inelastic demand for imports in Kenya and the current rate of inflation which is in excess of 20% per annum. Although the GOK is nominally committed to keeping the exchange rate realistic, it has resorted to administrative rationing of foreign exchange and delays in payments to defend the current rate of exchange.

The dimensions of the problem are indicated by the rate of issuance of import licenses . For CY 1982, the GOK forecast a demand for KSh 23 billion and established a target of KSh 24 billion. Yet at the beginning of the calendar year licences were being issued at a rate of KSh. 32 billion. By mid-year, this had been administratively cut back to the current rate of KSh. 18 billion per annum.

Clearly, such gyrations are damaging to the economy and aggravate an already delicate situation. The absence of a clearer commitment to a realistic exchange rate structure which can accommodate the pressures of inflation and restructuring of the economy is a lamentable defect in the IMF Stand-By agreement which requires remedy in the near future if the efforts of the IBRD and the donors, to include the U.S., to support restructuring of the economy are to be fully successful.

The GOK must be encouraged to cooperate with the IMF and move expeditiously toward a freer foreign exchange and continue the transition from license rationing to tariffs as a means of limiting demand for certain goods.

But here again, the reliance on high tariffs reinforces an overvalued exchange rate. The IMF and the GOK should be strongly encouraged to view the current tariff structure as transitional and establish, as an intermediate term goal, the elimination of as many tariffs as possible. Otherwise the effort to expand and strengthen the export sector could be severely handicapped, and the structural reforms hoped for from the IBRD Structural Adjustment Loans will be impeded.

The reforms in the foreign exchange and import regimes which have been taken to date are to be applauded because they move in the right direction. But they are substantially short of the necessary goals. It will take steadfast dedication on the part of the donors and the IMF to gain and sustain the necessary momentum for genuine reform, the sine qua non of which is an exchange rate and import regime which clearly reflect international market conditions and support exports. In this regard, a resident IMF presence would clearly make a difference and the U.S. should encourage the IMF to move expenditiously to establish one.

It is important to bear in mind that recent pricing reforms in maize and wheat, as well as fertilizer, are laudable only in so far as they are now in line with world markets at the official exchange rate. However, because of the substantial overvaluation of the Kenyan shilling, there is still a de facto subsidy to consumption on these and other commodities, which continues to distort investment and production decisions, and continues to discourage exports.

External borrowing from banks deserves close monitoring. Kenya's debt-service ratios, present and projected, are still manageable provided the appropriate discipline is maintained. But the debt service levels are at the margin of acceptability. Kenya's "bankability" can be maintained, and that is a great asset. Every effort should be made to keep it.

2) Public Finance

Financing of the budget has become a progressively greater problem. The result has been a substantial "crowding out" of the private sector as government borrowed ever greater amounts, both absolutely and proportionally.

It appears now that the targets of the second Stand-By may be met, and in order to further tighten discipline, the budgets of the parastatals are to be incorporated into the overall budget. Restrictions have also been placed upon external and internal borrowing.

These accomplishments were necessary and the maintenance and enhancement of discipline to continue their enforcement is essential. But they have not been cost free. The burden of recurrent costs problem, already troublesome, has become acute as the GOK has to meet increasing demand for payroll and other non-discretionary expenditures. There have also been substantial delays in certain payments due which cannot be delayed indefinitely.

The Kenya development budget is a particular case in point. The current budget contains 440 active development projects up from 360 last year. This number refers to major projects which contain numerous sub-projects, fifty or more in some cases. Projects in Kenya in the past has been funded at 85%. An IBRD sample compiled last year indicated a 45% funding. Since then the number of projects has increased by more than 20%. Some estimate that in the current year, funding for some projects may be as low as 25%. The internal rates of return on such underfunded projects have plummeted and the viability of many is in question. It is important that the donors and the GOK reach an understanding on project priorities, both existing and planned, and adjust to the funding realities. This implies a discontinuance or delay of some projects. Donors must be prepared to accept that fact if the IMF and IBRD packages are to receive the necessary support.

The inadequacy of the resource base to sustain the level of development activity indicates the urgent requirement for the GOK and donors to place special emphasis upon the rapid expansion of the private sector in order to expand the tax base.

Similarly, an all out effort should be made by the GOK to divest itself of parastatals, thereby limiting the fiscal and administrative burdens of the government and expanding the private sector.

Implicit in the sum total of the reforms in the IMF and IBRD packages is a substantial reordering of the tax structure to assure that it supplies adquate revenues without smothering the incentives to production, particularly for export. The GOK should request technical assistance is this area as a matter of high priority, and progress should be carefully monitored.

3) Credit

The agreement of the GOK to limit public borrowing should contribute significantly to providing liquidity for the private sector. The GOK has also complied with its commitment to raise interest rates. Lending rates have been raised to 14% which at the time it was done most likely constituted a positive real rate. Now the real rate is again negative in view of the 20% plus inflation rate. There is evidence however that banks and financial institutions are charging commitment and administrative fees and are requiring compensatory balances such that an effective positive real lending rate exists. On the supply side however, there is less opportunity to effectively adjust the interest rates paid, and therefore less incentive to save than should be the case. Interest rates paid to savers appear to still be negative in real terms. A lifting of ceilings on both deposits and loans would eliminate this disincentive without raising effective lending rates. Indeed, it could lower them.

B. Agricultural Marketing

This discussion will concentrate on maize because it is the most important food crop and food staple, and because changes in the handling of this crop eventually would have significant implications for the marketing of other commodities.

The official price of maize is set by the National Cereals and Produce Board. Currently it is approximately at world market levels at the existing exchange rate. The board purchases maize at the established price -- until it runs out of money. Then purchases cease and the market must rely more heavely on private traders.

Only 20 to 25 percent of the maize produced goes through the Board. The majority of the Board's transactions are with large commercial farmers. This structure has curious results. If supplies are tight and official prices are relatively low, the Board is unable to purchase sufficient quantities to meet

demand; thus the private market price rises above the official price and the private sector meets demand (unless imports are brought in to depress the price). On the other side, if supplies are high and official prices are also "high" as they currently are, the board is unable to purchase all that is offered for sale, the surplus goes to the private market and prices drop below the official price. Exports, if allowed, then become a significant determinant of actual market prices.

The Board, as it now functions, distorts markets, invites corruption and strains GOK administrative capacity. Moreover, because it inhibits the development of a rural commercial infrastructure, it is an impediment to economic development. Moreover, the currently overvalued exchange rate discourages production and favors imports. Studies indicate that small holders could significantly increase maize output with increased fertilizer use. A real world market price based upon a realistic exchange rate would supply the additional income to purchase the additional fertilizer and still retain a larger profit. And a free market would assure that the producer gets the fertilizer and can sell maize.

C. Strategy

1) The Short Term

USAID's short term objective is to respond to the current crisis by providing immediate resources to stabilize the economic system and allow time to determine with some degree of accuracy what is further needed in terms of resources, policy change and donor assistance to reestablish Kenya's development momentum. This project provides $4.4 million for essential fertilizer imports in the last quarter of 1982 and will provide part of the requirements for the 1983 season.

The prompt ESF cash grant of $10 million underscores U.S. resolve to assist Kenya and provides the foreign exchange resources to assure a continued flow of raw materials and spare parts, and to reassure the private sector of USAID support of the GOK's efforts to assure a prompt recovery from the damage suffered on August 1. By that action we hope to encourage other donors to be similarly forthcoming.

Including this assistance the FY 82 U.S. program assistance will now be $15 million. $5 million of this total will be applied to assist that segment of the private sector which was damaged during the looting of August 1. The shillings generated will be on deposit with the Central Bank of Kenya to be available for discounting facility to commercial

banks whose customers suffered losses. The increased liquidity thus created should facilitate recovery and reassure the private sector. This mechanism carries no subsidies, it simply provides the additional liquidity needed by the private sector, and in doing so, gives the commercial banks an incentive to be more forthcoming in assisting the victims of the civil disturbance that accompanied the coup attempt.

At the same time the U.S. Mission is making a concerted effort to encourage the GOK to adopt and publish the package of export incentives which it has announced are in preparation.

