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PD BCB 971

APPENDIX 3A, Attachment 1
Chapter 3, Handbook 3 (TM 3:43)

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A = Add, C = Change, D = Delete

Amendment Number

DOCUMENT CODE: 3

COUNTRY/ENTITY: KENYA

3. PROJECT NUMBER: [redacted]

4. BUREAU/OFFICE: AFRICA [06]

5. [redacted] (maximum 40 characters): [KENYA EXPORT DEVELOPMENT SUPPORT]

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 12, DD 31, YY 98

7. ESTIMATED DATE OF OBLIGATION (Under 'B:' below, enter 1, 2, 3, or 4)

A. Initial FY 91 B. Quarter [ ] C. Final FY 97

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

A. FUNDING SOURCE	FIRST FY 91 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total						
(Grant) DFA	(2,600)	( )	(2,600)	(15,000)	(–)	(15,000)
(Loan)	( )	( )	( )	( )	( )	( )
Other U.S. 1.						
Other U.S. 2.						
Host Country				4,000	1,974	5,974
Other Private Sector					1,476	1,476
TOTALS	2,600		2,600	19,000	3,450	22,450

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	C. 2. Loan	D. OBLIGATIONS TO DATE 1. Grant	D. 2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	E. 2. Loan	F. LIFE OF PROJECT 1. Grant	F. 2. Loan
(1) DFA	730	840				2,600		15,000	
(2)									
(3)									
(4)									
TOTALS						2,600		15,000	

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

11. SECONDARY PURPOSE CODE

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

A. Code	BUW	LAB	BL				
B. Amount							

13. PROJECT PURPOSE (maximum 480 characters)

To increase non-traditional exports.

14. SCHEDULED EVALUATIONS

Interim MM 06 YY 94 | MM YY | Final MM 09 YY 97

15. SOURCE/ORIGIN OF GOODS AND SERVICES

[ ] 000 [ ] 941 [ ] Local [X] Other (Specify) 935

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

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

KKR

CONT:KKTemp

17. APPROVED BY

Signature: Carol H. Steele

Title: Carol H. Steele
Acting Director, USAID/Kenya

Date Signed: MM 06 DD 19 YY 91

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION

MM 07 DD 19 YY 91

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KENYA EXPORT DEVELOPMENT SUPPORT (KEDS) PROJECT (615-0249)
PROJECT PAPER

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ANNEXES

Figures:

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ACRONYMS

AfDB	African Development Bank
AMP	Agriculture Marketing Project
A/PRE	Bureau for Asia and Private Enterprise
CBK	Central Bank of Kenya
CDC	Commonwealth Development Corporation
CED	Customs and Excise Department
EAS	Export Assistance Service
ECA	Export Control Act
ECS	Export Compensation Scheme
EDF	Export Development Fund
EDP	Export Development Project
EPPO	Export Promotion Programmes Office
EPZ	Export Processing Zones
EPZA	Export Processing Zones Authority
FPEAK	Fresh Produce Exporters Association of Kenya
GOK	Government of Kenya
HCDA	Horticultural Crops Development Authority
IESC	International Executive Service Corps
IFC	International Finance Corporation
IMF	International Monetary Fund
IPC	Investment Promotion Centre
IPS	Industrial Promotion Services (Kenya) Limited
JICA	Japanese International Cooperation Agency
KAC	KEDS Advisory Committee
KAM	Kenya Association of Manufacturers
KCB	Kenya Commercial Bank
KEDS	Kenya Export Development Support Project
KETA	Kenya External Trade Authority
KNCCI	Kenya National Chamber of Commerce and Industry
KIE	Kenyan Industrial Estates Ltd.
K-MAP	Kenya Management Assistance Program
LPG	Loan Portfolio Guarantee
MOA	Ministry of Agriculture
MOC	Ministry of Commerce
MOF	Ministry of Finance
MOI	Ministry of Industry
MUB	Manufacturing Under Bond
NBFI	Non-Bank Financial Institutions
ODA	Overseas Development Administration
OECD	Organization for Economic Cooperation and Development
PEMU	Private Enterprise Management Unit
PED	Private Enterprise Development Project
RPE	Rural Private Enterprise Project
SME	Small and Medium Enterprises
UNDP	United Nations Development Programme
USAID	United States Agency for International Development

KENYA EXPORT DEVELOPMENT SUPPORT PROJECT [redacted]
PROJECT PAPER

I. SUMMARY

A. Summary Description

The Kenya Export Development Support (KEDS) Project (615-0249) is a seven year project whose goal is to increase employment and foreign exchange earnings in Kenya on a sustainable basis. The purpose of the KEDS Project is to increase non-traditional exports. This will be accomplished through increased investment in the export sector and development of a more favorable trade environment.

KEDS responds to two major challenges facing Kenya: growing unemployment and increasing balance of payments disequilibria. The GOK, A.I.D. and other donors recognize that the private sector must become the engine of growth for the economy through export expansion if the GOK is to achieve its employment and income targets. USAID/Kenya has supported Kenya's private sector extensively through projects and program assistance since the early 1980s. The KEDS Project will continue this emphasis. KEDS will complement other donor activities, principally the World Bank's $100 million Export Development Project (EDP), and the GOK's efforts to improve Kenya's trade regime.

The KEDS Project will consist of four major components. A Public Sector Component will provide support to the newly-established Export Promotion Programmes Office (EPPO) and the Export Processing Zones Authority (EPZA) to assist the GOK to implement export incentives schemes. The Firm Level Assistance Component will provide direct assistance to Kenyan export firms and to several export sector support organizations to expand non-traditional exports. The EPZ Swap Facility will provide US dollars for local firms to invest in Kenya's new export processing zones augmented by a guaranty facility to be established in connection with the fund. The KEDS Studies Component will help develop a strong analytical base for ongoing improvement of Kenya's export climate.

KEDS will facilitate communications between the private sector and the GOK by setting up fora for discussing important private sector issues and concerns, by developing recommendations from studies concerning improvements in the export environment, and by a project management structure which ensures that the private sector is able to communicate regularly with its GOK counterparts.

Figure 1 describes relationships between various components of the project and its coordinating committees. As the graphic displays, overall Project management will be coordinated through a KEDS Advisory Committee (KAC). The KAC Secretariat will be drawn from the public sector component technical assistance team. The members of the KAC will be senior representatives of the institutions involved in implementation of the Project. The Private Enterprise Management Unit (PEMU) will be staffed by the members of the technical assistance team delivering services to the non-traditional exporters and trade associations.

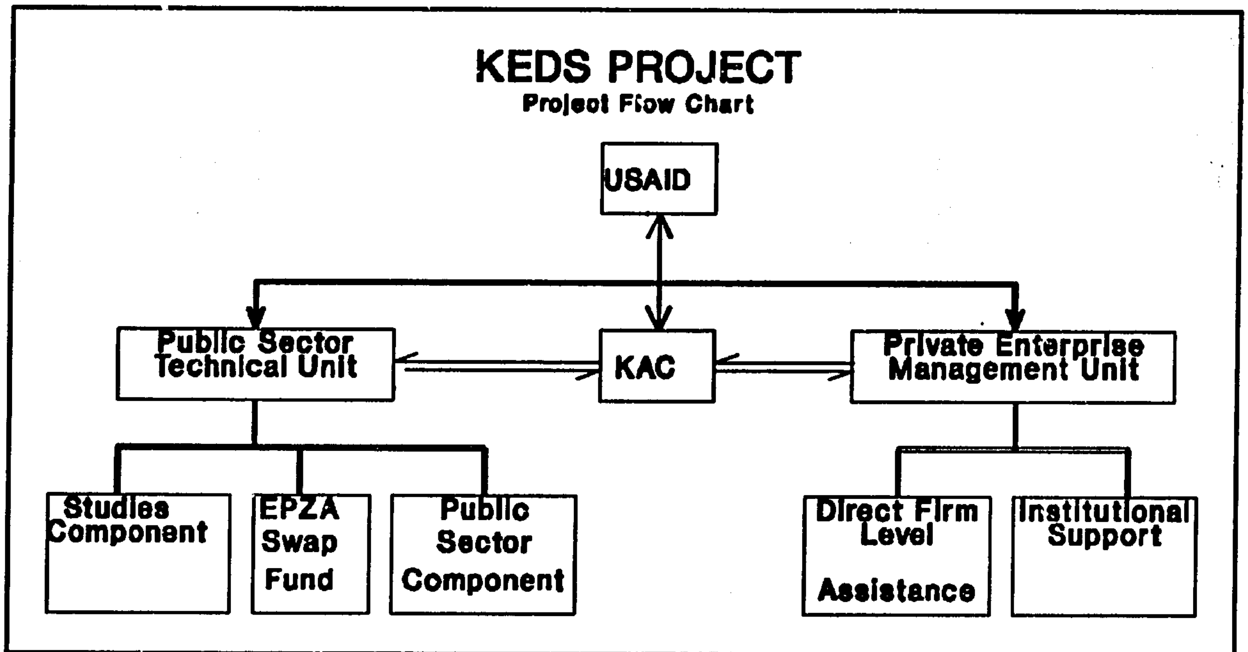

Figure 1: KEDS PROJECT FLOW CHART

The project costs by component are summarized as follows.

	Cost to USAID (U.S. $)
Public Sector Component	$ 2,550,000
Firm Level Assistance Component	6,280,000
EPZ Swap Facility Component	4,330,000
Studies Component	450,000
Evaluation/Audits	410,000
Mission Support	980,000
Total	$15,000,000

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B. Response to PID Guidance and Project Changes

The Project Committee reviewed the KEDS PID in Washington on December 4, 1990. USAID/Kenya has taken into account the guidance from AID/W in the PID Approval Cable when drafting the KEDS Project Paper. Since the PID was written, several components have been modified due to actions by the GOK and other donors and revised assessments of KEDS priorities by the mission.

The PID Approval Cable (Annex G) raised issues regarding proposed KEDS Project support to the Customs and Excise Department (CED), the Export Promotion Programmes Office (EPPO), and legislation which might be required to implement the Project. The following summarizes Mission responses to the PID Approval Cable and modifications of the Project design. Annex G discusses more fully USAID's response to the Guidance Cable.

KEDS Project assistance to the Customs and Excise Department is no longer necessary. Since the PID was completed, the African Development Bank (AfDB) has agreed to fund technical assistance, training and commodities to the CED for export promotion as part of the MOF/UNDP Tax Modernization Program. The AfDB's project will address all components which had been described as necessary in the KEDS PID.

With regard to the EPPO/Ministry of Finance, the Regional Legal Advisor has given an opinion that the work of the USAID-funded advisor to the EPPO (via the US Customs Service), falls outside the prohibited assistance described in Section 660 of the Foreign Assistance Act. Thus, KEDS Project assistance to the EPPO does not pose legal problems. However, in the contract with the institutional contractor implementing the program, a requirement will be included prohibiting the training of personnel from the CED without the prior written approval of A.I.D.

Several clarifications in existing regulations relating to the Export Processing Zones Swap Facility will be required before the Facility will be operational. Discussions with relevant GOK officials indicate that such changes are matters of further defining the Export Processing Zones Authority Act of 1990 and will be accomplished in such a fashion as to permit an orderly accomplishment of the KEDS Project purpose. These changes do not require Parliamentary action, and can be effected by the Ministry of Finance.

The GOK has recently approached the United Nations Development Program to fund two long-term advisors for the newly-legislated EPZA. Thus, it is no longer necessary for the KEDS Project to fund such assistance. Short-term assistance and training to the EPZA are included in the KEDS Public Sector

Component, and will be coordinated by the senior long-term advisor to the EPPO.

The pre-export finance facility has been dropped from the KEDS Project following further analysis. It was found that the facility is not required because financial institutions in Kenya provide pre-export financing to non-traditional exporters through overdraft lines. Other discouraging factors were that non-financial constraints are more serious impediments to small and medium-sized exporters, and financial institutions are not likely to view a targeted credit line as sufficient incentive to extend new facilities to small and medium-sized exporters of non-traditional products.

C. Project Design Committee

The KEDS Project Paper is the culmination of an 18 month design with considerable effort on the part of USAID/Kenya and REDSO/ESA. The PID Design Committee initiated work on the KEDS PID in early 1990. Representatives from USAID/Kenya's Projects/Private Enterprise, Program, Agriculture and Controller's offices as well as REDSO/ESA's Analysis, Projects, and Legal offices participated in the KEDS PID and Project Paper design.

II. Background and Rationale

A. Background

1. Current Status of the Kenyan Economy

Kenya has been a top economic performer in sub-Saharan Africa since Independence in 1963. Kenya's economy grew seven times faster in the 1980s than sub-Sahara Africa as a whole and has posted a real GDP growth rate of over five percent per year over the past five years. In addition, the Government has taken significant steps to reduce Kenya's population growth rate, which is now estimated at 3.8 percent per annum, down from 4.1 percent in 1984. Table I displays some key indicators of the Kenyan economy and their trends over the last four year period.

TABLE I
KEY ECONOMIC INDICATORS: 1987-1991

	1987	1988	1989	1990 (est)	1991 (est)
(real growth rates)					
GDP at Market Prices	5.8	6.1	5.0	4.5	3.5
GDP/per capita	1.9	2.1	1.1	0.7	-0.3
Consumption/per capita	3.1	4.0	-0.3	-0.5	-0.2
Inflation Rate	6.6	10.4	10.1	12.7	10.0
Real Effective Exchange Rate Depreciation	-14.0	-2.2	-7.2	na	na
Broad Money	12.4	8.3	17.8	15.0	12.0
Debt Service/Exports	33.0	29.3	30.6	32.0	30.0
GOK Expenditure/GDP	28.0	29.7	30.5	31.0	29.0
Budget Deficit/GDP	4.2	4.6	4.2	5.0	3.0
Current Act./GDP	-6.3	-5.3	-5.9	-5.8	-5.0
Gross Official Reserves (Months of non-gov. imports)	2.1	2.1	2.2	1.0	2.0

This high level of economic growth over the second half of the 1980s was fueled by (1) strong agricultural growth made possible by highly favorable weather conditions, increased fertilizer use, and policy reforms that have improved farmer incentives; (2) increased imports financed by lower oil prices and increased foreign assistance; (3) high levels of government spending (nearly 20 percent average annual increases) to "prime the pump" of the economy; and (4) strong performance in the tourism and horticulture sectors. Presently, however, there are strong signs that the growth surge of the late 1980s is weakening. Real economic growth for 1990 is estimated at 4.5

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percent, while inflation is re-emerging as a major problem. After averaging under 10 percent for the past five years, the annual inflation rate is presently estimated (unofficially) at over 15 percent.

2. The Employment Crisis

Kenya's high rate of population growth, combined with the inefficient utilization of labor in the economy, has generated a major employment crisis. Over the next decade, the labor force will grow by an average of 3.7 percent annually, 6.5 percent in urban areas and 2.2 percent in rural areas. The present rate of job creation in the economy (3 percent per annum) is too low to keep up with growth of the labor force. The World Bank estimates that 420,000 to 450,000 people will enter the work force each year between now and the year 2000. The rate of unemployment and underemployment will rise very quickly and downward pressure on wage rates will accelerate unless the rate of job creation is increased dramatically. This will lead to lower standards of living and growing discontent and disillusionment with the Government.