2) The Intermediate Term

While recognizing that it is imperative to stabilizing the immediate economic and political situation, USAID believes that it is important to use the time afforded by a prompt and forthcoming response to the needs of the GOK to promote longer term strategies.

a) Policy Objectives Macro:

USAID believes that the general framework of the IMF Stand-By Agreements and the IBRD Structural Adjustment Loans is consistent with the U.S. policy of supporting the evolution of a market based export oriented economy.

To accomplish this, USAID will continue its discussions with other donors to assure that they are aware of our objectives and enlist their support. There is already a good pattern of informal coordination among donors upon which this can be built. Similarly, an enhanced effort will be made to continue to expand the exchange of views with the GOK. Specific points of emphasis will be:

1) USAID believes that reform of the foreign exchange system and tariff structure is essential to the success of the structural adjustment program, particularly if it is to result in increased exports. Specifically, a floating exchange rate (or similar mechanism) accompanied by a low tariff structure and issuance of import licenses on demand is the appropriate objective.

2) A review of commercial and financial laws and institutions to assure their supportiveness of the continued modernization of the private sector is an important ingredient of success.

3) USAID will encourage other donors to cooperate with the GOK in the establishment of development priorities for projects and in the implementation of those priorities both in the rationalization of the existing portfolio and in the introdution of new projects. This activity is essential to solving the burgeoning recurrent cost problem, and in assisting the GOK in its efforts to contral its budget.

b) Agriculture and the Private Sector

USAID believes that a strengthening of the private commercial sector role in the marketing of agricultural inputs and products in a free market context is essential to place the agricultural sector on a more productive and rational basis. Accordingly, USAID will be exploring means of using its resources to accomplish the following policy and institutional changes.

1) Assuming that the level of ESF resources requested per 1983-85 will be available, USAID will strive to have fertilizer moved to Import Schedule 1; licence available on demand. This would expand fertilizer distribution through the private sector and strenthen its capacity to conduct commerce in the rural areas. An analysis of the fertilizer market indicates that it is now sufficiently large to eliminate the collusive abuses which were possible in the past.

2) To eliminate the current subsidy resulting from delayed counterpart deposits, and to channel credit to the commercial banking sector, USAID will strive for a requirement that the program be handled by private distributors with payment to GOK covered by commercial bank quaranties.

3) In order to strengthen the commercial capabilities of indigenous rural small traders and thereby strengthen the commercial sector, USAID will explore the possibility of placing deposits in commercial banks at favorable rates with the understanding that the banks will provide technical assistance and loans to indigenous small traders in rural areas.

4) USAID will encourage the GOK to lift the restrictions on the movement of maize among districts, thereby facilitating the free flow of maize in the countryside in response to economic incentives.

5) USAID will encourage the GOK to limit the role of National Cereals and Produce Board in direct purchase and sales and redirect it to the establishment and management of security food stocks, and their use for the maintainance of appropriate floor and ceiling prices.

USAID believes that this strategy offers an integrated approach to the use of its program resources. It will enhance donor coordination and effectiveness. It will give an integrated focus to USAID policy dialogue with the GOK on those elements of policy which affect agriculture, our prime sector. It will support reform of the institutions in the agricultural sector, and expand the role and effectiveness of the private sector to enable it to assume the functions implicit in this strategy.

The Kenyan economy is in difficulties and even under the best of circumstances, several years of effort will be required to establish a good development momentum. But the elements necessary for such success are at hand and properly managed and supported, Kenya can reach its goal. USAID believes that the strategy for support outlined above offers the most effective use of U.S. resources in support of Kenya's efforts.

IV. AGRICULTURE OVERVIEW

A. Crop Production

A strong recovery in the agriculture sector was seen in 1981 (sector growth was 6.2 percent in 1981) and 1982 following a relatively poor performance in the two previous years. The main factors supporting the increased production were improved weather, increased producer prices and improved input supplies. Table IV.1 provides details of agriculture input and output in current and constant prices as well as price and quantity index numbers.

AGRICULTURAL OUTPUT AND RECORDED INPUT, 1977-1981
(Calendar Years)

Table IV.1

	1977	1978	1979	1980	1981*
AT CURRENT PRICES--					
Total Output	755.32	732.93	747.58	791.19	917.48
Less Inputs	87.31	101.21	98.80	103.05	125.74
Value Added	668.01	631.73	648.78	688.13	791.74
AT CONSTANT (1976) PRICES--					
Total Output	591.68	614.99	607.55	594.27	629.12
Less Inputs	78.09	81.68	78.50	72.25	74.23
Value Added	513.60	533.31	529.05	522.03	554.89
Quantum Indices (1976=100)					
Output	111.0	115.4	114.0	111.5	118.1
Input	117.1	122.5	117.7	108.3	111.3
Price Indices (1976=100)					
Output	127.7	119.2	123.1	133.1	145.8
Input	111.8	123.9	125.9	142.6	159.4

*Provisional

Source: Economic Survey 1982

Although accurate data from this series are not available for 1982, it is fairly certain that price relationships between outputs and inputs will show improvement. Up to 1981 input prices were rising much faster than output prices. In 1982 input price rises should moderate somewhat (fertilizer for instance should be only 10-15 percent above 1981) while the official marketing agency prices of domestic crops (Table IV.8 page 35) particularly maize, wheat and rice are up between 17 and 53 percent.

Marketed production also made a strong recovery. Table IV.2 presents data on sales of major crops to Marketing Boards.

SALES TO MARKETING BOARDS OF MAJOR CROPS, 1977-1981
(Calendar Year Metric Tons)

Table IV.2

CROP	YEAR				
	1977	1978	1979	1980	1981
Maize	423,964	236,268	241,717	217,887	472,909
Wheat	169,880	65,941	200,968	215,674	214,437
Rice Paddy	41,415	35,816	37,466	36,408	41,153
Sugar-Cane	1,888,140	2,349,206	3,147,580	3,987,428	3,821,980
Pyrethrum(Extract Equivalent)	131.1	114.0	113.7	162.2	232.8
Cotton	16,257	27,190	27,597	38,129	25,484
Coffee	97,066	84,328	75,082	91,334	90,746
Tea	86,291	93,373	99,275	89,893	90,941
Sisal	33,196	31,456	36,457	46,910	41,326

Source: Economic Survey 1982

The recovery has continued into 1982 and the figures in Table V.2 which are based on calendar years mask the upsurge in production in crop year 1982. For example, maize production in the crop year June, 1981 to July, 1982 jumped from 1.7 to 2.3 million MT and marketing to the board from about 200,000MT to 690,000MT. The improvement in maize and wheat production (cereals) is evident from Table IV.3 below.

KENYA: QUANTITIES INDICES FOR MARKETED CROPS 1978-1982
(Calendar Year)

Table IV.3 1976=100

YEAR	TOTAL CROPS	CEREALS	TEMPORARY INDUSTRIAL CROPS	PERMANENT CROPS
1978	103.5	61.6	125.7	114.6
1979	104.1	68.9	153.2	108.8
1980	115.3	68.9	192.2	121.1
1981	119.2	92.2	191.4	119.8
1982	124.0	115.5	190.0	120.0

Source: Economic Survey 1982. USAID estimates for 1982

Table IV.4 presents production estimates for the main cereal crops of maize, wheat and rice by crop year (i.e. 1981 = June 1981 to July 1982)

ESTIMATED CROP PRODUCTION BY CROP YEAR
(million MT)

Table IV.4

	1978	1979	1980	1981	1982
MAIZE	2.000	1.400	1.700	2.300	2.500
WHEAT	.165	.130	.140	.225	.220
RICE	.022	.025	.025	.026	.027

Source: Economic Survey 1982. Mission estimates for 1982

The improvement in production and marketed output can be explained by better weather, more credit and improved input supplies, but as Tables IV.5 and IV.6 indicate there was a substantial increase in price incentives for cereals particularly for 1982.

KENYA: PRICE INDICES FOR MARKETED CROPS 1978-1982
(Calendar Years)

Table IV.5 1967=100

YEAR	TOTAL CROPS	TEMPORARY INDUSTRIAL CEREALS	PERMANENT CROPS	CROPS
1978	123.2	113.3	134.8	123.5
1979	120.5	112.6	141.8	118.7
1980	124.5	130.5	147.4	119.4
1981	124.8	134.4	161.2	115.5
1982	131.7	174.6	177.5	116.2

Source: Economic Survey 1982. USAID estimates for 1982

Table IV.6 presents the government producer prices from 1978 to 1982.

Table IV.6

CROP PRICE PER KG.KSH
(Crop Years)

	1978	1979	1980	1981	1982
MAIZE	.75	.65	.90	.95	1.30
WHEAT	1.25	1.35	1.50	1.60	1.90
RICE	1.60	1.60	1.70	1.70	2.70

The large increase in prices for maize and wheat give rise to the optimistic Mission estimates for 1982 production in Table IV.4 above. Rice production is constrained by the slow growth expected in irrigated area.

B. KENYA CROP PRICES AND WORLD MARKET PRICES

Two basic price systems operate in Kenya. For the export crops the world markets determine prices. For domestic crops traded in local markets (75 percent of maize for example) prices are determined by supply and demand. For the additional 25 percent the GOK sets prices that the marketing agencies will pay. Table IV.7 below presents average prices paid to farmers. For sugar-cane, cotton, maize, wheat, rice and milk these are the marketing agency prices.

AVERAGE CROSS COMMODITY PRICES TO FARMERS, 1977-1982
(Calendar Years)

Table IV.7 KSh. per stated Unit

	Unit	1978	1979	1980	1981	1982*
Coffee	100kg.	2,818	2,815	2,634	2,258	2,309
Tea	"	1,583	1,357	1,591	1,774	1,786
Sisal	"	272	361	414	412	320
Sugar-Cane	tonne	133	133	133	145	170
Pyrethrum (Extract Equivalent)	kg.	720	1,006	1,200	1,200	N.A.
Seed Cotton	100kg.	315	328	331	341	380
Maize	"	89	77	95	100	135
Wheat	"	133	144	164	167	189
Rice Paddy	100kg.	145	151	151	148	222
Beef (third Grade)	100kg.	676	689	795	960	1,190
Bacon Pigs	"	764	778	859	975	1,200
Milk	100lit	132	132	146	186	216

*Source: Economic Survey 1982. USAID estimates for 1982

For those crops over which Kenya has some price control, prices have been raised substantially both in 1981 and 1982.

Table IV.8 presents 1981 and 1982 prices and gives the equivalent price in US dollars per metric ton to show the effect of the recent devaluation of the Kenya Shilling. Finally, the percent change in Kenya Shilling prices is calculated.

GAZETTED CROP PRICES 1981 AND 1982
(Crop Years)

Table IV.8

CROP	1981	$ MT(a)	1982	Change $ MT(b)	%KSh
MAIZE	95	140.6	130	144.3	+ 37
WHEAT	160	236.8	190	216.5	+ 22
RICE	1.30-1.70	226.6	2.0-2.70	270	+ 53
SUGAR	150	20.0	170	17.0	+13.3
COTTON	3.60	480	3.80	380	+ .5
CASHEW	3.50	466	5.50	550	+ 57
MILK	1.85	246	2.15	215	+ 16

(a) 7.5 = $1.00
(b) 10.0 = $1.00

The price increases reflect the GOK intention of making food production (i.e. cereals) more competitive with sugar and cotton.

In dollar terms the prices of maize and wheat exceed current depressed world prices while the current rice price is close to recent trading levels. Maize is currently selling at $100 MT and wheat $160 MT ex gulf ports USA. Shipping (currently also a depressed market) ranges from $25 (bulk carrier) to $100 (US Flag) from gulf ports to Mombasa. It can be concluded from this that Kenya's internal prices are about as high as they should go under current world market conditions. Indeed if these prices stimulate production beyond domestic consumption needs, as is likely, then any exports would be made at a slight loss. Given the fact that the average import content of locally produced maize is probably about 25 percent, exports in limited quantities may be justified given the current foreign exchange shortages.

The net result of the improved pricing policy, better weather and improved credit and input supplies is that Kenya is again self-sufficient in basic food supplies. It is expected that modest imports of wheat and rice will be just about offset by exports of maize and beans. Performance in the export crops is good despite stagnant or declining international prices.

The donor committee and the MOA have agreed to use the commercial trade estimates to implement the import plan. Requirements for fertilizer for which the United States is most competitive (DAP and MAP) greatly exceed our ability to finance. The other donors and USAID along with MOA and the distributors are attempting to divide the imports in a way that secures the quantities required at lowest cost and allows maximum participation to the extent foreign exchange permits. In addition to the 17,000MT of DAP and MAP under the USAID program the Netherlands will supply 7,000MT of 20-20-10, Sweden 7,000MT of 20-20-0, Norway 13,500MT of 20-20-0 and Japan 8,000MT of ASN. Total donor supplies are expected to provide 40 percent of import needs.

B. General Considerations

In 1980-1981 the U.S. provided balance of payments support totaling $20.0 million to finance 67,000MT of fertilizer. In 1980 fertilizer and fungicides made up 21 percent of manufactured imports from the U.S. Adding construction equipment, industrial chemicals, aircraft and parts, oil and gas equipment, and trucks and buses brings the total to 65 percent of all U.S. imports. Although some of these additional imports may impact on the rural areas the connection is indirect at best. It appears that for non-traditional U.S. imports (which might include steel for hoes, for instance) the volume would not likely be adequate to absorb the U.S. resources provided. USAID and AID/W wanted to link the program to the USAID strategy of increasing production, incomes and employment in the rural areas. In addition, the food shortages of the time suggested a need to focus on food production. Strategies promoting food production and self sufficiency (when economically feasible) are also advanced by the recent AFR Food Policy Paper and the AID Food and Agricultural Development Policy Paper of May 1982, in Section I, Objectives.

In most of Kenya's agriculture capital inputs are the most costly factor of production and their use is therefore low. The hoe and human labor are still the key factors in production. In seeking increased production the usual first step by farmers is the use of improved seed followed by fertilizer and simple chemical pest control.

Administrative feasibility and quick disbursement are major considerations in balance of payments programs. The Kenya fertilizer program has met both criteria.

V. KENYA FEKTILIZER PROGRAM

A. DESCRIPTION OF THE 1982 FERTILIZER PROGRAM

Kenyan experience with fertilizer imports has provided the basis for an improved program in 1982. In 1982 AID-GOK can make a start on improving agribusiness in Kenya with emphasis on the input distribution system.

The following points have guided program development:

- the fertilizer must move quickly to distributors and farmers;
- program benefits should reach AID target population;
- the program should promote institutions and firms developing the rural sector;
- policies concerning prices and distribution of agriculture inputs should be rational and provide maximum incentives to producers;
- additional strains on government (personnel, expenditure, etc.) must be avoided.

USAID/Kenya has thoroughly examined the possibilities for providing agriculture sector assistance to Kenya and has confirmed that financing of fertilizer imports for distribution by the private sector is the preferred choice and will be effective because: (1) it will have direct effect on food production; (2) it will support expanded private sector efforts to supply agricultural inputs; (3) small farmers who are able to produce surpluses are participating in the market economy at an ever increasing rate; (4) the U.S. has a comparative advantage in fertilizer imports (mainly in the cost of phosphates); (5) fertilizer is easily procured in the U.S. and effectively distributed in Kenya and finally; (7) effective use can be made of local currencies generated to further mutually agreed development objectives.

Government projections of fertilizer requirements are presented in Annex A. These import requirements were prepared under the old Ministry of Agriculture system of aggregating district estimates. They overstate actual import needs. Annex B presents the KFA stock position on June 30, 1982 and projections of KFA import requirements for the next twelve months. In addition to KFA requirements an informal survey of other importers indicates their intention to import about 40,000MT bringing total import to 150,000MT and total supplies to 250,000MT for 1982/83.

C. Specific Considerations

Fertilizer is an effective productive input to food crops in Kenya as the correlation between steady increase in fertilizer use and higher production of grains clearly indicates. There have been times when producer prices for grains were not adequate but at present they are very attractive. We expect fertilizer use to expand rapidly, especially the fertilizers in which the United States is competitively strong.

Worldwide evidence also supports the view that supply constraints have been a major factor in the slow expansion of fertilizer use, especially by smaller farmers. Small farmers are always at the end of the distribution chain. In Kenya, prior to increased donor participation fertilizer supplies had been tight. In 1981 and currently supplies have been good with a carryover stock now at 100,000MT.