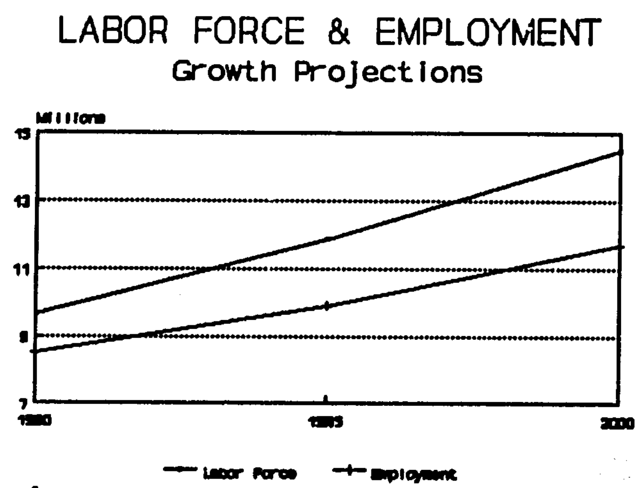

Figure 2
(Source: Private Enterprise Strategy, 1990)

In many ways, the present decade will be the most challenging in terms of the labor absorption problem. The labor force in Kenya is estimated to be 9.9 million, and is projected to grow to 14.2 million by the year 2000. Of the current labor force, only 1.8 million people are engaged in wage employment, and less than 700,000 of these jobs are in the formal private sector. The formal private sector was only able to generate 50,000 new jobs in 1990, compared with 400,000 new entrants in the labor market. The number of new jobs required each year to accommodate the growth in the labor force will rise from 400,000 per year in 1990, to over 600,000 new jobs needed each year by the year 2000. Figure 2 illustrates this problem.

The projected urban labor force growth of 6.5 percent per annum is particularly striking and troubling. This growth derives from the continuing high birth rate, continuing rural to urban migration, and a rapidly rising rate of female labor force participation. The need for the economy to provide jobs for women will be especially important. Open unemployment of women in urban areas is already twice that for men and the female urban labor force is growing faster than the male urban labor force.

Since Independence, smallholder farms and the public sector have been the primary sources of job creation. Only recently have other areas in the economy such as the informal urban sector and the rural non-farm sector begun to add jobs to the economy at a rate faster than the smallholder sector and the Government. Because of the GOK commitment to reduce government spending, the public sector can no longer be relied on to create jobs. Between 1963 and 1985, public sector employment grew by approximately 5.5 percent annually while private sector modern wage employment grew by approximately 1.6 percent annually. There is mounting evidence that the approach of absorbing labor through public employment is having increasingly adverse macroeconomic effects. The rising public sector wage bill is a major source of inflation-promoting budget deficits. It has increased the percentage of recurrent government expenditures spent on wages and salaries to over 70 percent, squeezing out necessary complementary expenditures on operations and maintenance.

A number of recent studies have looked at alternative employment growth models for Kenya and have identified several non-public sector approaches to faster employment creation. The recommendations in these studies revolve primarily around increasing the labor intensity of production, increasing the productivity of capital and increasing the overall rate of economic growth. With respect to increasing the labor intensity of production in agriculture, the solution involves moving to higher value crops, particularly export crops. Outside of agriculture, there is a need to move from the present capital intensive and inefficient import-substitution manufacturing in Kenya to more labor-intensive export oriented manufacturing such as garment assembly and electronic componentry.

3. <u>Balance of Payments</u>

Kenya's balance of payments has become a major problem in recent years as the import bill continues to grow while export receipts continue to decline. By 1989, imports were close to $2 billion while exports were less than $1 billion, with the difference funded in large part by foreign aid. Coffee and tea account for about half of total exports. Agricultural exports as a whole account for approximately 70 percent of total exports. For this reason, Kenya's trade and current account balances swing wildly from year to year, depending on commodity prices. For example, coffee prices were down 50 percent in 1989 from 1988. International coffee prices, hence producer prices, continued to decline in 1990, resulting in many farmers switching from coffee to other agricultural crop production.

Reliance on increasing foreign aid (about 12-13 percent of GDP in 1989) is not a sound strategy for Kenya. Although gross assistance may remain at current levels (about $1 billion in new commitments annually) provided Kenya continues to implement the policy reforms promised to donors, net aid will continue to decline as debt service payments increase. Foreign investment must replace foreign aid if sustainable growth is to be achieved. In 1987 and 1988, net foreign direct investment was negative. It was slightly positive in 1989.

Recent sharp declines in coffee prices, disruptions in the tea sector, and lower receipts from tourism have adversely affected Kenya's balance of payments position. Foreign aid flows have dropped in real terms over the past two years and show no sign of increasing. Thus, Kenya must markedly improve its non-traditional export performance if these reductions in foreign exchange are to be covered.

4. Description of the Export Sector

Kenya's external trade performance since Independence has been dominated by expansion of coffee and tea exports and the concurrent swings in commodity prices. Despite its position as one of the most industrialized countries in Africa, Kenya's export portfolio relies almost exclusively on primary commodities. Coffee and tea represented 38 percent of non-oil export earnings in 1963 and increased to 54 percent of exports by 1987. These increased coffee and tea earnings have been limited due to falling commodity prices, with Kenya's terms of trade index falling from 161 in 1964 to 74 by 1989.

TABLE II
KENYAN CURRENT ACCOUNT SUMMARY

	1964	1980	1985	1987	Est. 1989	Est. 1990
			(SDRs in Millions)			
Exports	217	969	929	702	718	768
Imports	246	1,987	1,447	1,457	1,771	1,773
Trade Bal.	(30)	(1,019)	(520)	(755)	(1,052)	(963)
Tourism	..	184	230	256	305	348
C.A. Bal.	51	(682)	(89)	(387)	(471)	(280)
			(Percent of GDP)			
Exports	22	18	16	11	12	na
Imports	25	37	24	24	25	na
C.A. Bal.	5.1	-12.5	-1.5	6.3	-7.3	-5.8

As a result of a declining terms of trade and reliance on coffee and tea exports, the ratio of Kenya's exports to GDP fell from 22 percent in 1964 to 12 percent in 1989. By 1980, falling exports receipts could no longer pay for the import capacity necessary to sustain growth. While exports have fallen as a share of GDP, imports have remained at roughly the same 25 percent share of GDP over the 1964 to 1990 period. In 1964, exports just about covered the import bill while in 1990 exports covered less than half of the import bill.

Manufactured exports have not been a significant source of foreign exchange earnings in Kenya. Because of the import substitution strategy pursued by Kenya since Independence, manufacturers have received strong import protection, guaranteeing higher returns in the domestic market. The results of a recent World Bank study estimated that the effective rate of protection (ERP) was 89 percent, with some industries' ERP as high as 1000 percent. These anti-export policies have resulted in a large, inefficient manufacturing sector which is a substantial net user of foreign exchange, earning less than 20 percent of its foreign exchange requirements.

The growing trade imbalance since the late 1970s has been financed mainly by tourism growth and foreign aid. Tourism became a major foreign exchange earner in the early 1980s, increasing by over 60 percent between 1980 and 1990, with most of the growth occurring in the 1984-88 period. Tourism has taken a marked downturn due to the Gulf War. However, it is expected to continue to grow, though at a slower rate than over the past decade.

Foreign aid has increased dramatically in Kenya since 1985, financing the growing disparity between exports and imports. Public and private grants increased from $172 million in 1980 to an estimated $370 million by 1989. Increased lending from the World Bank, the African Development Bank and the Japanese, increased net official long-term capital inflows from negative $55 million in 1985 to an estimated $475 million by 1989.

Net private foreign direct investment, however, has been negative in recent years. This is primarily attributable to the growing concerns over Government transparency and burdensome investment regulations. There are a number of specific reasons for foreign investors not investing in Kenya including: government controls on ownership and repatriation of profits; government delays and costs involved with licenses and regulations; low and mid-level corruption which increases the cost and risk of doing business; government price and interest rate controls; and government capital and exchange controls. While the large increase in foreign aid experienced over the past six years has cushioned the impact of declining exports and fluctuating oil prices, it has also allowed the GOK to avoid

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necessary policy changes that are required to increase foreign investment and exports.

For the purpose of this analysis, Kenya's exports of goods and non-factor services have been divided into four categories: traditional; tourism; oil exports; and, non-traditional. Traditional exports include coffee and tea. Non-traditional exports include manufacturing, horticulture and other. The "other exports" category includes agro-processing and raw materials like soda ash and sisal.

TABLE III
KENYAN EXPORTS BY CATEGORY

(Millions of $)

	1985	1987	1989
1. Traditional	514	434	460
a. Coffee	281	236	197
b. Tea	233	198	263
2. Tourism	240	354	418
3. Oil Exports	155	124	110
4. Non-Traditional	318	401	416
a. Manufacturing	73	72	98
b. Horticulture	65	94	77
c. Other	180	235	241

Traditional Exports

Traditional exports will continue to be a staple in Kenya's export portfolio into the next century, but coffee and tea will play a declining role in the nation's foreign exchange earnings. World Bank estimates suggest that slow growth in coffee and tea exports is expected to continue, though typical commodity boom and bust periods can be expected. These estimates are based on a continued oversupply in the world market leading to downward pressure on world market prices, and Kenya's limited arable land that constrains expansion of coffee and tea production. Productivity in the traditional export sector is one of the highest in Africa and is not a binding issue in Kenya today.

The oversupply of traditional export commodities is expected to continue well into the next century with predictions that the terms of trade for traditional exporting countries will continue to decline. Kenya's limited supply of arable land requires difficult decisions by farmers on planting preferences. In fact, with declining prices, some farmers have recently returned a portion of their coffee crop land to maize production in order to meet food requirements, even though it is illegal to uproot a coffee tree. Many farmers are also turning to higher valued horticultural crops instead of coffee and tea.

The role of the marketing parastatals continues to be the single largest problem facing the coffee and tea farmer. The coffee and tea parastatals have been plagued with mismanagement and, as a result, have been extremely late in paying farmers for their crops, disrupting capital expenditures by farmers and in some cases bankrupting them. In addition, there is need to rehabilitate much of the processing capacity. The World Bank has taken the lead in the traditional export sector with two projects that have as their primary goals to revitalize the parastatals and ensure timely payment to the farmers. The European Economic Community and the Overseas Development Agency are also supporting infrastructure and pricing reforms in the sector.

Tourism

Tourism is presently Kenya's largest foreign exchange earner. It is also one of the country's largest employers. Tourism grew rapidly during the early 1980s and became Kenya's largest single foreign exchange earner in 1987. The sector has continued to grow, though at a slower pace, in the past several years. In 1989, total visitor arrivals increased to 714,000, from a base of 430,000 in 1980.

The depreciation of the Kenyan shilling continues to make Kenyan holidays price-competitive, with increasing numbers of tourists combining coastal holidays with up-country safaris. The Gulf Crisis has resulted in a marked drop in international tourists visiting Kenya. The tourist industry has reduced real prices by over 25 percent during the first quarter of 1991. Nonetheless, the Government is counting on tourism receipts to increase by an average of 9.4 percent a year over the next five years in SDR terms. These estimates may be overly optimistic given the recent slowdown and the substantial constraints that will confront the tourism industry over the next decade.

The World Bank will study the effectiveness of official tourism agencies as part of their Export Development Program. The study will also examine the efficiency of the GOK's Kenya Tourism Development Corporation, particularly compared to private sector bodies such as the Kenya Association of Tour Operators.

The primary constraints to rapid tourism growth fall into four areas: recent negative publicity concerning violence in the parks and malaria at the coast; infrastructure and capacity constraints at major parks and beach resorts; degradation of wildlife and the environment; and increasing competition from other African countries. Negative publicity surrounding violence at the National Parks is being combated by an aggressive anti-poaching campaign by the Kenya Wildlife Service (KWS) and improved park management. USAID is working with the KWS and the World Bank to assess the extent of the environmental problem and is committed to an ecologically sound tourism strategy in the design of its new natural resource management project. As Tanzania, Rwanda and Uganda expand their tourism industries, Kenya will see increased regional competition. In addition, a post-apartheid South Africa will bring new competition to Kenya's market position.

<u>Oil Exports</u>

Exports of oil comprised approximately four percent of total goods and non-factor services exports in 1990. This figure represents the re-export of refined oil which has been imported into Kenya as crude. Despite the fact that oil is listed as an export item, Kenya is a net importer of oil, and the only foreign exchange actually earned through oil exports is the value added from the refining process.

Kenya exports oil to land-locked countries -- primarily Burundi and Rwanda. The value of oil exports has declined since 1985 due to transport transit problems with neighboring countries. With recent sharp declines in the availability of foreign exchange in Kenya, the GOK has chosen to limit oil importation to close to the amount needed for domestic consumption. Oil export earnings are expected to drop sharply in the future.

<u>Non-traditional Exports</u>

The non-traditional export sector has experienced mixed results in Kenya. The manufacturing sub-sector has retained the same 12-14 percent share of non-oil exports since Independence. Manufactured exports have been the one category that has actually seen a decrease over the past fifteen years, declining by an average of four percent per year in real terms, though they have begun to increase again in 1988/89. This long term stagnation in real manufacturing exports is a result of the drying up of the regional market following the demise of the East African Community and the economic crisis faced by virtually all of Kenya's neighbors. The decline caused by the collapse in regional markets has been reinforced by Kenya's strong anti-export bias in manufacturing and its extremely high rate of protection for domestic manufacturing firms.

Since 1980, horticultural and agro-processing exports have almost tripled in value. Part of the reason for these successes relates to strong European demand and favorable soil and climatic conditions in Kenya. Horticulture and agro-processing have only recently become major export earners, with horticultural exports increasing substantially between 1985 and 1987 while processed fruits and vegetables, and hides and skins increased substantially over the 1985-89 period.

Reasons for the success of horticulture and agro-processing and for the failure of manufacturing are closely related. The relatively favorable regulatory environment and limited taxation have greatly helped rapid horticulture expansion while the overbearing regulatory controls and anti-export bias for manufacturing has led to stagnation in manufactured exports.

USAID/Kenya has recently funded a number of studies on Kenya's export regime including a 1988 study on price controls, a 1989 Kenya Association of Manufacturers study on export incentives and a 1990 Government study on establishing export processing zones. The studies found that Kenya's existing policy environment must be completely overhauled before non-traditional exports can be expected to grow substantially.

Using the above studies as a base, USAID/Kenya has undertaken a detailed constraints analysis of the non-traditional export sector. Kenya's non-traditional exports face a set of constraints that fall into three general categories: policy and regulatory; firm level and market; and credit.

Governmental policy constraints constitute a general anti-export bias. This is caused by: foreign exchange controls; import restrictions; regulatory controls and extensive registration and licensing criteria; fiscal policy; transport constraints and rent seeking.

Foreign exchange controls and limited access to foreign exchange inhibit firms from marketing their products, from identifying and developing new market opportunities, from importing necessary inputs and from investing foreign exchange in required capital equipment. Import restrictions, regulatory controls and customs requirements include licenses of various types and controls which inhibit investment in most sectors.

Registration and licensing requirements, and taxes and cesses at local, district, provincial and national levels, all make it difficult for exporters, particularly those new to the business, to begin operations and to compete internationally. Transport problems, especially delays and high charges at Mombasa Port and Nairobi Airport (JKIA), also make Kenya's non-traditional exports less competitive. Finally, rent seeking, in its various forms, discourages both investment in new production and diversification of markets and production.

The GOK, with extensive donor support, is committed to improving the climate for non-traditional exports, and the KEDS Project will work to augment those efforts. USAID believes that if most government and policy-related constraints can be relieved, or lifted entirely, Kenya's competitive position would improve dramatically. Therefore, considerable emphasis will be placed, in coordination with the GOK and other donors, on reducing the anti-export bias that prevents new firms from entering the market and other firms from expanding their markets. Firm level constraints are primarily attributable to:

- Lack of market knowledge and information by industry and trade associations;
- Lack of access to relevant technical assistance;
- Lack of access to specific market information;
- Poor quality, particularly of manufactured goods;
- Lack of representation in foreign markets; and,
- Poor access to world markets.

Geographic distance from European, North American and Asian markets has led to many problems in expanding Kenya's export base. Many of the firm-level constraints could be removed if more information on these markets could be provided. Non-traditional exports can expand substantially if firms become more attuned to consumer demand, the level of quality required, and the competition faced in these markets.

Exporters of non-traditional goods, particularly new or small scale exporters, also face constraints in the following credit-related areas:

- Lack of accessibility to credit by small and medium enterprises;
- High collateral/security requirements for exporters;
- Cost of credit; and,
- Credit ceilings.

B. Project Rationale and Strategy

1. Conformity with GOK Priorities

The Government's 1986 Sessional Paper #1, "Economic Management for Renewed Growth" outlines policies to be followed to accelerate growth into the 21st century. It stresses the dominant role that must be played by the private sector in revitalizing the economy and the need for the Government to establish market-based incentives to promote private sector activity. Although implementation has been slower than planned and many proposed actions have not taken place, the strategy is laudable and one USAID supports. The Government's medium-term trade and development strategy has been presented in the 1990-92 Policy Framework Paper (PFP) and in the Vice President's budget speech in June, 1990 entitled "Enhanced Economic Growth through Export Promotion."

The GOK recognizes the parameters of the growing problems that the country faces and has articulated an appropriate strategy to address them. The GOK has outlined its new medium-term development plan with priorities given to: expanding and diversifying the export base while improving the enabling environment for the private sector; intensifying agricultural production and increasing the efficiency of marketing arrangements; and rehabilitating and improving the overall quality of the infrastructure.

The Government's medium-term policies to decrease the trade deficit are conceived as part of a broad strategy to eliminate the anti-export bias in the economy and to revitalize the productive sectors. Macroeconomic policies, such as a flexible exchange rate management system, and specific sectoral reforms are to be pursued to establish a diversified base for growth and to reduce the country's dependence on coffee and tea as its major exports.

Specific export growth incentives that promote the efficiency of the industrial sector mainly concentrate on consolidating the reform of the trade system by completing the second phase of the World Bank's import liberalization program. Imports which were previously limited by quotas have been replaced with a tariff system. Import schedules were liberalized in 1988. The Government intends to liberalize most of the goods that are still subject to quantitative restrictions by June 1991.

The GOK recognizes that an increasing share of its future industrial growth and export receipts will have to come from non-traditional exports. The Government tabled legislation with Parliament in the June 1990 Budget Speech to provide a framework for export processing zone development. In order to reduce the anti-export bias of existing export activities, the Government has established a duty drawback/exemption scheme so that exporters of non-traditional goods will pay international prices for their imported inputs by being exempt from import duties. The Government also announced in the June Budget Speech plans to implement a line of credit scheme for exporters and provide specific firm-level assistance as required.

The Government has set up a Cabinet-level committee on investment to remove bottlenecks in the investment approval process in an effort to encourage foreign investment. The GOK also plans to continue to decontrol items on the controlled price list. In late 1989, the GOK decontrolled the prices of animal feed, soft drinks and fertilizer, reducing the number of controlled items to 18. On May 3, 1991, the GOK further decontrolled 6 products: cement; iron and steel bars; barbed wire; nails; margarine (Blue Band); and beer (Tusker, Premium and Guinness Stout) leaving 12 products on the Price Control Order. The GOK will also continue to devalue the Kenya shilling.

The broad policy framework is in place for the transition to a more outward-oriented strategy. Senior government officials strongly support policy change to enhance foreign exchange earnings. However, effective implementation of this strategy and private sector confidence in the credibility and sustainability of the strategy remain areas of concern.

2. Conformity with USAID CPSP & Private Enterprise Strategy

The KEDS Project will directly address the issues of generating employment and foreign exchange as set out in USAID's March, 1990 Country Program Strategic Plan (CPSP). USAID has identified these as important constraints to the development of the Kenyan economy. The Project will indirectly address income and production, other key elements of the Mission's strategy.

The Mission's Private Enterprise Strategy (PES) emphasizes employment generation as its strategic objective. Exports and Small and Medium Enterprise (SME) profitability are the two targets under this employment objective. The ongoing activities under the Private Enterprise Development Project, address the Small and Medium Enterprise target. The KEDS Project will complement those projects by addressing the export target.

Non-traditional exports, particularly from the horticultural and agro-processing sectors, have been identified by USAID, the GOK, the World Bank and other donors as the primary "engine" for export growth and its attendant employment creation and foreign exchange earnings. The KEDS Project will support the growth of these exports through assistance to the GOK to improve the trade climate. KEDS will provide support to the private sector on marketing and promotion; will strengthen trade institutions, will provide foreign exchange for investments in the new export processing zones; and will finance a series of trade policy studies.

3. Relation to Other Donor Activities

The GOK has agreed to a number of reforms included in the IMF/World Bank Policy Framework Paper and the World Bank's Export Development Project (EDP). The KEDS Project is a direct complement to this $100 million credit facility. USAID-financed technical assistance will enable the GOK to enact the policy and operational reforms agreed to in the EDP.

These major policy conditions which are supported by USAID include:

- o Extension of tariff reductions to further reduce the level and variability of effective protection and resulting revenue losses;
- o Extension of the automatic licensing to include additional scheduled items;
- o Implementation of agreed upon reforms to enterprise regulations;
- o Continued ongoing evaluation of export compensation schemes to include indirect exporters; and,
- o Continued support and legislative actions relating to Export Processing Zones.

The EDP credit will finance the installation of additional cargo handling equipment conditioned on the completion of a study and initiation of an action plan to introduce private sector management for air cargo handling operations. It also provides an investment loan for site development of the export processing zone at Athi River.

The UNDP is funding two major elements in the GOK's export development program. The first (with USAID co-financing) is a major tax modernization program with the Ministry of Finance's Fiscal and Monetary Unit. The second is support for two long-term advisors to work with the Export Processing Zones Authority (EPZA). KEDS assistance to the EPZA will be coordinated closely with the UNDP technical assistance project.

The GOK and donors have recognized that a major constraint to export development in Kenya is the lack of a modern, efficient tax system. Tax modernization and tax reform can be key instruments to encourage exports, and promote expansion and additional investment in export enterprises. Toward this end, the African Development Bank (AfDB) is providing approximately $4.7 million in institutional support to the MOF for several components under the UNDP Tax Modernization Program. The AfDB facility will provide three long-term experts to the Customs and Excise Department in systems development, control and audit, and computer system implementation management. Additionally, there will be short-term consultancies in systems development for export promotion, development of computer-based tax models, and computer system development.

The Kenya Ports Authority has received a grant of approximately $20 million for technical assistance and commodities to improve ports operations, especially container handling. The Netherlands and France are also working with the ODA and the Kenya Ports Authority to improve export and import operations. This is directly in line with constraints identified during the KEDS design. This assistance will improve Kenya's export environment and support KEDS efforts.

The Kenya External Trade Authority (KETA), of the Ministry of Commerce, is undergoing an institutional review by JICA of Japan in order to improve its export promotional capabilities through Kenya's overseas diplomatic missions. KETA hopes to develop a "Masterplan for Exports" with Japanese assistance. It is expected that the Japanese will provide promotional assistance to KETA which will complement KEDS export promotion efforts directed through the private sector.

The International Finance Corporation (IFC) and the African Project Development Facility (APDF) offer long-term finance and business plan preparation primarily to import companies and industrial exporters. The UNDP has implemented a management assistance program through the Kenya Industrial Research Institute to create viable small and medium enterprise supplier linkages to larger firms. A new two year UNDP-financed pilot project will be initiated in late 1991 to assess small and medium enterprise quality control activities. UNDP programs are channelled indirectly to the private sector through public institutions.

Most donors who offer financial assistance to small and medium enterprises channel their assistance through lines of credit with commercial banks. Other donors, such as the Germans and in the past the World Bank, provide credit assistance through guarantees with parastatal development financial institutions. This assistance can provide indirect financial support to exporters. However, there are no donor programs which are specifically targeted to assisting small and medium scale exporters.

The World Bank's Export Development Project (EDP) includes a $2 million Export Assistance Service (EAS) credit component for firm level assistance. The EAS program will be coordinated through a public sector organization, likely the Kenya Commercial Bank (KCB). The EAS will include cost-sharing grants, a European-based export specialist and a management contractor in Kenya. The EAS component will emphasize manufactured and processed exports. The KEDS Project Firm Level Assistance Component will complement this program. The KEDS and EAS approaches are similar. The two sets of promotional activities will be closely coordinated.

The World Bank will finance a series of studies during 1991 to satisfy conditions set out in the EDP. These include:

o Needs evaluation of the MOF's export compensation scheme;

- Design of alternative export promotion schemes such as bonded warehouses, and expansion of free trade status to indirect exporters;
- Further development of export financing facilities;
- Evaluation of the effectiveness and efficiency of official tourism sector institutions;
- Review of import duty exemptions extended to non-exporters; and,
- A study of factors constraining air cargo handling at Nairobi airport, with a view toward introducing private sector management for air cargo handling.

The KEDS Project, through its Studies Component, will examine a number of issues complementary to those set out by the World Bank, including foreign exchange rates and allocation, policies which directly and indirectly discourage exports, taxation issues regarding imports and exports. The KEDS Project may fund studies regarding the effects of regulations, licensing and taxation with the objective of improving the policy environment to encourage non-traditional exports.

4. Relation to USAID/Kenya's Past and Present Activities

The KEDS Project will form an integral part of USAID's private enterprise portfolio in Kenya. It will follow on past private enterprise activities and will complement several ongoing projects both in the private sector and those directed towards improving the GOK's private sector policy environment. The Project will directly aid the GOK's stated objective of promoting non-traditional exports. The Mission's Private Enterprise Strategy of 1990 highlights the fact that both the GOK and USAID recognize the need to change the policy environment to increase employment and to generate foreign exchange. The private sector must take the lead in export growth within a favorable and encouraging policy environment.

A.I.D. has developed three projects in the areas of firm level and institutional assistance: Rural Private Enterprise (RPE), Agricultural Management (AMP) and Private Enterprise Development (PED). Between 1983 and 1991, the RPE Project delivered training courses to the banking sector, packaged feasibility studies and provided direct management assistance to medium-scale firms. From 1987 to 1991, the AMP Project has provided customized training and assistance to agribusinesses. The PED Project is funding direct investor assistance through the GOK's Investment Promotion Centre business plan preparation, by A.I.D.-funded equity capital institutions Kenya Equity Capital/Industrial Promotion Services, and low cost technical consultancies through a reimbursable grant to the International Executive Services Corps.

Various institutions have benefited from PED support, including the Kenya National Chamber of Commerce and Industry and the Kenya Association of Manufacturers (KAM). Through KAM, A.I.D. has funded studies of the impact of government policies on the manufacturing sector and a series of business development seminars for smaller companies. In addition, management and entrepreneurial development resources were used in the start-up of the Kenya Management Assistance Program (K-MAP), a new organization which mobilizes experienced Kenyan managers for voluntary counseling to small businesses.

Several of the financial activities that have preceded the KEDS Project have addressed the lack of term credit and venture capital in Kenya's financial system for business start-up and expansion. Many of the activities have dealt with small and medium enterprises, which traditionally have had the most difficulty in accessing formal credit institutions.

The first of these activities was a Bureau for Asia and Private Enterprise (A/PRE) loan to the Kenya Commercial Bank. The loan tested the initial concept of providing development credit through a commercial lender. Next, RPE focused on the need for medium-term credit for rural businesses by providing funding assistance to commercial banks for on-lending to rural businesses. This was followed by an A/PRE loan guarantee program which guaranteed 50 percent of the credit risk of small businesses as a means for addressing collateral constraints of small businesses.

USAID managed an informal sector loan program (Jua Kali Program) to provide working capital to microenterprises. Through a Kenyan NGO, Rural Enterprise Program, the Mission supports institutional strengthening of other NGOs involved in microenterprise development, and direct lending to microentrepreneurs using a minimalist credit approach. The KEDS Project will continue to provide support to SMEs, thereby building upon previous private sector activities.

III. PROJECT DESCRIPTION

A. Project Overview

The KEDS Project consists of four interrelated components to facilitate development of the export sector. The planned mix of public and private sector Project activities encompasses technical assistance, training, commodities, analytical research and finance activities.

The KEDS Project will provide support to the newly-formed Export Promotion Programmes Office (EPPO) and other agencies in the Ministry of Finance to assist the GOK in its efforts to improve the export environment, to enhance dialogue with the private sector, and to expand non-traditional exports. KEDS will provide technical assistance, training and commodities to make the EPPO an effective export promotion and policy unit, and to make the EPPO the direct link between private sector exporters and the GOK. The KEDS Project will also work with other GOK agencies, including the newly-legislated Export Processing Zones Authority (EPZA), the Central Bank of Kenya (CBK), and the Horticultural Crops Development Authority (HCDA) to streamline the export process and promote exports in non-traditional sectors.

Technical assistance will be provided to non-traditional exporters directly and through private sector associations and groups to identify promising export markets; to produce internationally competitive products; to promote and sell products in established and new markets; to obtain information on changing markets; and to expand export production. The KEDS Firm Level Component will finance a Private Enterprise Management Unit (PEMU). The PEMU will oversee the provision of technical assistance and training, and will manage the Export Development Fund (EDF), a facility for providing firm level advisory services in a variety of areas.