D. Economics of Fertilizer Use

While there is little hard data on the use of fertilizer by crop in Kenya its use has been economic in the last two years as demonstrated by the fact that fertilizer has been imported, sold and used. Table V.1 below presents quantity and price indices for fertilizer. The quantity index records imports and not use and therefore can be misleading.

KENYA: FERTILIZER INDICES 1978-1983
(Calendar Years)

Table V.1 1976=100

YEAR	FERTILIZER QUANTITIES INDEX	FERTILIZER PRICE INDEX
1978	155.6	98.3
1979	101.8	128.9
1980	109.9	128.9
1981	137.6	131.3
1982	151.2	145.6

Source: Economic Survey 1982. USAID estimates for 1982

Each year the Ministry of Agriculture prepares estimates of the cost of production and the probable returns to major crops. Table V.2 presents an adaption based on the 1981 data for commercial maize production. At lower levels of input use and resulting production the use of modern inputs is only marginally profitable while at high production levels and with weather cooperating high returns are possible.

GROSS MARGIN FROM COMMERCIAL MAIZE 1982
(Crop Year)

Table V.2 K.Shs.

Yield Level bags/ha	30	45	60
GROSS OUTPUT	3900	5850	7800
Variable Costs:			
Seed	138	138	138
Fertilizer DAP	206	492	811
ASN	375	625	875
Transport, Fertilizer	13	18	25
Chemicals:			
Insecticides	26	37	48
Herbicides	300	300	300
Costs of Machinery	1449	1502	1509
Labor	279	335	458
Gunnies	372	558	744
Transport, Maize	108	162	216
TOTAL	3266	4167	5124
GROSS MARGIN	634	1683	2676
INTEREST 14%	457	583	724
ADJUSTED GROSS MARGIN	177	1100	1952

Source: Adapted from Yields-Costs Prices 1981, Ministry of Agriculture.

Moving up the production function for maize requires improved cultural practices but it is clear that the variable cost of fertilizer is the major factor in the increased costs and returns. In the above example increased expenditure on fertilizer from Ksh 581 to 1686 (+ 1105) increased returns from Ksh 177 to 1952 (+ 1775). Table V.2 presents a commercial maize situation. It is difficult to generalize a production function in Kenya because of the diversity of conditions.

However, it is possible to suggest orders of magnitude for the response to fertilizer use. In grain crops, at Kenya's current level of fertilizer use an additional kilogram of nutrient should yield between 8 and 12 kilograms of grain. On a pure nutrient basis N and P_2O_5 are currently selling at about 10Ksh per kg. while maize is selling (officially) at Ksh 1.44 and wheat at Ksh 1.89 per kg. In areas of adequate rainfall fertilizer use is clearly economic for these main food crops. The real situation is that some farmers are heavy fertilizer users whereas other use little or none. U.S. fertilizer supplied in 1980 and 1981 was used on maize, wheat, barley and sugar-cane and lesser amounts on a wide variety of other crops.

Another indirect method of estimating which crops benefit from a fertilizer program is to trace deliveries to the Kenya Farmers Association (KFA) sales points and compare sales to the cropping pattern, crop calendar and known agronomic practices. This analysis also confirms the DAP connection to maize and wheat, MAP to barley and TSP to all three and sugarcane production.

Production from the 1981/82 long rains crop was far beyond expectations. Total maize production jumped from 1.7 million MT to 2.3 million MT. While the GOK tended to blame the weather for the two previous bad crops the real problems were poor prices, lack of credit and lack of fertilizer. Due to timely arrival in January 1981 of USAID- supplied fertilizer, stocks were more than adequate. Past trends and the foreign exchange rationing in place at that time lead us to conclude that AID was instrumental in insuring these supplies. If 75 percent of U.S. fertilizer (say 20,000 nutrient MT) were used on that maize crop, between 160,000 - 240,000MT of additional grain production was the likely result. To import that quantity of grain under PL.480 would cost $50 million plus shipping at GOK expense versus a cost of $7.5 million for fertilizer.

E. Fertilizer Pricing and Marketing:

Fertilizer prices are controlled in Kenya. Control was established as a result of proven price collusion among the limited number of importers (Havelock Report 1971). The present system is designed to control profit margins but not to serve as a subsidy scheme. The system uses the C&F price, all proven internal costs and fixed maximum profit to fix a maximum

retail price on each importation. There are obvious problems with such a system since prices for fertilizer of the same type can vary widely depending on source, size of tender and shipping arrangements. GOK is reluctant to return to uncontrolled prices since the number of importers still remain small and the potential for the corrupt practices to resurface is great under such an imperfect market structure. GOK does admit to inefficiency in the system and has been open to and has held discussions with the recently established fertilizer donor committee.

The second major objective of the current system is designed to ration foreign exchange. Import licences must be approved by the Ministry of Agriculture on the basis of its perception of national requirements and then by the Central Bank. In theory there is no reason for the Ministry of Agriculture to turn down import requests and once permission has been received the Central Bank should provide the foreign exchange. Changes undertaken and under discussion by government on prices and import policy are discussed below.

Fertilizer marketing has undergone changes in Kenya. At independence the major distributors were European manufacturers. These large companies have left and the Kenya Farmers Association (KFA) and small distributors have become the only market channels. KFA currently handles about 60 percent and six to eight other private importers handle the remainder.

F. Fertilizer Program Performance 1980/81

The experience of 1980-81 reveals both positive impact and problem areas.

Positive

- The use of bulk tender and local bagging procedures has resulted in reduced costs and creation of local employment;
- overall availability of fertilizer has increased;
- fertilizer arrived when needed, was distributed efficiently by KFA and no unusual losses were incurred;
- agricultural production and farmer incomes have increased.

Problems

- With KFA as sole agent for U.S. imports there has been limited competition and no expansion of other distribution networks;

- due to pricing policies the benefits of reduced import costs have not been fully passed on to farmers. In addition, there is no system to rationalize the price of plant nutrients in competing fertilizers.

- local currency generations have moved relatively slowly from the distributor to Treasury.

Coverage of productive farming areas by the KFA distribution system has been good. KFA has 42 main outlets and uses local stockists for areas of more limited demand. The generation of local currency for budget support has been slower than projected. This was due to unforseen delays caused by the shipping schedule and credit system. Generations are now flowing (about 100 million KShs out of 130 million as of May 1, 1982) and being used to support the agreed list of development programs.

AID believes that the fertilizer program has been very successful. Several possible additions and improvements to this program are discussed below.

VI. POLICY CHANGE

As a result of the USAID fertilizer program steady progress has been made in fertilizer handling and planning.

The first policy reform, which has been achieved, was to get the Ministry of Agriculture to use private sector demand estimates as the basis for import levels. The past system aggregated District Agriculture Office estimates to reach a national requirement. It was inefficient, time consuming and did not reflect real demand. USAID collected the data on local stock and private sector import projections and convinced MOA (after careful comparison with their projections) to use the private sector figures (with minor adjustments). The benefits will be substantial; lower carry-over levels of slower moving types, reduced storage and handling; reduced losses from pilfering and damage. USAID estimates that without this change GOK would have imported 20,000 to 40,000MT of fertilizer which would not have been used in the coming season and therefore tied up foreign exchange equal to USAID's planned assistance.

The second policy reform relates to the timing of the import plan, issue of private import licences and scheduling of donor imports. By moving the planning and imports forward just 6-8 weeks a reduction in port congestion will be achieved and stock levels at up country distribution points will be more adequate to meet the early planting dates recommended as the result of recent research.

A major change yet to be achieved relates to pricing policy. GOK does not subsidize fertilizer but attempts through price control to limit margins to what it considers reasonable levels. When the pricing was not controlled there was proven collusion among the limited number of importers (Havelock Report 1971). The current system takes the C&F price of each importation and establishes a maximum retail price allowing for transport and profit. Depending on source, shipping, etc. competing fertilizer prices can vary widely. Possible improvements are under discussion. The donor committee intends to table with GOK a position on pricing policy in October.

In the future, should resource levels permit, the GOK will be asked to agree to a condition precedent that fertilizer be moved from Schedule II.A of the Import Schedule to Schedule I which would allow unrestricted imports. This step is in line with the Structural Adjustment Program and is the best way market forces can be allowed to develop.