The KEDS Project will provide a credit swap (Kenyan Shillings for US dollars) through the Export Processing Zone Swap Facility established at the Central Bank, working through local commercial banks. The Facility will allow local medium-scale investors to obtain the hard currency necessary to invest in the new export processing zones (EPZs). Training and technical assistance will be provided to the Central Bank and commercial banks regarding the utilization of the EPZ Swap Facility and the accompanying Export Processing Zone Guaranty Facility. Emphasis will be placed on promoting credit facilities for small and medium scale exporters by commercial banks through more extensive use of A/PRE's loan portfolio guarantees (LPGs) with six bank and non-bank financial institutions (NBFIs)

Finally, the Project will finance key studies which will be undertaken through private sector associations, the Ministry of Finance and the Central Bank. The purpose of these studies will be to determine ways by which export bottlenecks, whether caused by government policy, the general trade regime, lack of information, poor implementation, inaccessibility to foreign exchange or other constraints, can be removed to improve the overall environment for Kenyan exports. Studies funded under KEDS will complement work being carried out or planned, through the MOF, other GOK agencies and private sector organizations funded by USAID, the UNDP, the World Bank, ODA, the AfDB and others.

B. Project Goal, Purpose and EOPS

The goal of the KEDS Project is to increase employment and foreign exchange earnings in Kenya on a sustainable basis. Employment and foreign exchange generation have been identified, both by the GOK in several of its policy and strategic planning documents and by the international donor community, as two main problems facing the Kenyan economy as it moves towards the new century. There is a growing consensus that only in the context of an outward looking economic development strategy can Kenya generate productive employment opportunities for its growing labor force. The KEDS Project will support the extension of Kenya's structural adjustment program into the area of export promotion as a crucial component of the shift from an inward to an outward looking strategy.

The purpose of the Project is to increase non-traditional exports. This will be accomplished through increased investment in the export sector and development of a more favorable trade environment. Analysis has shown that Kenya's traditional export sector, while it has a critical role to play in both employment and foreign exchange generation, will simply not be able to grow at the rate needed to meet the goals that the GOK has set for itself on both employment and foreign exchange earnings. KEDS will help Kenya to expand non-traditional exports by facilitating the rapid implementation of key policy changes; by improving the policy and regulatory environment for exporters, both in the export enclave EPZs and in the economy as a whole; and by enhancing the speed and scope of the private sector response to this changing environment with efficient export investments. In the context of continued implementation of the structural adjustment program as agreed to in the 1990-1992 Policy Framework Paper; sustained donor support, especially by the World Bank; and continued buoyant performance by Kenya's traditional export earners, the KEDS Project will be able to achieve its goal and purpose.

KEDS achievements will include up to one million jobs created and up to $770 million in additional foreign exchange earnings by the end of the decade.

End of project status indicators will consist of:

* 55 percent increase in foreign exchange earnings from manufactured, horticultural and other non-traditional exports.
* 6 percent increase in non-traditional exports relative to traditional exports.
* Geographical diversification of exports and export markets--Exports to EEC reduced by 3 Percent.

C. Project Components

1. Public Sector Component

The KEDS Project will finance technical assistance, training and commodities to improve GOK trade policy analytical capabilities, and to assist with the implementation of new export incentive programs through the EPPO in the Ministry of Finance. KEDS, through the EPPO, will also provide technical services, short-term technical assistance, and limited training and commodities to the Export Processing Zones Authority (EPZA) in conjunction with the UNDP's long-term technical assistance program.

The Public Sector Component technical team will oversee technical assistance to the Central Bank of Kenya (CBK) and commercial banks for the EPZ Swap Facility Component. The Public Sector team will also provide primary oversight and management for the Studies Component of KEDS.

Day-to-day management of the KEDS Public Sector Component will be provided through the Export Promotion Advisor attached to the MOF. Her/his responsibilities will include overall management of the KEDS EPPO, EPZA, EPZ Swap Facility and Studies activities.

The KEDS Public Sector Support Component will consist of highly qualified technical assistance consultants located within the Ministry of Finance, working directly with counterparts in the EPPO. The consultants will work with other relevant officers and advisors in the MOF, particularly those working on the Tax Modernization Project, in all aspects of export promotion to strengthen the EPPO as the MOF's key export promotion agency.

KEDS assistance will consist of a long-term Export Promotion Advisor (4.5 years), short-term technical assistance, commodities and training. The Export Promotion Advisor will serve as the lead technical consultant and will be assigned to the Project for four and a half years. The Export Promotion Advisor's overall objective will be to work with GOK counterparts to promote the growth of non-traditional exports. Promotion will take several forms. These will range from ensuring that relevant GOK agencies and the private sector are aware of GOK export promotion programs, to providing the GOK with up to date information and recommendations on means to streamline trade processing requirements.

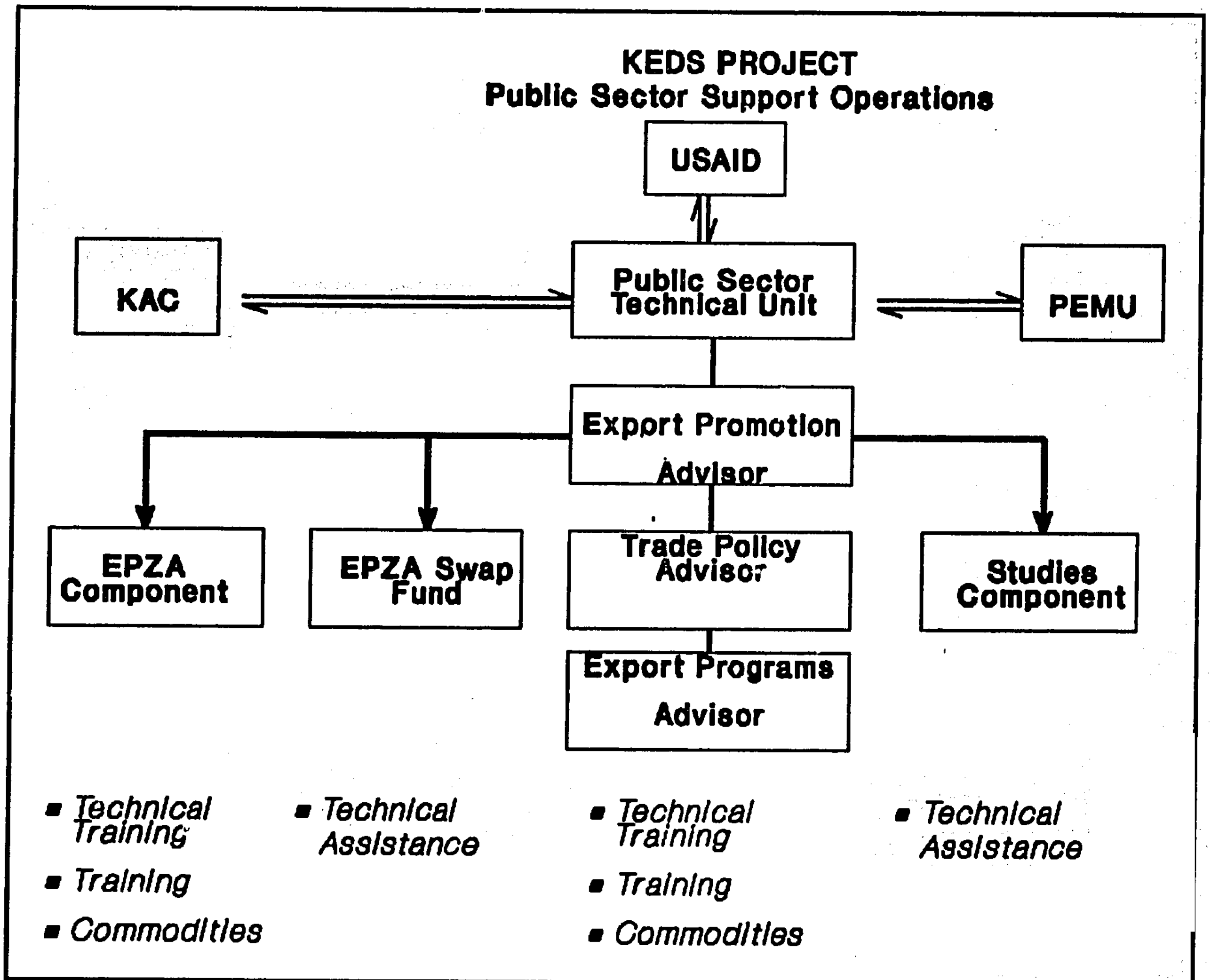

Figure 3: PUBLIC SECTOR OPERATIONAL FRAMEWORK

The Export Promotion Advisor will coordinate the Public Sector Assistance activities to assist in the smooth functioning of the EPPO. The Export Promotion Advisor will work with MOF counterparts to assure responsiveness to private sector needs both on individual applications and through the KEDS Advisory Committee (KAC) on industry wide needs. The Export Promotion Advisor will recommend program changes and procedures;

liaise with USAID/Kenya and other donors to coordinate export support activities; and prepare needs assessments, training activities, and scopes of work in both EPPO and EPZA activities. He/she will advise the EPPO and the MOF's Economic Secretary on policy changes that will remove anti-export biases, establish technical guidelines and procedures on ratio estimation, analyze trade performance statistics (in light of specific trade promotion programs and projects), recommend staff members for additional academic education, and oversee the planning of studies.

The Advisor's GOK counterpart will be the Head of the EPPO. The Advisor will ensure that appropriate GOK counterparts are available to work with all consultants in order to carry out short-term technical assistance. The Export Promotion Advisor will oversee the purchase of commodities. Finally, the Advisor will coordinate the short-term EPZA and EPZ Swap Fund technical assistance provided under KEDS.

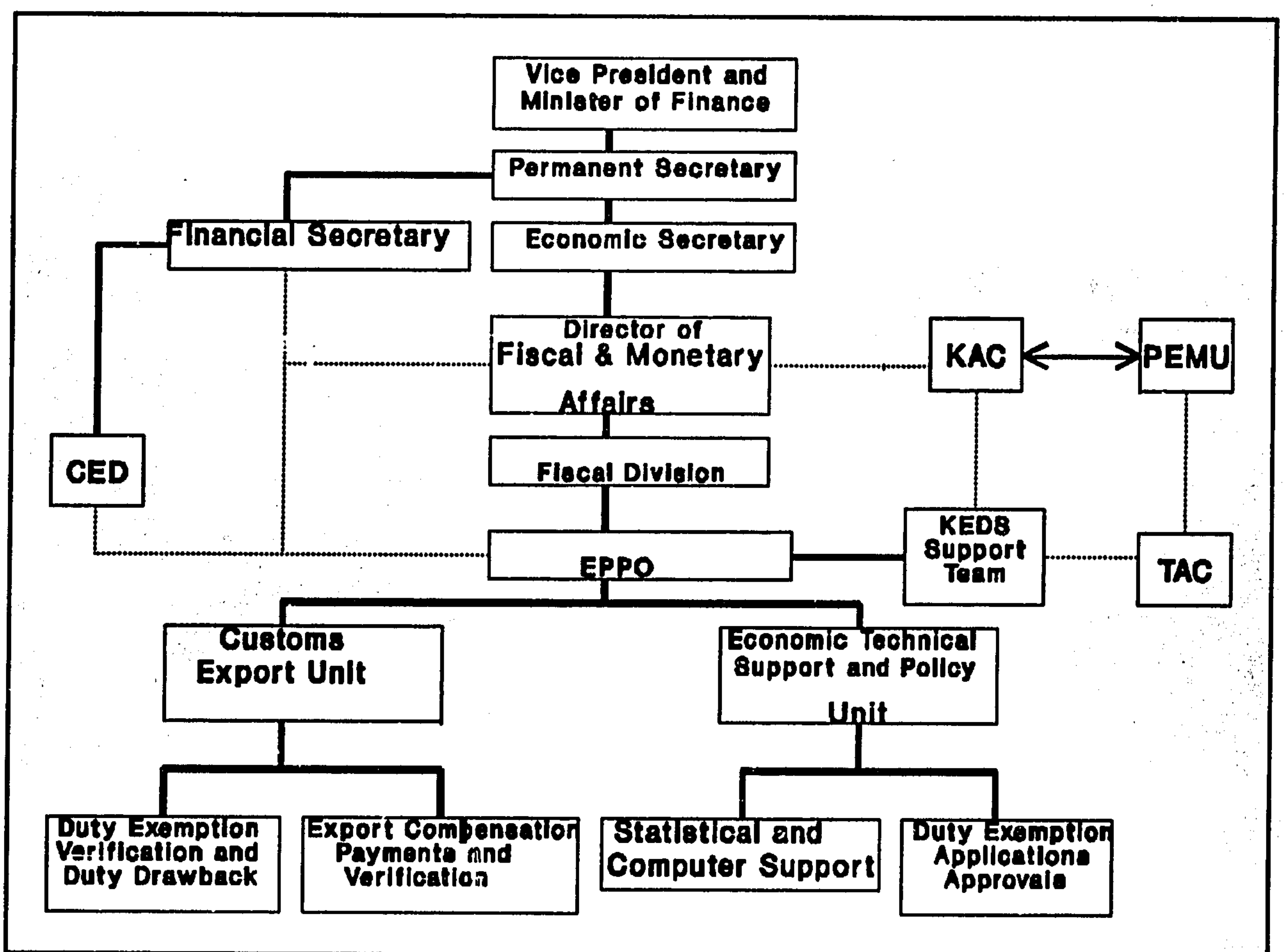

Figure 4:KEDS PUBLIC SECTOR ASSISTANCE ORGANIZATION

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One of the initial tasks of the Export Promotion Advisor will be to design and carry out a baseline survey for the MOF on current policies, regulations and rules, and their effects on trade, while monitoring changes in the trade regime during the course of the Project. The Advisor will work closely with the PEMU technical team to assist them with the Firm Level Assistance baseline survey and impact assessment monitoring mechanisms.

An Export Programs Advisor will be funded for one year under the KEDS Project as a continuation of USAID support to the Ministry of Finance. This PASA position with the United States Treasury will have been financed for the first year before KEDS start-up through Mission PED funds. The Export Programs Advisor is charged with assisting the MOF to develop and administer the duty exemption, duty drawback and export processing programs to promote exports and verification procedures. (Although this position may be considered part of the Public Sector Component, the cost and related person-months are not included in the Public Sector Component. They are included in the Mission Support Component.)

Short-term technical assistance will also be provided to the EPPO through the KEDS Public Sector Component. Consultants will examine various trade constraints in detail and recommend appropriate policy changes. Short-term assistance to the EPPO will also include management information systems development, and training on the maintenance of program performance statistics, trade statistics, and monitoring and verification procedures. EPPO training and institutional needs assessments, and procurement of computer hardware and software will also be provided. A specialist will prepare recommendations on the coordination and sharing of database information among government entities and private sector associations on export-related data, and means for accessing international data relevant to the EPPO's export promotion programs.

A needs assessment for EPZA short-term technical assistance will be provided by the KEDS Public Sector team. It will be difficult to define the specific types of short-term technical assistance required by the EPZA until the two long-term UNDP advisors to the EPZA are on board. The Export Promotion Advisor will work with the UNDP advisors and the EPZA to set out the scopes of work for technical assistance to the EPZA. It is expected that KEDS will finance short-term technical assistance early in the Project to promote EPZs in Kenya and generate Kenyan and foreign investor interest in those export processing zones.

KEDS will provide short-term training courses both abroad and in Kenya. In-country seminars and workshops on topics ranging from promotion of GOK trade policies to streamlining GOK export approvals will be financed. Ten 60-day study trips to the U.S.A are budgeted for EPPO and EPZA officials.

Commodity assistance for the EPPO will be provided on the basis of an initial technical assessment of the EPPO's specific needs. KEDS will finance the procurement of computer equipment for the EPPO and for the KEDS technical team. The Project will supply computers, software, printers and other essential office equipment to support the technical team and the EPPO. The computers will link with various GOK, private sector and international databases. KEDS will provide the EPZA with a computer, printer, software and other office equipment.

Public Sector Component Inputs

KEDS Public Sector assistance will consist of the following:

- Long-term technical assistance to the EPPO (54 person-months);
- Short-term technical assistance to the EPPO (22 person-months);
- Short-term technical assistance to the EPZA (9 person-months);
- Ten short-term (avg 60 days) training courses for individuals in the USA;
- A series of EPPO seminars (ten 1-day seminars)
- A series of EPZ seminars (ten 1-day seminars); and,
- Commodities for the EPPO and EPZA (approx. $115,000).

Public Sector Component Outputs

KEDS Public Sector assistance will result in the following:

- A functional EPPO as the key unit in the MOF export promotion drive;
- A staff well trained in export trade policy analysis;
- A reduction of GOK controls ranging from licensing simplification to import and export liberalization;
- Increased export incentives provided by the GOK;
- A functional dialogue between the GOK and the private sector;
- An operating EPZA providing timely inputs to two export processing zones; and,
- Coordinated export-related technical assistance.

2. Firm Level Assistance Component

The KEDS Firm Level Assistance Component will increase non-traditional exports, foreign exchange earnings and employment generation through Kenya's private sector. The component will strengthen Kenya's private sector capacity to accelerate manufacturing, agro-processing and horticultural exports to foreign markets.

The Firm Level Assistance Component consists of two principal parts: direct firm level assistance to current and new exporters; and institutional support to trade associations to reinforce their capacity to deliver trade-related services and information to export firms. Firm level assistance will be used to provide Kenyan exporters with market assessments, quality and production assistance, planning for business expansion, and export promotion through short term consultancies. Institutional support will be provided to key Kenyan trade associations and will comprise export market information, seminars and trade association export promotion in overseas markets.

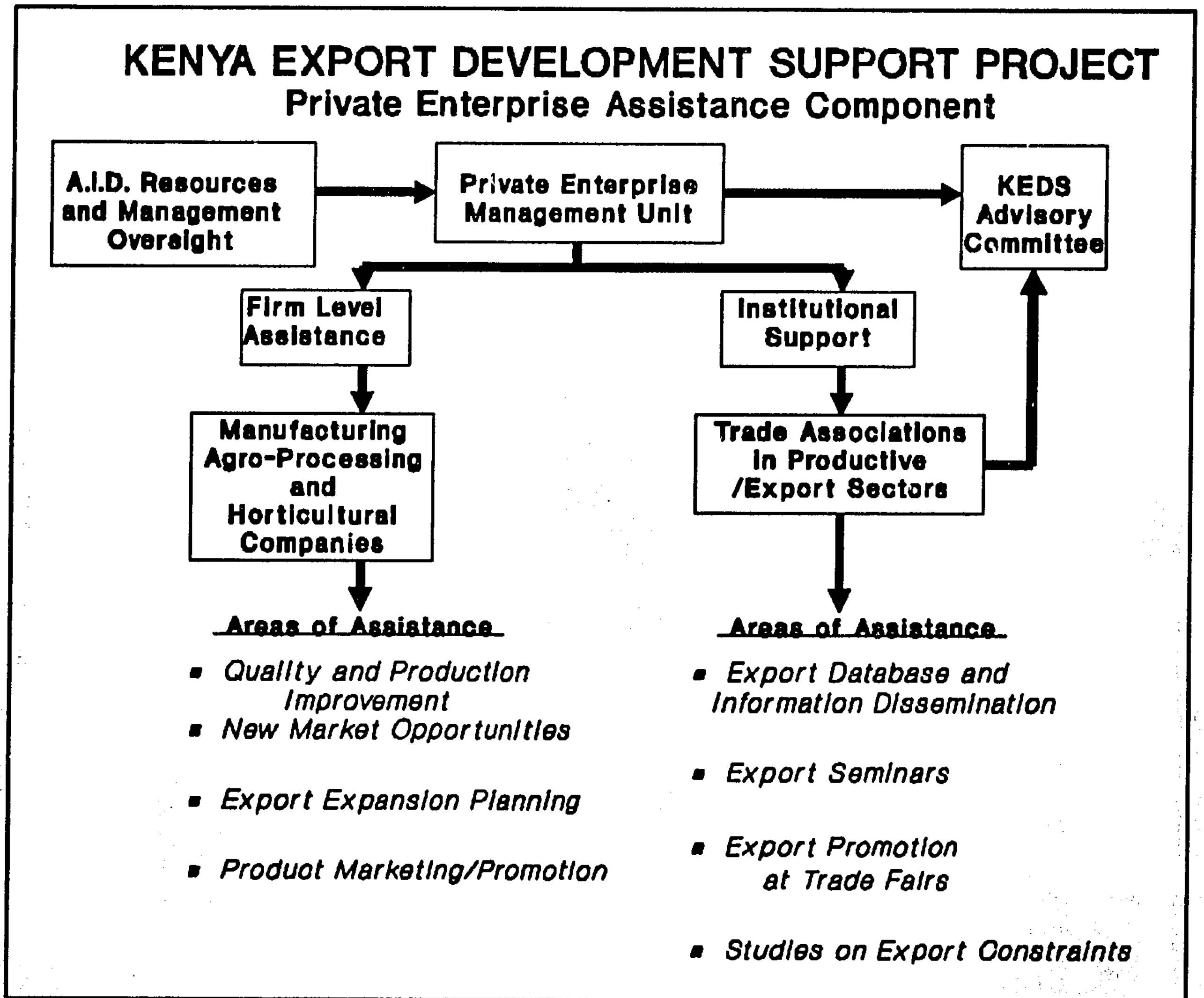

Figure 5: PEMU ORGANIZATIONAL FRAMEWORK

Both firm level assistance and institutional support activities will be delivered through a Private Enterprise Management Unit (PEMU) financed by KEDS. The Unit will have independent offices and administrative support staff in Nairobi, and will work closely with the leading export trade institutions in Kenya. Inputs will include a technical team of two expatriate export development advisors; PEMU office support, short term technical experts and commodities. USAID will also establish an Export Development Fund (EDF) to support cost-shared technical assistance activities for export-oriented enterprises.

The total level of effort for the Firm Level Assistance Component will be 288 person-months over seven years. This will consist of 108 person-months of long-term expatriate support, 147 person-months of PEMU office support and 33 person-months of short-term assignments. Commodities will include computer hardware, promotional materials and equipment, overseas travel and office equipment.

Export Development

The PEMU team, in collaboration with KEDS-assisted trade associations, will establish a strategic action plan for identifying enterprises with direct and indirect export potential. The action plan will define criteria for selecting eligible firms such as product development opportunities, financial performance, expansion capability, export experience and employment potential. Preliminary discussions with the firms, evaluations of export markets for available products, and examination of opportunities for similar product lines in overseas locations will be initiated by the PEMU team.

The PEMU will utilize short-term consultants to design market-oriented promotional strategies and identify specific product development opportunities for Kenyan export groups. The PEMU team will forge input linkages between intermediate producers and larger exporters, explore EPZ supplier links on behalf of indirect exporters, establish contacts with buyers, and develop systems to access information on entry-level trade requirements in foreign countries.

This methodology will be repeated on an enterprise-by-enterprise basis and will be used to design an introductory program for non-traditional exporters and established firms. The PEMU will use its preliminary findings to encourage firms to make more extensive assessments of their export potential. In this way the unit will help targeted firms to follow through with stronger commitments to export development. KEDS will provide guidance through the core contract to assist each firm with its preliminary export plans. These preliminary consulting assignments and each series of "first contact" interventions with firms will be funded with PEMU core funds.

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Specialized Technical Assistance

Export-related expansion activities often occur in phases combined with promotional visits as new products are developed and tested in alternative markets. Specialized services will be marketed to companies to help them through each stage of their export development process. Under KEDS, a company interested in developing an international niche would go through various phases of pre-export development.

First, the firm would need detailed information on market trends, sampling, seasonality, promotion techniques, quality control, packaging requirements and other marketing and production standards. Second, a financing plan, product costing, skill training program and supplier links for new materials and equipment would have to be developed. Third, after financing is secured and production capability is established, the firm must conduct production and market trials. Finally, the feedback from distributors and retailers would then be used to fine tune the production process, adjust product content and/or change for a full scale export operations.

An Export Development Fund (EDF) will be established to provide cost shared co-financing for specialized technical assistance. The fund will be allocated in two ways:

- Direct cost-shared services to obtain specific market and product information, finance technical assistance for firm expansion, test marketing and follow up advice through PEMU; and,

- Indirect IESC production and quality improvement assistance to KEDS-targeted firms.

Selection of participants in the EDF cost sharing scheme will be the overall responsibility of the core contractor. As such, the core contractor will decide whether TA should be provided by the core contractor or the IESC. In making this decision, the core contractor will work in consultation with the client to match the type of TA required with expertise available from the contractor or the IESC.

In order to make fees charged by the core contractor and the IESC comparable, the core contractor will charge out for services at its actual direct labor cost. That is, overhead, direct costs, G&A and fee for the core contractor will not be charged out to the client. This will result in a charge out rate of approximately $40/hr. The IESC charge out rates, assuming the client pays one-half the cost, should approximate $35/hr, a slightly lower rate, but appropriate for the longer term IESC projects.

The PEMU will access the Fund directly to deliver technical services to new exporters to help each firm enter new markets, obtain specific market knowledge and develop detailed financing and expansion plans. The Project will offer firms EDF co-financing to cover eligible consultancy and exploratory market visits and for promoting and test marketing new products. For established exporters, EDF funds would finance follow-up services to refine products or re-examine markets and production limitations and identify solutions to serious firm level constraints which would limit export expansion.

EDF eligibility requirements will include quality of business development and management plans, type of enterprise, financial capacity of the beneficiary firm, and preliminary evaluations of firm level export capacity and opportunities. Assistance will only be provided to privately owned firms. Acceptable activities would include product upgrade, packaging re-design, quality improvements, travel to export markets, acquiring design and processing knowledge, and in-house training.

While the PEMU will focus on a broad range of direct export development services, it will also buy into a limited number of specialized business assistance programs to address specific firm level production and quality constraints. Typically, KEDS will obtain these services after the PEMU's preliminary assistance has been completed, as part of its first series of pre-export development interventions.

The PEMU will provide direct firm level assistance in identifying new market opportunities, export expansion planning and in export marketing and promotion. IESC activities will focus on production and quality improvement assignments. The PEMU will be responsible for identifying KEDS-targeted client firms and for brokering IESC assistance for firms under the cost-shared Export Development Fund. Through the PEMU, KEDS will reimburse IESC up to 50% of project costs. To ensure uniformity within the EDF cost shared program, IESC will be required to adhere to the KEDS cofinancing structure and criteria for firm level assistance.

Both PEMU direct assistance and indirect IESC assignments will be funded under the EDF. Disbursements will allow for a maximum of three cofinancing grants per company up to a ceiling of $15,000 per grant on a cost reimbursable and declining scale. That is, KEDS will pay for 60 percent of the first assistance intervention (assistance), 40 percent of the second, and 20 percent of the third. On average, KEDS will fund between 40-50 percent of this type of assistance. Each client firm will be permitted to access up to a maximum of $45,000 of EDF funds.

<u>Institutional Support</u>

Institutional support to export service institutions will consist of four key activities including development of export market databases and dissemination of market, industry and product information; seminars and workshops for exporters; targeted export promotion in overseas markets; and studies on regulatory and fiscal constraints to rapid export growth.

KEDS institutional support will be provided to export support institutions which, in the first instance, already have an institutional framework to immediately utilize KEDS support to deliver improved export-related services. The current organizations which supply services in manufacturing, agro-processing and horticulture, and meet this criteria are: the Kenya Association of Manufacturers (KAM), the Fresh Produce Exporters Association of Kenya (FPEAK), and the Horticultural Crops Development Authority (HCDA). Provision will be made for similar support, on a case-by-case basis, to smaller associations as they evolve into viable exporter bodies. The core contractor will recommend to USAID the amount of funding to be provided to each association.

Through USAID support under the PED Project, KAM has emerged as a clearinghouse for enquiries from export markets. It has expanded its services through technical seminars for its various industry groups and has become an effective proponent of policy reform for its members. KAM has over 600 members and is now well-positioned to develop and offer similar export services to its membership.

The HCDA, a government parastatal, is responsible for facilitating and regulating the development of Kenya's horticultural sector. HCDA concentrates on small farmer development, and has worked successfully to increase the share of total horticultural exports by small scale exporters from 45 percent in 1985 to 60 percent in 1989. The HCDA provides small farmer groups with extension services and information on international market prices. The HCDA also issues Export Certificates which certify export prices and product quality on a fee basis. The Authority is financially autonomous of GOK subsidies as its activities are funded through a direct tax on all export produce. The HCDA is constrained by its revenue mechanism. Unless export volumes increase, it cannot broaden its service base without raising taxes. This impedes the development of the horticultural sector because marginal tax revenues are inadequate to support further expansion of HCDA services, particularly to small farmers. The HCDA, like KAM, is well-respected for its professional approach to institutional services for its members. Most of the growth in horticultural exports has come from increased small farmer production, and the HCDA has proven to be the most effective vehicle for channelling export assistance to this subsector.

The FPEAK is at an early stage of development but is beginning to surface as a legitimate representative of Kenya's larger horticultural exporters. FPEAK has approximately 100 members, including a significant number of large producers and exporters. Its first priority is to lobby the GOK for investment and export incentives, and for improved export facilities for its members through periodic meetings with various GOK ministries.

FPEAK needs institutional support, particularly in organizational development, to expand its membership base and to offer basic information, seminars and other support services to exporters. FPEAK is a prime target for KEDS institutional support given the employment generation and foreign exchange implications of improvements in the horticulture sector. USAID's previous success with support to KAM lends further credence to the utility of providing institutional support to FPEAK under the KEDS Project.

Institutional support inputs under the KEDS Firm Level Assistance Component will be delivered through the PEMU, and will consist of limited technical assistance, commodities to develop trade information libraries, computers, and on line access to foreign databases. The PEMU will help FPEAK prepare a development plan on the association's behalf. Critical areas for institutional support are summarized below:

<u>Development of Export Market Databases and Dissemination of Market, Industry and Product Information</u>

The PEMU will supply expertise to the associations and the HCDA to improve their delivery of publicly-available information on export markets. This will occur through short-term technical assistance in database development to KAM and HCDA, and through institutional development assistance to FPEAK.

<u>Seminars and Workshops for Exporters</u>

The PEMU will use market feedback such as import market requirements, buyer priorities and product specifications to identify training needs and access professional resources to help KAM, HCDA and FPEAK develop the capability to upgrade exporters' business skills.