Adequate resource levels are needed to do this, however, for two reasons. If foreign exchange is inadequate the Central Bank must ration funds. Secondly, the volume of fertilizer use must be high enough to allow sufficient participants. At levels of under 100,000MT per year the quantities of each type imported are inadequate to capture any of the savings inherent in large tenders and bulk shipping. At current levels of between 150,000 and 250,000MT expanded numbers of participants are possible and the conditions which would allow for full play of competitive market forces could become operative. This is because the major categories of fertilizer will be in sufficient quantities to overcome the "lumpiness" caused by the economics of scale in large tenders and bulk shipping.

VII. FINANCIAL PLAN

Kenya's fertilizer imports in 1982/83 are expected to cost about $50.0 million of which USAID will finance 10 percent. The Government and the distributors will finance all costs after arrival at Mombasa. These include unloading, rail

and road transport, storage and distribution to farmers. In addition, the Government finances the costs of extension and fertilizer research and demonstration programs. The Government's contribution to the agriculture development budget is $56.0 million in 1982/83.

VIII. IMPLEMENTATION

The implementation process is designed to profit from past experience and to test new methods. It will evolve during the period of this program.

A. Distribution 1980/81

Importation and distribution of USAID fertilizers during 1980/81 was handled by the KFA, a private and independent farmers association. KFA prepares tenders and conducts inspections, off loading, warehousing and final distribution. Fertilizer is distributed to KFA warehouses throughout the country on the basis of historical cropping patterns and the fertilizer requirements of individual crops. KFA's performance in all these tasks has been good. KFA handled approximately 140,000 MT of fertilizer in 1979/80 and 180,000 MT in 1980/81.

GOK policy of using KFA as the sole agent for donor fertilizer has increased its market share at the expense of other dealers. This was not the intent. For 1982 KFA will remain the importer up to Mombasa port. GOK is asked to covenant that if commerically viable mechanisms can be developed through the commercial banking system other distributors will be allowed to participate. USAID and GOK will work out details prior to shipment in November. Such a system will attempt to address the following issues; (a) the need to increase competition and expand distribution; and (b) the desirability of providing the GOK with local currency resources in a more timely manner. Such an approach will reduce the large amount of time expended by GOK and AID in tracking local currency. A potential problem could be the inability of private dealers to get local financing in the current tight credit market.

B. Credit

Fertlizer in the past has been generally obtained from the KFA in exchange for financial instruments (so-called chits). The Agricultural Finance Corporation (AFC) makes credit available, and issues the required chits, to farmers with five acres of crops or more. Such farmers present their chits directly to the KFA and receive their fertilizer. The AFC deals with smaller farmers indirectly through the Cooperative Bank of Kenya. Member co-op unions submit the chits of small farmers collectively to the KFA in exchange for fertilizer sold on credit.

The AFC seasonal credit program is not working as well as it should mainly because GOK underfinanced the program. This is compounded by the overall lack of liquidity in Kenya.

To review how the system works may also explain why these problems arise and how they have been resolved. The 1980 fertilizer arrived in country in late November 1980. It was stored and about 60-70 percent sold in February-April 1982 on credit. KFA was to pay GOK quarterly but could not since AFC was short of funds until the 1981/82 budget in July. Payments began to KFA and as the harvest progressed in the period September to December 1981 payments accelerated. By March 1982 a very acceptable repayment had been achieved. As will be shown below, however, only part of the delay in generation of local currency is due to the credit system.

While performance in credit and generation of local currency should be improved, the program as currently established is working. With any fertilizer imports there will be time lags between arrival of commodity, sale, transfer to Treasury, and budget and expenditure on programs.

IX. PROGRAMMING LOCAL CURRENCY GENERATIONS

Under the 1980/81 fertilizer program the GOK and AID agreed to identify priority areas for local currency use in support of the current five year development plan. Such agreement was reached by an exchange of letters within the required six months. The original list is presented as Annex C.

The shipments of the first $14.5 million in fertilizer arrived between November 1980 and April 1981 for use during the long rains of March to July 1981. Proceeds have therefore been continuously generated from then to the present as some fertilizer is yet to be sold. The second shipment of $5.5 million arrived between September and November 1981, was mostly sold during the long rains of March to July 1982 and generations from those shipments are currently being received.

Given this timing it only became possible to budget the funds to activities in the 1982/83 GOK fiscal year. Planning for that budget begins in April 1982 for the June 1982 to July 1983 period. Between the time the original list of programs was developed and the funds became available, several important events had occured. Negotiations with the IMF on Standby Credits and with IBRD on the Agricultural Structural Adjustment Program had reached an advanced stage. The priorities of these programs combined with extra shillings being made available to some of the Development Assistance supported projects from the devaluatior required preparation of a new list of projects for CIP generations. That revised list appears as Annex D. These funds are budgeted in the 1982/83 Development Estimates published in June 1982.

The generations currently being received and those from the proposed project will be similarly programmed for use in Kenya fiscal year July 1, 1983 to June 30, 1984. Criteria to be followed in identifying eligible budget items includes the compatibility with USAID CDSS, GOK Development Plan and Food Policy Paper.

USAID strategy is focused on programs to support increased production, employment and incomes in the rural areas. The programs supported to date include rural roads, the Rural Development Fund, agriculture extension and research and soil conservation. USAID has two ongoing rural roads projects and believes the additional effort very supportive of our objectives. The Rural Development Fund is administered with assistance from the Rural Planning II Project and supports local small scale development efforts. In research the funds are being used to supply water and power to a USAID-supported project at the Kiboko Range Research Station which was identified as the highest priority action to be taken by GOK in the recent evaluation of that project. Soil conservation is a major objective of the strategy to improve productivity in the arid and semi arid lands. The relatively small amount allocated reflects the current austerity measures but at least provides indication of support to the USAID ASAL Project.

The process of programming additional generations will continue to use the CDSS strategy as the basis of negotiations along with strengthening the commercial sector. Annex E presents an illustrative list of programs to be supported in 1983/84.

X. U.S. INTERESTS

The United States has important political and strategic interests in Kenya. Kenya is one of the few countries in Africa with democratic political institutions and a freely elected civilian government. The economy is based on free market principles with a strong private sector. The economic and political well being of Kenya is important to the U.S. as a demonstration that progress and stability are possible under a government committed to democratic institutions and a market oriented economy.

In international affairs, Kenya pursues a moderate course and has been a good friend of the United States on numerous issues of importance to us. On international and regional security matters, Kenya provides important support to the U.S. strategic position in this part of the world through access for U.S. forces to its airfields and the Indian Ocean port of Mombasa. This security cooperation is formalized by a facilities access agreement between the United States and Kenya signed in 1980.

Kenya today faces economic and political difficulties much more serious than observers had anticipated earlier this year. A coup attempt on August 1, 1982 demonstrated cracks in the facade of political stability and its negative impact on tourism and capital account inflows will widen the balance of payments gap.

Lack of confidence about the political future is closely related to growing economic pressures on what has been generally perceived as a sound economic system. In recent years, Kenya's poor economic growth performance, its high inflation rate, population explosion and demands on the availability of scarce social services have all contributed to a deterioration of the quality of life for the average Kenyan. Unrest and economic and political frustration are increasingly manifest and the Government has been hard pressed to respond with better performance of the economy.

There is little doubt that world economic conditions contributed to Kenya's poor performance following the 1970s. However, the Government must assume responsibility for policies that tended to exacerbate economic problems. High levels of protection for inefficient, high cost import substitution industries, for example, resulted in a misallocation of scarce capital resources. An untimely decrease in prices paid to maize growers in mid-1979 and a delay until 1981 in adjustment of prices to provide an adequate economic return to farmers resulted in significant cutbacks in plantings and a production deficit.

A serious foreign exchange shortage now threatens Government's strategy for structural readjustment of the economy. Since 1980, with the support of the World Bank, IMF and bilateral donors, Kenya has undertaken the serious task of modifying certain key policies affecting currency exchange rates, quantitative restrictions on imports, tariff schedules, agricultural prices, energy prices, debt management and domestic borrowing.