<u>Targeted Export Promotion in Overseas Markets</u>

The PEMU will help KAM, FPEAK, and other organizations which meet KEDS institutional support criteria prepare and participate in overseas trade fairs. The PEMU team will access sector-specific trade and market information and will help associations and emerging exporters develop the capability to pre-screen exhibitions and organize attendance programs. The associations will draw on short term specialists for advice on promotional methods, effective follow-up techniques and logistical arrangements to ensure that maximum results are achieved through business involvement at overseas fairs.

Studies on Regulatory and Fiscal Constraints

Obstacles to rapid private sector export growth, such as the impact of fiscal measures on Kenya's competitiveness in export markets, will be identified by KAM, HCDA, and FPEAK through interaction with, and feedback from, members and through KEDS assistance under the Studies and Public Sector components. On the firm level side, the PEMU and the KEDS-supported institutions will raise key issues for analysis and evaluation and will establish agendas for conducting related studies and for following up on implementing solutions through the KEDS Advisory Committee.

Firm Level Assistance Inputs

KEDS Private Enterprise Assistance inputs will consist of the following:

- Long-term technical assistance (108 person-months of expatriate long-term);
- Short-term technical assistance (33 person-months);
- 147 person-months of administrative support for the PEMU;
- Commodities for KAM, HCDA and FPEAK (approx. $125,000);
- Commodities for PEMU office (approx. $90,000);
- An Export Development Fund (EDF) over 7 years for special cost-sharing technical assistance programs to export enterprises ($500,000 in a Cost Sharing Fund for TA and $250,000 for IESC TA (The KEDS contractor will disburse the IESC funds through a sub-contract with the IESC); and,
- 15 2-day Export Seminars in Kenya over a six year period.

Firm Level Assistance Outputs

KEDS Private Enterprise Assistance outputs will consist of the following:

- A fully staffed Private Enterprise Management Unit (PEMU);
- Direct technical assistance delivered by PEMU (and supported by the cost sharing EDF) to 15-40 exporting firms over seven years;
- Indirect technical assistance delivered by IESC to 10-20 firms over the first five years of project implementation;
- Attendance by trade associations at 15 international trade fairs over the first six years of project implementation;

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- o Increased employment in KEDS-targeted firms by at least 5 percent per year over life of Project; and,
- o Increased exports to international markets by KEDS-targeted firms by at least 10 percent per year over life of Project.

3. EPZ Swap Facility Component

KEDS will finance the creation of an Export Processing Zone Swap Fund ("Swap Fund") that will provide medium-sized Kenyan firms access to foreign exchange to allow them to set up operations in the export processing zones. USAID will provide technical assistance to the Central Bank and commercial banks to establish and monitor the Swap Fund. In addition, to address the constraint of lack of collateral by medium-sized Kenyan firms in securing a foreign currency loan, A/PRE will establish a guaranty facility covering 50 percent of the credit risk of the foreign currency loan. Finally, the Project will utilize the technical assistance provided to the Central Bank and commercial banks to promote the use of existing A/PRE loan portfolio guarantees (LPGs) for pre-export financing through Kenyan commercial banks.

The KEDS Project will provide assistance to medium-sized Kenyan entrepreneurs to operate in the newly-created export processing zones (EPZs). This is an important part of the process of consolidating domestic support for the GOK's export expansion strategy. It complements World Bank assistance under the Export Development Project (EDP) to establish operational EPZs. USAID will help overcome barriers to entry of Kenyan firms into the EPZs and provide an opportunity for Kenyan firms to participate in the benefits of the EPZ regime.

By enabling Kenyan firms to operate in the EPZs, KEDS will also promote the development of forward and backward linkages between firms in the EPZs and Kenyan firms operating outside the EPZ. Kenyan firms, more so than foreign firms, are poised to provide goods to and absorb exports from the EPZs. For example, a Kenyan agroprocessing firm might establish an operation in the EPZ to produce packaging material for its use. This type of linkage in the EPZ would ensure timely delivery of proper packaging materials to an important Kenyan non-traditional export sector.

USAID will make a grant of $4.0 million to the GOK (Central Bank) to create the EPZ Swap Fund as a pilot project to demonstrate the utility of making foreign exchange available to domestic firms to invest in EPZs. The GOK will match USAID's contribution to the fund. Thus, the initial capital for the Swap Fund will be $8 million. The size of the Swap Fund will be sufficient to serve as a demonstration project. It is expected that, over the seven year life of the Project, 8-11 firms will be assisted by the Facility. Most loans will be for capital purchases and working capital and will be for a period of three to four years.

The purpose of the Swap Fund is to begin to liberalize the foreign exchange regime, get more Kenyan firms involved with exports, raise the comfort level of the GOK in allowing domestic companies to operate in the EPZs, and induce foreign companies to invest in the EPZs. The pilot project will produce a rapid and visible response in terms of companies operating in EPZs. By illustrating the profitability of exports, these EPZ enterprises will provide a powerful demonstration effect to producers who have been oriented historically towards domestic markets and help mobilize domestic support for implementation of more comprehensive reforms in the trade regime. Furthermore, firms operating in the EPZs will send a signal to foreign investors that the EPZs are functioning and serve to attract foreign investment in the EPZs. The pilot project will demonstrate the need for continued availability of foreign exchange for domestic companies to operate in the EPZs and encourage other donors to contribute to the Swap Fund. (The following illustration assumes a conversion rate of $1 = Ksh 25.)

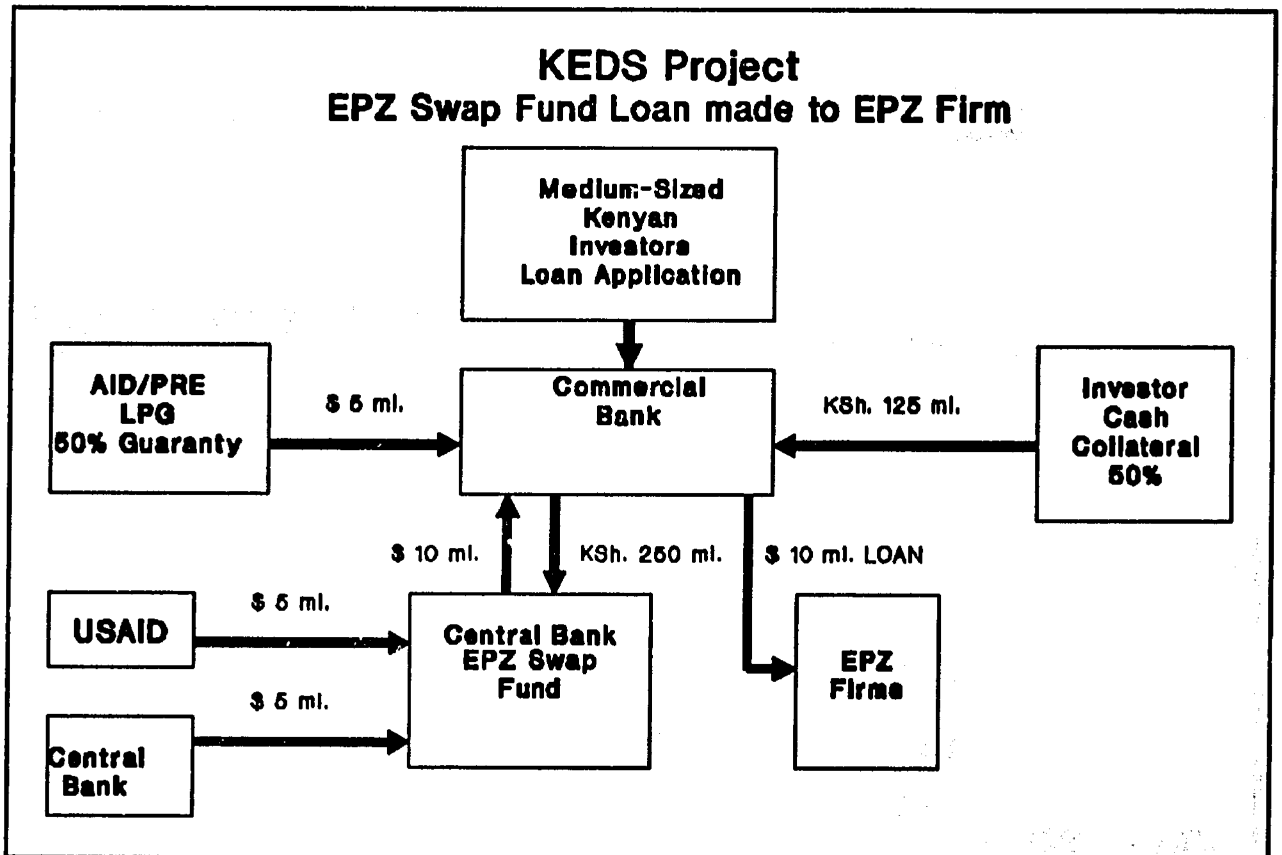

Figure 6: SWAP FUND OPERATIONAL FRAMEWORK

Kenyan EPZ Investors and the Commercial Banks

The EPZ Swap Fund will be directed at medium-sized firms which would otherwise find it difficult to acquire the necessary foreign exchange to enable them to operate in the EPZ. Access to the EPZ Fund will be available to any privately-owned business operating in Kenya with a net asset value under $1 million (Ksh. equivalent), excluding property and buildings. All of the domestically owned firms located in the EPZ will be export companies involved in non-traditional products.

The first step in the investment process for domestic firms to establish a firm in the EPZ is to apply to an eligible commercial bank for a US dollar loan to operate in the EPZ. The commercial bank will use standard credit procedures to analyze and evaluate the loan application. USAID will not participate in the credit approval process, although selection criteria for the loans will be mutually established at the start of the Project. Upon approval of the loan, the commercial bank gives a commitment letter to the Kenyan firm that, conditional upon the firm establishing a company in the EPZ, the commercial bank will make a US dollar loan to the future EPZ enterprise.

With the commitment letter in hand, the Kenyan firm applies to the Export Processing Zones Authority (EPZA) for an EPZ enterprise license to establish a company in the export processing zones. The EPZA is charged with the responsibility of approving all investments in the EPZ, whether foreign or domestic. The EPZA will vet the application to assure sufficient financial resources to implement the investment.

After obtaining an EPZ license, the Kenyan firm forms a company in the EPZ (i.e., legally registers a company). When the EPZ company is formed, the commercial bank (to fulfill the terms of the commitment letter to make a US dollar loan to the EPZ company) obtains foreign currency for the loan by accessing the EPZ Fund in the Central Bank. The commercial bank will swap, or exchange, Kenya shillings for US dollars from the EPZ Fund.

The commercial bank will make a US dollar loan to the newly-formed enterprise in the export processing zone because companies operating in the EPZ are considered by the GOK to be operating extra-territorially and, as such, are not bound by Kenya's foreign exchange control regulations. (Kenyan citizens and companies operating in Kenya cannot legally hold foreign exchange). The US dollar loan will cover both capital equipment purchases needed by the EPZ enterprise as well as working capital requirements for an initial start-up period before export earnings can be generated to finance working capital needs.

The foreign currency required by each borrower will be determined by the type of investment and the size of the investment. In order to maximize the number of borrowers using the EPZ Fund, yet not unduly restrict the amount each borrower can access, the EPZ Fund will have a limit of $1.0 million per borrower. It is expected that the loans will range in size between $750,000 and $1,000,000. The ability of firms operating in the EPZ to retain foreign currency is expected to generate strong demand for the EPZ Fund.

The commercial banks will provide all the funding and bear all credit risks of the foreign currency loans. The tenor and grace period appropriate for each loan will be determined by the commercial banks. The commercial banks will charge market interest rates on the loans. The loans will be collateralized 50 percent by a Kenya Shilling cash deposit, or security equivalent, from the Kenyan firm and 50 percent by an A/PRE foreign currency guaranty facility, which is to be established in connection with the Swap Fund.

The commercial bank will use standard procedures to disburse the loan proceeds through letters of credit for capital equipment and raw materials. The EPZ Act states that "all transactions including payments of salaries and wages between export processing enterprises and persons resident in Kenya shall be carried out through authorized bank accounts." Thus, working capital needs will also be disbursed through commercial banks. In short, the commercial banks will tightly control the disbursement of funds and little, if any, of the loan proceeds will be directly handled by the borrower.

Part of the swap arrangement between the commercial bank and the Central Bank will include an agreement by the commercial bank to "reswap" all US dollar proceeds from loan repayments of the EPZ borrower into Kenya shillings. This reswap feature will allow the Swap Fund to become a revolving facility whereby the commercial bank swaps Kenya shillings for US dollars (which the commercial bank lends to the EPZ firm), then US dollars are reswapped back into Kenya shillings (at repayment of a loan installment) and then swapped again for US dollars (for a new loan).

The Swap Fund and the Central Bank

The EPZ Swap Fund will be housed in the Central Bank. The Central Bank will manage the Swap Fund and the commercial bank will, in effect, administer the Swap Fund, disbursing foreign currency against the requirements of the enterprise in the EPZ. KEDS will provide short-term technical assistance over the first four years to facilitate operation of the Swap Fund by working with the Central Bank and the commercial banks.

The technical assistance will involve the following activities:

- Work with the Central Bank to establish mechanisms for the swap and reswap facility;
- Provide training to the commercial banks in analyzing Kenyan enterprises which apply for foreign currency loans;
- Work with A/PRE and the commercial banks to establish the guaranty facility for firms applying for foreign currency loans;
- Solicit additional funding for the EPZ Fund from the GOK and from other donors once the facility has been established and is operational; and,
- Work with commercial banks to obtain offshore financing to fund part of the foreign currency requirements of EPZ borrowers.

EPZ Swap Facility Guaranty

It is anticipated that Kenyan firms in the EPZ (particularly medium-sized firms) will face a major constraint in obtaining sufficient collateral for a US dollar loan. Existing domestic facilities of the Kenyan firm will most likely be pledged to a financial institution in order to finance domestic operations. Therefore, the Kenyan firm will have limited resources to pledge to a commercial bank for collateral. The A/PRE guaranty facility will help address the collateral constraint of Kenyan firms. A/PRE will work with the Mission to determine which of the commercial banks will be eligible for the EPZ Guaranty Facility. Under A/PRE's current loan portfolio guaranty program, eligible commercial banks are those which are privately-owned and operated.

At the end of the Project, based on an EPZ Swap Fund of $8 million, it is expected that between 8-11 export businesses will be established in EPZs by medium-sized locally-owned firms. Furthermore, commercial banks will have learned positive lessons about project finance and project development.

The limited funding and modest outputs for this component should be sufficient as a demonstration activity. The real success of this component will be if the Swap Fund is increased by other donors and the GOK, thereby benefiting a larger number of locally-owned firms and further increasing employment, generating foreign exchange, and creating backward and forward linkages.

During the life of the Project, should the GOK completely liberalize all exchange controls, then Kenyan companies would have unlimited access to foreign exchange directly from the Central Bank. The need for the EPZ Swap Fund would disappear since the rationale for the Swap Fund stems from the Central

Bank's lack of sufficient foreign exchange, hence the foreign exchange restrictions. In the event of freely available foreign exchange USAID will, in consultation with the GOK, reprogram the balance of the proceeds remaining in the EPZ Swap Fund for other Project activities.