The U.S. firmly supports the democratic institutions and private enterprise system in Kenya, both currently under a great deal of stress. In order to give these institutions a greater chance of survival in time of crisis, the Kenya economy will need to be strengthened, the trade balance improved and the quality of life enhanced. In the short run the timely provision of foreign exchange for balance of payments support and fertilizer imports will help as the Kenya Government continues adjustment of economic policies.

XI. NEGOTIATING STATUS, CONDITIONS, COVENANTS AND RECOMMENDATION

A. Negotiating Status

The GOK and USAID have been in close contact during the development of the fertilizer program and no delays are foreseen in reaching final agreement.

B. Conditions and Covenants

In addition to the standard conditions included in AID Project Agreements, the following conditions and covenants are proposed:

1. Conditions Precedent to Initial Disbursement

(a) The GOK will provide a statement representing and warranting that the named person or persons have the authority to act as the representative or representatives of the Grantee together with a specimen signature of each person certified as to its authenticity.

(b) The GOK will designate a repository and special account for deposit of local currency generations from the sale of commodities financed under the grant.

(c) GOK will reach agreement on a suitable reduction in the retail price of TSP fertilizer now in KFA stocks such that KFA will assure GOK and USAID in writing that the TSP is competitive with other fertilizer types.

2. Covenants

(a) The GOK and USAID will agree on a plan for the disbursement of local generations within six months from signature of the Agreement.

(b) The GOK agrees to use, if commercially feasible, an import and distribution system whereby other private companies will participate in the program with local commercial bank guarantees to ensure prompt payment of generated local currency to Treasury.

3. Recommendations

USAID/Kenya recommends that a four million four hundred thousand dollars ($4,400,000) grant from Agriculture, Rural Development and Nutrition Funds be authorized to the Government of the Republic of Kenya for financing the importation of selected commodities, subject to the following provisions:

-- Procurement will be restricted to A.I.D. Geographic Code 000.
-- Such other terms and conditions as A.I.D. may deem advisable.

ANNEX A

Kenya: Imports of Fertilizer by Type

(Metric Tons)

	1980/81 Planned	1981/82 Planned	1982/83 Projected	1983/84 Projected
SA	12,703	13,033	13,434	13,961
UREA	2,805	4,000	4,120	4,285
ASN	30,457	47,346	48,766	50,717
CAN	34,670	51,454	52,998	55,118
SSP	898	920	948	986
TSP	40,288	44,813	46,157	48,004
DAP	50,971	60,561	62,378	64,873
MAP	13,500	18,000	18,540	19,282
MOP	1,800	1,845	1,900	1,976
SOP	1,000	1,025	1,056	1,098
NPKs 17:17:17	3,500	4,063	4,185	4,352
15:15:15	2,500	2,653	2,640	2,746
20:20:0	22,375	28,059	28,901	30,057
15:15:6+4	389	398	410	426
6:18:6+4+10	389	398	410	426
Others	1,000	1,025	1,056	1,098
	248,620	308,866	318,133	330,859

Source: GOK, Joint Ministerial Fertilizer Committee.

ANNEX B

KFA FERTILIZER SITUATION 1982/83

Metric Tons

PHOSPHATE	STOCK JUNE 30, 1982	REQUIRED IMPORTS
TSP	21,000	- 0 -
SSP	5,000	5,000
DAP	3,500	30,000(40,000 Max)
MAP	4,000	10,000
NPK		
15 x 15 x 15	600	- 0 -
17 x 17 x 17	3,200	4,000
20 x 20 x 0	26,000	5,000
25 :5 x 5	2	5,000
20 x 10 x 10	45,000	10,000
NITROGEN		
ASN	700	10,000(15,000 Max)
CAN	25,000	10,000 (Max)
S of A	17,000	- 0 -
UREA	4,000	15,000
TOTAL	101,000	109,000

This was prepared by KFA. They were requested to estimate their requirements given their estimate of other private sector intentions.

ANNEX C

OFFICE OF THE VICE-PRESIDENT AND MINISTRY OF FINANCE

Telegraphic Address:
FINANCE-NAIROBI
Telephone: 338111
When replying please quote
Ref. No. and date .....EA/FA 9/03

THE TREASURY
P.O. Box 30007
NAIROBI
KENYA

.....March 31, 19 81.

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

ACTION COPY

Action taken: Ref Letter #4

No action necessary:

JJW (Initials) 3/31/81 (Date)

Dear Mrs. Herrick,

Grant Agreement No. 615-K-601
1980 Commodity Import Programme.

In accordance with the Grant Agreement for the 1980 Commodity Import Programme, I would like to inform you that the Government of Kenya has taken action to establish an account with Cereals and Sugar Finance Corporation as a repository for Kenya shillings generated under this programme.

I would also like to submit to you formally the list of activities agreed on by the Government and USAID for funding under this programme. The attached list indicates priority projects for which Kenya shillings are currently required. The amounts listed against each project are indicative of the requirements and do not necessarily represent the actual level of funding.

I trust that this meets the conditions precedent to the utilization of the Grant under Section 5.6 of the Grant Agreement.

Yours sincerely,

H.M. MULE
PERMANENT SECRETARY/TREASURY.

LIST OF PRIORITY PROJECTS FOR USE OF REFLOW FUNDS GENERATED BY SALE OF U.S.-FINANCED FERTILIZER IMPORTS

NAME OF PROJECT	ESTIMATED COST KSH.
1. Egerton College: Costs to complete part of the physical construction of the College not covered by USAID project 615-0169	40,000,000
2. Kiboko Range Research Station: Improvement and expansion of social facilities at the Research Station	4,500,000
3. Rural Development Fund: Supplemental resources to fund District Development Committee initiatives	17,500,000
4. Seed multiplication: Production of seed for crops known to do well in arid and semi-arid lands	1,000,000
5. Private volunteer organisations: Developmental projects in rural areas proposed by such organisations as partnership for productivity, NCCK, Maendeleo ya Wanawake, other women's organisations	8,200,000
6. Micro-irrigation schemes managed by the small scale irrigation section of Ministry of Agriculture aimed at increasing and stabilising the production of food near market and town centres	12,600,000
7. Programme seeking to increase the effectiveness and efficiency of extension activities through decentralised strategies	9,000,000
8. Soil and water conservation activities	10,000,000
9. National Fodder Bulking and Multiplication Project	22,500,000
	125,300,000

Funds available $14.5 (KSh. 116,000,000)

ANNEX D

REPUBLIC OF KENYA

MINISTRY OF FINANCE

Telegraphic Address:
FINANCE-NAIROBI
Telephone: 338111

When replying please quote
Ref. No. EA/FA 9/03
and date

THE TREASURY
P.O. Box 30007
NAIROBI
KENYA

19th April, 1982

Ms. Allison B. Herrick,
Director,
U.S.A.I.D.,
NAIROBI.

USAID DISTR(4-21-82)JK
ACTION:AGR -W/atch
(DUE:4-29)
INFO:O/DIR;PROG;PRJ;RFMC;CHRON;RF.

Dear Allison,

KENYA SHILLING GENERATIONS FROM PL 480 TITLE I (1981) AND CIP FERTILIZER SALES (1980)

Thank you for your letter of 15th January, 1982 regarding the Generation and Plans for Utilization of Kenya Shilling from PL 480 Title I (1981) and CIP Fertilizer Sales (1980). Based on your discussions with Mr. Roy of the Treasury, I confirm the following:

PL 480 Title I (1981)

We will, as agreed with you, utilize the funds to support our Agricultural Credit Scheme during 1981/82 and 1982/83. The Self-Help Measures Report due as per the PL 480 Title I Agreement has been despatched to you by Mr. Mayaka on 8th April, 1982.

CIP Fertilizer 1980

As per our agreement of 30th September, 1980, these funds are to be placed in a Special Account to support programs agreed between us. The current position is shown in the attached Schedule from which you will notice that we expect a realization of approximately KShs. 110.6m. of which KShs. 83m. have already been received in the Special Account.

We intend to utilize the entire amount and to support the following programmes in 1981/82 which are already included in the budget and are being funded.

..../2

MINISTRY OF FINANCE

Telegraphic Address:
FINANCE-NAIROBI
Telephone: 338111

When replying please quote
Ref. No. .....
and date

THE TREASURY
P.O. Box 30007
NAIROBI
KENYA

....., 19....

Program	Government of Kenya Contribution
	KShs.
1. Vote 14-Sub-vote 141-Head 465 Rural Roads	63
2. Vote 10-Sub-vote 104-Heads 241 and 244 Agriculture Extension	17
3. Vote 10-Sub-vote 104-Head 243 Soil Conservation	3
4. Vote 10-Sub-vote 105 Rural Development Fund	29
5. Vote 10-Sub-vote 108 Agriculture Research	6
Total	118

I believe the above is in conformity with our recent discussions and understanding in which case, it will be appreciated if you would confirm your agreement to the transfer of the present and future funds from the Special Account for application as above.

Yours

(H. M. Mule)
PERMANENT SECRETARY

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ANNEX E

ILLUSTRATIVE LIST OF PROGRAMS FOR LOCAL CURRENCY SUPPORT

Rural Development Projects Fund	$ 1,200,000
Kiboko Research Station	$ 800,000
Buchuma Research Station	$ 400,000
Fodder Bulking Project	$ 1,000,000
Sheep and Goats Developmemt	$ 800,000
Crop Production	$ 3,000,000
Soil Conservation	$ 1,000,000
Soil Conservation and Land Preparation	$ 2,000,000
ASAL Development	$ 400,000
Agricultural Information Center	$ 500,000
Agriculture Education	$ 3,500,000
Rural Roads	$ 6,000,000
TOTAL	$20,600,000

ANNEX F

Unclassified
AID 09/10/82
Dir:ABHerrick
PRJ:SPShah:am
1. PROG:RGreene, 2. AGR:TWorrick, 3. RLA:PScott
DIR PRJ-2 RF, PROG AGR RLA, CHRON ECON

Amembassy Nairobi
Secstate WashDc

AIDAC

E.O. 12356: N/A
SUBJECT: Kenya Agriculture Sector Grant, 615-0228
- - - Environmental Examination, Reg. 16

1. USAID/Kenya requests AID/W concurrence in quote negative determination unquote of Initial Environmental Examination for the subject project. Details are as follows:

A. Project Location: Kenya

B. Project Title: Agriculture Sector Grant

C. Funding: FY 1982 - Dol. 10,000,000

D. Project Description: This project proposes to provide a grant of 10 million US dollars to the Government of Kenya from Development Assistance Funds to be obligated in FY 1982. The primary purpose of the grant is to provide for basic balance of payments and budgetary assistance while financing imports of high priority agricultural inputs. Fertilizer has been identified as the commodity most appropriate for achieving significant impact on agricultural output. Local currency generations from the sales of fertilizers will be deposited in a special account to be established in the Central Bank of Kenya. Disbursements from this account will be made for jointly agreed activities in support of programs to increase agricultural production. Foreign exchange and budgetary imbalances have emerged as key constraints limiting Kenya's growth to unacceptable levels, and restricting the governments' ability to carry out important social policies and planned structural reforms. The purchasing power of Kenya's exports has grown by only 12 percent since 1972, the last full year before the OPEC-induced oil crisis. Restricted imports of

capital equipment, of required inputs (including fuels), and of consumer goods have resulted in reduced capacity utilization, lowered output, and decreased tax revenues. Increased balance of payments deficits are projected through 1983 with peak deficits in 1980 and 1981. Government budget deficits will peak in fiscal year 1981/82. Projections of per capita GDP growth during the 1979-83 Development Plan have been revised downward to 0.3 percent per annum from a planned level of 2.4 percent. The revised estimates are themselves based on levels of government expenditures, and foreign exchange availability which will not be attained without increases in overall external assistance of which the proposed U.S. program grant forms an important part. Kenya imports virtually all of its manufactured fertilizer requirements, an amount that exceeded 150,000 MT in 1980/81, and which represented over 40 million dollars in foreign exchange. Through a series of short term programs, 67,000 MT of fertilizer were supplied by four external donors in 1980/81. The proposed AID grant of 10 million US dollars will permit import of approximately 35,000 MT of fertilizer at current market prices, depending on the portion of each type ultimately delivered. The AID contribution to overall fertilizer supplies would be approximately 20 percent. Other donors will supply another 20 percent of total imports.

E. Identification and Evaluation of Environmental Impacts: Funds provided by the proposed grant have been programmed to finance purchase of fertilizer imports within the limits of quantities and types projected for government licensing in 1982/83. The Government's estimate for fertilizer imports in 1982/83 is 150,000 MT. The types of fertilizer normally imported by Kenya are as follows: sulphate of ammonia, urea, calcium ammonium nitrate, ammonium sulphate nitrate, calcium nitrate, single super phosphate, hyperphosphate , triple super phosphate, di-ammonium phosphate (DAP), mono-ammonium phosphate (MAP), muriate of potash, sulphate of potash and NPK. The AID grant funds will be used to import basically DAP and MAP, the two types for which the United States is most competitive. To the extent that provision by AID of necessary foreign exchange will guarantee the delivery of required fertilizer inputs, overall fertilizer usage may be greater in 1982/83 than would otherwise have been the case. The environmental impact of any potential increase in fertilizer usage would be related primarily to changes in soil character, and in the chemical and possibly, biological state of water. In general, Kenya soils are normally deficient in nitrogen and phosphates while potassium is generally well supplied. The phosphate and nitrogen/phosphate formulations proposed for financing are of the specific types being recommended primarily for application to maize, wheat, barley and other food crops. When applied to

crops, such fertilizers are capable of causing changes which may be adverse, beneficial or of no significant consequence. Improper use by inexperienced handlers and farmers is a possibility for limited quantities of fertilizer. For the most part, however, fertilizer will be obtained by established farmers who have used them previously, and farmers who have attended training courses at Farmers' Training Centers where fertilizer applications are normally taught and demonstrated. In general, applications of fertilizers will increase yields per hectare which are very low. The use of fertilizer will thus have a significant beneficial effect on the welfare of farm households with a low probability of adverse effects on the land. Overuse of phosphate and nitrogen/phosphate complexes poses the possibility of negative effects on water quality. The permissible criterion for nitrates (determined as nitrogen) in public drinking water is 10 milligrams per litre. Overuse of nitrates and phosphates can also contribute to over-growth of objectionable plant forms in lakes and other standing bodies of water. GOK's Ministry of Water Development has over 100 stations which monitor quality of water. Chemical tests are regularly carried out, and no sources with unsafe quantity of nitrates and phosphates linking fertilizer use have been identified. In general, overall fertilizer use in Kenya is quite low, averaging 25 kilograms per hectare of cropped land in 1976. Comparable national averages for other East African countries in 1976 range from less than .5 kg/ha in Uganda, to 63 kg/ha in Zimbabwe, and 269 kg/ha in Mauritius. A list of comparable 1976 figures (in kg/ha) for important developing countries outside the region might include the following: Brazil (63); China (49); Colombia (48); Egypt (210); India (20); Mexico (42); Philippines (34); South Korea (287); Taiwan (776). While conditions among countries vary widely, it is clear that Kenya falls nearer to the bottom than to the top of the list of major developing countries in terms of comparative fertilizer use. Required fertilizer imports of specific types will be assured by the Grant, but import of quantities and types beyond those already projected for licencing by government are not contemplated. The Grant will have its effects primarily through improvements in the balance of payments and through increases in development revenues available to government in agreed-upon areas. Such effects, though important in underwriting significant and ongoing structural adjustments in the Kenya economy, are generalized rather than specific and affect the overall environment in a manner that is primarily indirect. The local currency generated by the grant will be placed in a special account and jointly programmed by the GOK and AID for mutually agreed upon purposes which would be in consort with the U.S. assistance strategy in Kenya: Increased rural production, employment and

income. It is anticipated that special account funds will be used for general budget support for GOK development projects and programs which are already underway. An illustrative list of such projects and programs is included in the PAAD, Annex E. AID does not intend to reserve right of review or approval over specific activities other than general approval of the project or program to be supported (in order to insure that it is of an appropriate developmental character and in line with the Mission's CDSS) and the level of funds to be allocated. If it is subsequently determined that AID review and approval of specific activities to be financed is required, environmental analysis will be undertaken before such activities are approved for financing from the Special Account.