Swap Fund Inputs

The KEDS Project inputs to the Swap Fund will consist of the following:

- A grant of $4.0 million to establish the EPZ Swap Fund for medium-sized firms who wish to establish an enterprise in the EPZ;
- 13 person-months of technical assistance to the Central Bank and commercial banks to establish and implement the swap facility and monitor the EPZ Swap Fund; and,
- Through A/PRE, a guaranty mechanism to address the collateral constraint of medium-sized firms in securing foreign currency borrowing.

Swap Fund Outputs

The Swap Fund outputs are expected to be the following:

- Between 8-11 export businesses will be established, locally-owned and operating in the EPZ;
- Approximately 1,600 jobs will have been created;
- Approximately $30 million in foreign exchange earnings will have been earned;
- Commercial banks will have become familiar with export related project finance targeted to the medium-scale enterprise sector.

4. Studies Component

The objective of the KEDS Studies Component will be to provide up to date information, analyses and recommendations to key policy officials on relevant export development issues. Studies will be administered through the KEDS Public Sector Component technical unit. The KEDS Public Sector Technical Advisory Committee (TAC) will review all studies funded under KEDS.

Most studies funded under the Project will be undertaken through the EPPO of the Ministry of Finance under the guidance of the Trade Policy Advisor. However, specific studies will be carried out with the Central Bank of Kenya, the Private Enterprise Management Unit (Firm Level Assistance Component) and at the initiative of USAID. Findings from studies will be distributed extensively to reach as wide a range of decision makers in the GOK and the private sector as possible. Key study areas will include export bottlenecks and trade policy improvements, trade finance, and new areas for exports.

Study Areas

Baseline data will need to be collected in several areas of the KEDS Project to measure progress and outputs achieved. For example, baseline data will be assembled on GOK agencies working with the Project (see Public Sector Assistance Component). Data will also need to be assembled on current levels of exports, tax revenues from exporters, customs receipts on imported inputs for exports, and local taxes applicable to exporters. These data will be essential for monitoring exports, changes in GOK policies and the effects of KEDS.

Baseline data will also need to be assembled on current non-traditional export sectors. Information on trade associations and firms which will be assisted directly under the Project will need to be assembled. This information will be important not only to determine the areas of Project focus but to determine level of exports, value-added in targeted sectors, general import requirements and expenditures, level of employment, direction of trade, and other information over the life of the Project. This will help both the GOK and USAID to determine the impact of Project interventions, and should prove valuable in supporting policy initiatives on the GOK's part.

These data will enable the Project to focus on areas which have the highest export potential. These will include both producers who are poised to increase exports as well as those which show good potential for exports in the medium- to long-term. Studies will help identify the latter, and to set out the conditions under which they can be encouraged to diversify and improve Kenya's export base.

One of the key elements to improve Kenya's export climate is improving the foreign exchange regime. This includes reducing the anti-export bias inherent in an overvalued exchange rate. Additionally, the allocation of foreign exchange is a critical area to examine in order to encourage more exports, particularly non-traditional exports. It is anticipated that this will be one of the major areas of study during the KEDS Project.

KEDS will also conduct at least one study on the effects of Kenya's regulatory environment on non-traditional exports. The regulatory environment should be examined in order to determine how both export and import policy can be improved. Licensing criteria, marketing requirements and other areas of regulation need to be examined within this context to suggest sound policy recommendations to improve Kenya's export climate.

The Project will also examine labor costs within this context. While Kenyan labor is reputed to be inexpensive relative to other countries, the legislation regulating the use of labor is extensive. Competitive labor is one of the most important elements of a successful export regime. It may be necessary to examine how labor can be made more competitive.

Fiscal policy plays a major role in determining the competitiveness of Kenya's exports. The Project will build upon work being undertaken within the Ministry of Finance through the UNDP Tax Modernization Programme (which USAID is co-sponsoring). The effects of various taxes, including local cesses, customs and excise taxes, and indirect taxation need to be analyzed, particularly to determine how these taxes affect Kenya's exports vis-a-vis her competitors. This will be of particular importance to Kenya's horticulture sector.

KEDS might also examine the overall Kenyan investment climate, especially with regard to investments in non-traditional export sectors. Mobilization of both local and foreign capital requires a thorough understanding of the incentives and disincentives to investment in target areas.

The total costs of delays from point of production to actual international shipment need to be examined with an eye to recommend where the GOK can remove critical bottlenecks. Delays are experienced at the ports, on the railways, on roads, through Customs, and through other GOK enforcement agencies. Rents are often collected at these points which increase the cost of inputs to the export sector and reduce Kenya's advantages vis-a-vis her competitors. These delays will have to be drastically reduced if Kenya's competitive advantage is to be realized. Studies will be undertaken in these areas to determine how Kenya can best reduce these bottlenecks and improve its export environment.

The Project will examine the prospects for pre-export finance and subsidized credit (ex ante) to exporters. Virtually all industrialized countries, and most newly industrialized countries (NICS) have developed extensive credit schemes to finance their exports. These include pre-export guarantees, easy credit on concessional terms (or interest free), and export insurance for targeted sectors. The Project will examine the potential for utilizing one or several of these mechanisms to stimulate exports.

The KEDS Studies Component will also fund other studies during the life of the Project. Topics for such studies will generally focus on direct implementation issues relevant to the Project. These could include direct market analysis for specific sub-sectors; targeted surveys to gauge the impact of the KEDS Project; and studies of the impact of particular policy interventions which occur during the Project.

Studies Component Inputs

KEDS Studies Component inputs will consist of the following:

- 15 person-months of technical assistance to complete eight to twelve studies.

Studies Component Outputs.

The KEDS Studies Component outputs will consist of:

- Between eight and twelve studies in export policy related areas; and,
- Ten 2.5-day workshops to discuss studies and policy issues raised from studies.

IV. IMPLEMENTATION AND MANAGEMENT PLAN

A. AID, GOK and the Implementing Organizations

The KEDS Project will be implemented under the general framework of a Project Agreement with the Government of Kenya. A series of side letters will be executed between USAID and each of the targeted organizations. The Project Agreement will state overall content and objectives of the Project, describe project activities, secure any special arrangements required to implement the Project, and describe the various roles of the participating institutions under the Project.

A.I.D. direct contracting will be utilized to procure the technical assistance to implement the Project. The decision to utilize direct A.I.D. contracting rather than Host Country Contracting was based on a practical assessment of current and projected workloads, contracting resources, and other considerations at the Ministry of Finance and USAID/Kenya. One particular consideration was that much of the project involves private sector activities, and as such, is outside the GOK's particular scope.

The GOK will have responsibility only for those items which directly relate to the participating government ministries or bodies and those project elements which require additional GOK action to ensure successful Project implementation.

For overall Project management, a ten member KEDS Advisory Committee (KAC) will be established which will be responsible for overseeing the Project in terms of general policy direction and administration. The KAC Secretariat will be drawn from the public sector component technical assistance team. The KAC will initially consist of senior officers representing the MOF, the EPPO, the EPZA, the CED, the HCDA, KAM, FPEAK, the Firm Level Assistance Private Enterprise Management Unit (PEMU), and USAID/Kenya. The KAC Secretariat and representatives of the PEMU will serve as ex-officio members of the Committee.

The chief GOK counterpart agency during KEDS will be the Ministry of Finance. The MOF's Export Promotion Programmes Office (EPPO) and the Export Processing Zones Authority (EPZA) will assign counterpart personnel and commit required counterpart contributions through the Public Sector Assistance Component. The Central Bank of Kenya (CBK) will be responsible for providing counterpart financial contributions to the EPZ Swap Facility Component as well as overall management, with technical assistance provided through the Public Sector Assistance Component.

B. USAID Project Management

The primary responsibility for implementing the KEDS Project will be given to USAID/Kenya's Private Enterprise Office. The Private Enterprise Office will be responsible for preparing obligating documents; ensuring that conditions precedent are met; approving major actions and expenditures by the contractors and assisted organizations; and monitoring the contractors and organizations to ensure that project activities are being carried out.

One FSN direct hire officer will be assigned overall Project management within the Mission's Private Enterprise Office. One US PSC and one FSN PSC will assist in implementation of the project.

C. Implementation Activities and Schedule

USAID/Kenya intends to execute a Project Agreement with the GOK in June, 1991, which will obligate funds for the KEDS project. Concurrent with the obligation plans, procurement arrangements are scheduled as follows:

June 5, 1991	-	Project Paper Approved
June 5, 1991	-	Project Authorization Signed
June 15, 1991	-	PIOT Forwarded to Contracts
June 20, 1991	-	CBD Notice Published
June 28, 1991	-	ProAg Signed Obligating Funds
July 15, 1991	-	RFP Issued
Sept. 15, 1991	-	Proposals Received
Oct. 11, 1991	-	Evaluations Completed
Oct. 25, 1991	-	Contract Signed

The following events are in chronological order together with primary responsibilities:

	Mobilization Events	Primary Responsibility AID	GOK	Contractor
Oct 91	Initial Implementation Letter to GOK summarizing Conditions Precedent, Principals, Planning Schedules, Budgets, Procurement regulations, Documentation requirements, Funding contributions, and division of responsibilities between AID, GOK and Contractor	X	X	
Oct 91	Contractor Mobilization Schedule (Inc. 6-mos ST TA staffing pattern) approved by AID/GOK			X

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		AID	GOK	Contractor
Oct 91	Contractor's On-Site Logistical Schedule Finalized			X
Nov 91	Coordination Schedule Finalized			X
	Public Sector Component			
Oct 91	Orientation of LT US Advisor	X	X	
"	MOF Offices & Counterparts Assigned for LT Advisors		X	
"	Contractor Payment Procedures Finalized			X
Nov 91	First Monthly Progress Report			X
Dec 91	EPPO Training Seminar Schedule Prepared			X
	EPPO Commodity Purchase List Finalized			X
Jan 92	EPZ Training Schedule Prepared			X
Feb 92	EPZ Commodity Purchases List Finalized			X
Mar 92	First EPPO Seminar			X
May 92	First EPZ Seminar			X
	Firm Level Assistance			
Oct 91	Orientation of two LT US Advisors (Inc. Trade Associations)	X	X	
Nov 91	Accounting Procedures for Contractor, Cost-Sharing Fund, and IESC finalized			X
"	PEMU Office Commodities purchased			X
Dec 91	EDF Client List Prepared and First Consulting Engagement Arranged			X
Mar 92	Detailed Institutional Assistance Budgets			X

Primary Responsibility: AID, GOK, Contractor

		AID	GOK	Contractor
		Primary Responsibility		
Apr 92	First Trade Fair Attendance			X
May 92	First Institutional Seminar			X
"	Initial Institutional Commodities Purchased			X
	Swap Facility			
Dec 91	CBK Swap Fund Counterpart Assigned & CBK Circular Published		X	
Jan 92	Arrival of Advisor and Beginning of Marketing Effort			X
"	AID/GOK Initial Contribution to Fund	X	X	
"	Advisor's 4-year Action Plan Finalized			X
Sept 92	Approval of $1.0 million in Swap applications	X	X	X
Sept 93	Approval of additional $1.25 million in Swaps approved	X	X	X
Sept 94	Approval of additional $1.75 million in Swaps approved	X	X	X
	Studies Component			
Jan 92	Public Sector/Firm Level Assistance Advisors Submit Research Agenda for Approval			X
Mar 92	First ST Consultants Arrive for First Study			X
Apr 92	Studies Seminar/Workshop Timetable Prepared and Submitted for Approval			X
May 92	First Seminar Convened			X

Date	Evaluation & Audit	AID	GOK	Contractor
			Primary Responsibility	
Jan 93	Procure Evaluation TA	X		
Jul 93	First Evaluation Conducted			X
Jan 94	Mission/RIG Assemble Audit Team			X
Mar 94	First Audit Conducted			X
Sep 97	Second Audit Conducted			X
"	Second Evaluation Conducted			X
	Mission Support			
Aug 91	Identification/Selection/ Assignment of FSN DH	X		
Sep 98	Project Close-out Formalities	X		

D. Procurement Plan

The following categories of goods and services will be procured under the KEDS Project:

- o Technical services to the GOK and to the Kenyan private sector, to carry out policy, feasibility, export sector studies including business plan preparation and evaluations of investments will be sourced from the United States (A.I.D. Geographic Code 000) and Kenya. Estimated $ amounts are $4.8 million from the United States and $3.6 million from Kenya.

- o Office supplies, equipment and furnishings will be procured from A.I.D. Geographic Code 935 amounting to $120,000 and Kenya amounting to $383,000.

- o Training equipment estimated to cost $5,000 will be purchased from Kenya but their origin will be in countries included in A.I.D. Geographic Code 935;

- o Vehicles estimated to cost $50,000 will be purchased from Kenya but their origin will be in code 899; and o Publications, printing and promotional materials will be sourced from the United States of an estimated cost of $15,000 and Kenya at an estimated cost of $15,000.

Purchase of the commodities for each activity will fall under the A.I.D. procurement regulations included in the contract and grant documents. USAID will require that administrative systems and procedures, including those which govern procurement of goods and services, are satisfactorily designed and functioning properly. USAID staff will provide assistance to assure that regulations are understood and implemented.

The budget for US dollar and local currency expenditures (in Thousands of Dollars) for commodities is as follows:

Source/origin	000	935	899	Kenya	Total
Technical Services	4,826			3,551	8,377
Training/Seminars	120			525	645
Office Equipment		120		383	503
Training Equipment		5			5
Vehicles			50		50
Materials	15			15	30
EPZ Swap Fund	4,000				4,000
Eval/Audit	246			164	410
Mission Support	490			490	980
TOTAL	9,697	125	50	5,128	15,000

E. Monitoring and Evaluation Plan

The KEDS Project is a complex project, which builds upon prior USAID experience in providing support to both public and private sector organizations. For this reason, it will be important that an efficient monitoring and evaluation plan be designed and incorporated into the Project design. The information gathered through monitoring and evaluation will be used to:

o Inform USAID management decisions about the project, including the identification of implementation problems and recommendations for implementation improvement and re-orientation of activities as may be required; and,

o Determine the effectiveness of Project activities in achieving the Project's objectives.

Macroeconomic data will be gathered from secondary sources when possible. Project level data will be incorporated in an ongoing monitoring and evaluation system and will be routinely collected. Special surveys will take place as needed. Having baseline data will be extemely important in detemining impact; therefore, identification of sources and collection will begin before project implementation. Moreover, one of the first activities of the Project will be to identify individuals in the counterpart institutions who will collect project data and track project progress. Output level indicators will be measured and reported on at least twice a year while impact level indicators will be measured at least once a year.

Separate evaluation and monitoring plans will be developed for the Project in consultation with the Private Enterprise Office's Evaluation Advisor and the Mission's Monitoring and Evaluation Coordinator. Each plan will include selected indicators that cover institutional features relating to project management, implementation status and direct benefit being derived from Project inputs. Below is a general outline of the plan.