F. Recommended Environmental Action: In accordance with AID Regulation 16, it is recommended that, with regard to that portion of the project involving financing of fertilizers, a negative determination is appropriate. The primary purpose of the grant is to provide balance of payments and budgetary assistance while financing the import of fertilizer. As noted above, the use of fertilizer financed by AID will not have significant impact on the physical and natural environment.

With regard to the component of the project which will utilize local currency generations to provide budget support existing GOK development projects and programs, a categorical exclusion is recommended with the provision that appropriate environmental review will be conducted prior to approval of any activity for financing from the Special Account if AID is required or determines to review and approve specific activities to be financed from that account.

2. This message has been cleared by RLA. HOUDEK##

ACTION
AUSNN
FUENC #1135 2680912
UUUUU ZZH
P 2605Z SEP 82
FM STATE WASHDC
TO AMEMBASSY NAIROBI PRIORITY 3312

26 SEP 82
TOR: 0812
CN: 02959
CHRG: AID

LAS STATE 271135

10

. 12356: N/A
:
SUBJ: IEE - AGRICULTURE SECTOR GRANT (615-0222)

: NAIROBI 22143
NEGATIVE DETERMINATION HAS BEEN RECOMMENDED ON HE
SUBJ IEE AND HAS BEEN APPROVED BY AA/AFR. SHULTZ

UNCLASSIFIED

ANNEX G

AGRICULTURE SECTOR GRANT 615-0228

5C(2) PROJECT CHECKLIST

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

CROSS REFERENCES:	IS COUNTRY CHECKLIST UP TO DATE?	Yes, see Kitui Rural Health Project Paper (615-0206) approved on January 29, 1982
	HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT?	Yes

A. GENERAL CRITERIA FOR PROJECT

1. FY 1982 Appropriation Act Sec. 523; FAA Sec. 634A; Sec. 653(b).

   (a) Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project; (b) is assistance within (Operational Year Budget) country or international organization allocation reported to Congress (or not more than $1 million over that amount)?

   A notification was sent to Congress on September 13, 1982. The fifteen day waiting period expired on Sept.27,1982 without Congressional objection.

   Yes

2. FAA Sec. 611(a)(1). Prior to obligation in excess of $100,000 will there be

(a) engineering, financial or other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?	Yes.
3. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?	No further legislative action is required.
4. FAA Sec. 611(b); FY 1982 Appropriation Act Sec. 501. If for water or water-related land resource construction, has project met the standards and criteria as set forth in the Principles and Standards for Planning Water and Related Land Resources, dated October 25, 1973? (See AID Handbook 3 for new guidelines.)	N/A
5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and all U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability effectively to maintain and utilize the project?	N/A

1.10

6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.	NO.
7. FAA Sec. 601(a). Information and conclusions whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, and credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.	Commodity Import Program Grant will finance importation of fertilizer, a key agricultural input. The program will increase the flow of international trade and encourage efforts of the country to foster private initiative and competition, discourage monopolistic practices, and improve technical efficiency of industry, agriculture and commerce. Impact on development and use of cooperatives, credit unions, savings and loan associations, and labor unions is not clear, but no adverse impacts are anticipated.
8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).	Goods procured with this assistance will be obtained from private U.S. companies in the U.S. and at least 50 percent of the goods will be shipped on U.S. ships.

9.	FAA Sec. 612(b), 636(h); FY 1982 Appropriation Act Sec. 507. Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.	Government of Kenya will contribute $56 million in 82/83 for development of Agriculture Sector.
10.	FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?	The U.S. does not own excess foreign currency.
11.	FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?	Yes
12.	FY 1982 Appropriation Act Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?	The assistance is not for the production of any commodity for export.
13.	FAA 118(c) and (d). Does the project comply with the environmental procedures set forth in AID Regulation 16? Does	Yes.

the project or program take into consideration the problem of the destruction of tropical forests?	Yes.
14. FAA 121(d). If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (dollars or local currency generated therefrom)?	N/A

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

a. FAA Sec. 102(b), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better lif , and	(a) Rural farmers will utilize fertilizer to increase crop production. (b) The activity will not directly help develop cooperatives. Increased agricultural production resulting from increased fertilizer use may indirectly strengthen the role of cooperatives.

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

(c) Assist in Kenya's goal of being self-sufficient in food crops.

(d) Since many small farms are managed by women, increased crop production will improve economic status of women.

(e) N/A

b. FAA Sec. 103, 103A, 104, 105, 106. Does the project fit the criteria for the type of funds (functional account) being used?

Yes.

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

Yes.

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

Yes.

e. FAA Sec. 110(b). Will grant capital assistance be disbursed for project over more than 3 years? If so, has justification satisfactory to Congress been made, and efforts for other financing, or is the recipient country "relatively least developed"? (M.O. 1232.1 defined a capital project as the construction, expansion, equipping or alteration of a physical facility or facilities financed by AID dollar assistance of not less than $100,000, including related advisory, managerial and training services, and not undertaken as part of a project of a predominantly technical assistance character."	NO.
f. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?	Yes.
g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage	The assistance will not directly affect utilization of demoncratic institutions by the people. It may assist in preserving such institutions by strengthening the Kenyan economy.

institutional development; and supports civil education and training in skills required for effective participation in governmental processes esential to self-government.

2. Development Assistance Project Criteria (Loans Only)

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

b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20% of the enterprise's annual production during the life of the loan?

c. ISDCA of 1981, Sec. 724 (c) and (d). If for Nicaragua, does the loan agreement require that the funds be used to the maximum extent possible for the private sector? Does the project provide for monitoring under FAA Sec. 624(g)?

3. Economic Support Fund Project Criteria

a. FAA Sec. 531(a). Will this assistance promote economic or political N/A

stability? To the extent possible, does it reflect the policy directions of FAA Section 102?

b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities?

c. FAA Sec. 534. Will ESF funds be used to finance the construction of the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such use of funds is indispensable to nonproliferation objectives?

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

5C(3) - STANDARD ITEM CHECKLIST

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

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

A. Procurement

1. FAA Sec. 602. Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?	The procurement of fertilizer will be advertised in the U.S. Therefore, U.S. small business will be able to participate in the furnishing of commodities.
2. FAA Sec. 604(a). Will all procurement be from the U.S. except as otherwise determined by the President or under delegation from him?	Yes
3. FAA Sec. 604(d). If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?	Yes
4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If offshore procurement of agricultural commodity or product is to be	N/A

	financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.)	
5.	FAA Sec. 604(g). Will construction or engineering services be procured from firms of countries otherwise eligible under Code 941, but which have attained a competitive capability in international markets in one or these areas?	N/A
6.	FAA Sec. 603. Is the shipping excluded from compliance with requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent that such vessels are available at fair and reasonable rates?	NO
7.	FAA Sec. 621. If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? If the facilities of other	N/A

	Federal agencies will be utilized, are they particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?	
8.	International Air Transport. Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?	Yes
9.	FY 1982 Appropriation Act Sec. 504. If the U.S. Government is a party to a contract for procurement, will the contract contain a provision authorizing termination of such contract for the convenience of the United States?	Yes

B. Construction

1.	FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services to be used?	N/A
2.	FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable?	N/A

3. FAA Sec. 620(k). If for construction of productive enterprise, will agggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the CP)? N/A

C. Other Restrictions

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

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

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

4. Will arrangements preclude use of financing:

a. FAA Sec. 104(f); FY 1982 Appropriation Act Sec. 525: (1) To pay for performance of abortions as a method of family Yes.

planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; (4) to lobby for abortion?

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

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

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

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

f. FY 1982 Appropriation Act, Sec. 503. To pay pensions, annuities, retirement pay, or Yes

adjusted service compensation for military personnel?	
g. FY 1982 Appropriation Act, Sec. 505. To pay U.N. assessments, arrearages or dues?	Yes
h. FY 1982 Appropriation Act, Sec. 506. To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)?	Yes
i. FY 1982 Appropriation Act, Sec. 510. To finance the export of nuclear equipment, fuel, or technology or to train foreign nationals in nuclear fields?	Yes
j. FY 1982 Appropriation Act, Sec. 511. ~~With assistance be provided~~ For the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights?	Yes
k. FY 1982 Appropriation Act, Sec. 515. To be used for publicity or propaganda purposes within U.S. not authorized by Congress?	Yes