Public Sector Component: The monitoring and evaluation of this component will primarily measure the Project's success of strengthening public sector institutions. Indicators used to measure success are: streamlined procedures, increased responsiveness, improved management and increased efficiency. Examples of measures that will be used are: number and types of services provided by targeted institutions; number of recommendations developed/designed, forwarded and accepted by the GOK; length of time to process licenses; number of licenses granted; and changes in tariff structures.

Private Sector Component: The impact of the technical assistance being provided to private sector firms will be tracked routinely and will follow the number of services available to clients, number of requests for services, the amount clients are willing to pay for services and numbers of firms assisted. These indicators should show: 1) specific operational changes undertaken as a result of the technical assistance provided and 2) increases in production (firms) and institutional support activities/membership (private sector support organizations).

Swap Facility Component: This component will measure the assistance provided to firms that have used the facility to operate in the EPZ and the banks that supplied the finance. Indicators used to measure performance of success are the numbers of firms assisted, the numbers of jobs created by those firms and the amount of foreign exchange earned. Indicators to measure the technical assistance aspect of this component will be the commercial banks' ability to provide export related financed, length of time to process a loan application, etc.

Studies Component: The success of the studies component will be measured by numbers of studies completed, published and how widely disseminated they are. Dissemination includes the numbers of individuals attending workshops to discuss the studies. Impact will be much more difficult to track; however, ancedotal vignettes will be collected.

The KEDS Project monitoring and evaluation plan calls for ongoing data collection by assisted organizations (public and private), regular reporting to USAID, periodic reviews by USAID staff, a major mid-term evaluation for each of the components as well as a separate evaluation earlier for the SWAP fund, and a final evaluation at the end of the Project. As the Project components function independently of each other, monitoring and evaluation activities are separately designed to take into account varying needs of USAID and the client organizations.

A mid-term evaluation is scheduled in year three with the final evaluation in year six/seven. In addition to monitoring and evaluation activities, there will be two audits undertaken for the SWAP Fund, EDF and Institutional Grant Funds in years four and six.

V. Financial Plan and Analysis

A. Financial Plan

1. Summary of Cost Estimates

The KEDS Project is composed of the following four core components and two supporting components. The person-months level of effort and estimated corresponding A.I.D. costs are as follows:

	PM	(U.S. $)
a. Public Sector Component	85	2,550,000
b. Firm Level Assistance Component	288	6,280,000
c. Swap Facility Component	13	4,330,000
d. Studies Component	15	450,000
Total	401	13,610,000
e. Evaluation/Audits	11	410,000
f. Mission Project Support	126	980,000
Total	538	15,000,000

Project expenditures over the 7-year life of project period and the Obligation Schedule are shown in Table IV. A detailed budget of each component is contained in Annex K: Detailed Budgets. Each budget contains estimated person-months and discrete activities associated with the component.

2. Component Review

a. Public Sector Component ($2,550,000/85 Person-Months)

The Public Sector Component is primarily designed to provide long and short-term expert advice to the EPPO and EPZ Authority. The budget calls for a total of 85 person-months to be devoted to this effort with a slightly heavier concentration of effort in the first two years of the Project, tapering off in the third, fourth and fifth years. After five years, it is anticipated that these entities will not require continuing technical assistance under the KEDS Project for operational purposes.

Included also in this component is funding for an extensive training program in the areas affecting EPPO and EPZ operations. Funding for ten 60-day training courses for individuals in the USA are programmed. In Kenya, twenty 1-day seminars are scheduled. (Note that for budget purposes, the person-months and costs associated with the PASA Export Programs Advisor have been included under the Mission Support Component. This was done to segregate core contract dollar requirements from dollar requirements outside the core contract.)

b. Firm Level Assistance ($6,280,000/288 Person-Months)

This component is the largest component in terms of dedicated resources. A total of 288 person-months are programmed over a 7-year period to assist the Kenyan private sector in their export efforts.

In addition to 141 person-months of core long and short-term advisor services, this component includes 147 person-months of administrative support for a Private Enterprise Management Unit (PEMU). The budget for this office also includes funds for temporary, shorter term assistance to help manage workload requirements. This Office will be essential in coordinating and assisting advisors in utilizing the $0.5 million Export Development Fund (EDF) and $0.25 million IESC Fund. As a practical matter, the PEMU office will also assist the Public Sector Component and Studies Component advisors and researchers in planning and conducting their seminars and workshops. Institutional assistance to selected trade associations will be provided by the institutional contractor through subcontracts or through grants from A.I.D.

c. Swap Facility Component ($4,330,000/13 Person-Months)

The $4,000,000 USAID contribution to the Swap Facility is combined with 13 person-months of short-term TA spread over the first four years of the project. The $4,000,000 USAID contribution is divided into tranches $1.0 million in year 1, $1.25 million in year 2, and $1.75 million in year 3.

d. Studies Component ($450,000/15 Person-Months)

The Studies Component programs 15 person-months for research, report preparation, and dissemination. The component budget plans 9 studies over the life of the KEDS project. Ten 2.5 day seminar/workshops in Kenya are programmed for study presentations and review.

e. Evaluation & Audits ($410,000/11 Person-Months)

The Evaluation and Audit schedule calls for a total of 11 person-months devoted to evaluations in the third and sixth years and audits for the fourth and sixth years. The Mission will coordinate with RIG to undertake the Non-Federal Audits.

f. Mission Support ($980,000/126 Person-Months)

Mission support for the project includes a long-term US PSC and a long-term FSN PSC to oversee and manage the project. A total of 114 person-months are programmed for this activity, plus an additional 12 person-months for PASA TA.

TABLE IV

Summary of Project Costs ($)

Component	FY91/92 Year 1	FY92/93 Year 2	FY93/94 Year 3	FY94/95 Year 4	FY95/96 Year 5	FY96/97 Year 6	FY97/98 Year 7	TOTAL
Public Sector	649,612	599,506	518,415	462,680	305,909	7,923	8,320	2,552,365
Firm Level	1,206,628	1,193,478	1,212,708	880,324	924,355	719,950	140,070	6,277,513
Swap Facility	1,142,409	1,353,006	1,829,251	6,272	0	0	0	4,330,938
Studies	46,392	128,534	101,360	96,430	56,389	11,669	0	440,774
Subtotal	3,045,041	3,274,524	3,661,734	1,445,706	1,286,653	739,542	148,390	13,601,590
Evaluation/Audit	0	0	105,383	70,891	0	229,481	0	405,757
Mission Project	191,888	293,912	211,556	187,907	29,727	31,214	32,774	978,978
Total	3,236,929	3,568,436	3,978,675	1,704,504	1,316,380	1,000,237	181,164	14,986,325

Obligation Schedule ($)

FY91	FY92	FY93	FY94	FY95	FY96	FY97	TOTAL
2,600,000	2,000,000	2,500,000	2,600,000	2,500,000	2,000,000	800,000	15,000,000

3. GOK and Other Contributions to KEDS

The GOK will contribute approximately 27 percent of the overall project costs. The private sector will contribute approximately 6 percent of overall project cost. Together, these contributions represent 33 percent of total project costs.

The GOK's major contribution to the project is a $4.0 million contribution to the SWAP Facility. In addition, the GOK will be contributing salaries and related expenses for Kenyan Government workshops under the Public Sector and Studies Components.

Local currency will be generated under the Firm Level Assistance Component as part of a $0.5 million cost sharing scheme, whereby private companies receiving TA will pay 40 percent, 60 percent and then 80 percent of the first, second, and third TA interventions respectively. In addition, private firms receiving IESC assistance under a $0.25 million fund will similarly share the cost burden of TA. Consequently, private firms are expected to pay from 40 percent to 80 percent of the $0.75 million in TA in local currency. The overall amount paid by private firms will depend on the size of each TA intervention, but if private firms paid one-half of all TA, then $0.375 million equivalent in local currency would be generated. The local currency generated under the cost sharing EDF will be used to reduce the local currency portion of contractor invoices to USAID.

The following table indicates cost contributions from USAID, the GOK and the private sector.

COST CONTRIBUTIONS
(US $ equivalent)

COMPONENT	USAID	GOK	PRIVATE SECTOR	TOTAL
Public Sector	2,550,000	1,801,535	-	4,351,535
Firm Level	6,280,000	-	1,475,962	7,755,962
Swap Facility	4,330,000	4,109,500	-	8,439,500
Studies	450,000	62,500	-	512,500
Eval/Audit	410,000	-	-	410,000
Mission Support	980,000	-	-	980,000
TOTAL	15,000,000	5,973,535	1,475,962	22,449,497

B. Financial Analysis

1. Budget Analysis

The budgets presented in this section are composites of detailed estimates prepared for each project component. Each component budget was prepared with inputs from the project committee and design team regarding funding needs, levels of effort, and types of activities to be carried out. These inputs have been discussed with various GOK officials for reasonableness of funding levels and cost. Financing arrangements in this project paper are expected to be sufficient to fund the anticipated activities and are reasonable in terms of cost.

2. Illustrative Budgets

In structuring the illustrative component budgets, only the $4,000,000 USAID contribution to the Swap Facility, the Evaluation/Audit Component and the Mission Support Component (including the PASA position) are placed outside the core contract bid amount. Training, seminar, commodity, assistance tc Kenyan trade associations and Export Development Fund items were placed within the contract bid package since these activities will require intensive administration and management and coordination and therefore, justify being part of the contractor's level of effort. By permitting a fee to be applied to these items, the contract will build in an incentive to put the training and seminars in place, procure commodities, and administer the EDF and grant funds in accordance with project timetables. It should be noted, however, that a General and Administrative (G&A) fee has not been applied to most of the training, seminar, commodity grant, and EDF amounts, since U.S. contractor(s) should not incur much, if any, home office G & A expense on these items.

Regarding contract award for the KEDS Project, a single contract is planned in order to reduce the management burden to USAID of contract administration. The project design is also based on a single support office which would be most cost effective. Since the entire Project is focused on export development, it is felt a single contractor will have the expertise to staff all expatriate long term positions.

C. Methods of Implementation and Financing

The mechanism for obligation of project funds will be by Project Agreement. An A.I.D. institutional contract will be used to carry out major portions of TA. Typically, component activities will be financed through the direct pay method to the contractor.

Component	Method of Implementation	Method of Financing	Approximate Amount ($000)
Public Sector			
TA	Institutional Contract	Direct Pay	2,302
Training (Kenya)	" "	"	14
Training (USA)	" "	"	120
Commodities	" "	"	114
			2,550
Firm Level			
TA	Institutional Contract	Direct Pay	4,613
PEMU Office Costs	" "	"	383
Commodities	" "	"	91
Institutional Grants	" "	"	443
Cost Share Fund	" "	"	500
IESC Fund	" "	"	250
			6,280
Swap Facility			
TA	Institutional Contract	Direct Pay	330
Swap Fund	Grant	"	4,000
			4,330
Studies			
TA	Institutional Contract	Direct Pay	382
Seminars	" "	"	68
			450
Eval/Audits	Institutional Contract	Direct Pay	410
Mission Support	US PSC, FSN PSC, PASA	Direct Pay	980
			15,000

Total Direct Pay (Inst. Contractor)	9,610
Total AID Pay (Non-Inst. Contractor)	5,390
	15,000

Implementation arrangements requiring special attention are addressed below.

Firm Level Assistance

This component includes the Export Development Fund which consists of a Cost Sharing Fund and an IESC Fund. Regarding the Cost Sharing Fund, it will not pay for TA budgeted elsewhere in the KEDS Project. However, the direct labor cost of such TA will be billed to the client (who will pay 40 percent, 60 percent, and 80 percent of the first three TA interventions respectively in local currency.)

The Cost Sharing Fund will pay for the total cost (i.e. direct labor, O/H, direct costs, G&A, and fees) of any TA and services not budgeted elsewhere in the Project, although only the direct labor and service cost will be billed to clients. Therefore, outside TA and services will reduce the Cost Sharing Fund, while core TA will not. Overall, it is estimated that an amount equal to approximately 50 percent of the Cost Sharing Fund will flow to the Project as local currency.

Regarding contractor invoicing procedures, the contractor's monthly invoice to USAID will separate dollar expenses from local currency expenses. The local currency expenses will be reduced by the amount of local currency generated from the Cost Sharing Fund. If, at project completion, there is a residual of local currency, USAID will convert these amounts to dollars on behalf of the institutional contractor.

Implementation of the IESC portion of the EDF will require a sub-contract to the core contract. Under this arrangement, the IESC will undertake assignments identified by the institutional contractor. Fifty percent of the cost of these assignments will be paid to the IESC by the institutional contractor who will invoice USAID. The IESC client will pay the IESC for one-half the assignment cost in local currency.

Swap Component

The Swap Component will be implemented as a grant under the Project Agreement. Dollar reflows to the USAID Swap account in the CBK will be used for swapping throughout the KEDS Project life.

Regarding USAID financing mechanics, the USAID/Kenya Controller's Office will make advances to a segregated dollar account at the CBK based on approved applications. Upon receipt by the Controller of documentation indicating a matching of dollars by the CBK for a successful applicant, the advance will be liquidated.

Administrative oversight of the swap facility will be the responsibility of the US PSC assigned to the KEDS Project. A review with respect to source and origin of anticipated purchases will be made prior to USAID administrative approval of disbursements.

Regarding implementation of the APRE/I Guarantee Facility supporting the Swap facility, on April 10, 1991 a Concept Paper reviewing the facility was presented to the APRE/I Credit Committee and approved in principle. See Annex E for a copy of the Concept Paper and APRE fax confirming acceptance of the guarantee facility in principle.

On April 19-24, 1991, the APRE/I Africa Investment Officer visited potential client commercial banks in Nairobi and received a favorable response to the guarantee facility and swap concept.

USAID/Kenya is currently expecting a draft guarantee facility agreement for review pending favorable credit reviews of the banks under consideration and formal approval of the guarantee facility.

VI. SUMMARY OF ANALYSES

A. Technical Analyses

1. Public Sector Component

USAID/Kenya has funded several studies over the past two years which highlight the need for improved GOK capabilities to analyze and implement trade policy reforms, and the need for better government promotion and encouragement of exports. The Mission has worked closely with the World Bank and other donors to coordinate assistance to the GOK to address these needs. The World Bank, through its $100 million Export Development Project (EDP) is providing loan financing for the development of export processing zones (EPZs), and for studies and limited technical assistance to reduce trade barriers to non-traditional exports. The World Bank and USAID are promoting trade liberalization as a means to accelerate job creation and to increase Kenya's foreign exchange earnings.

Exporters face a number of difficulties imposed over the years by the GOK. Numerous line agencies, such as Agriculture, Livestock Development, Commerce and Industry, issue licenses and approvals for eligible imports and exports. Once line agency approval has been granted, then other obstacles must be cleared. These include obtaining Customs and Excise Department (CED) approvals, and transport clearance through the Kenya Ports Authority (KPA), if goods are shipped by sea, or through the Kenya Air Handling Limited facilities, if goods are shipped by air.

Over the past ten years, the Government of Kenya has increased the number and variety of programs to compensate for these barriers and to encourage exports. These include the Manufacturing Under Bond (MUB) Scheme, the Duty Drawback Scheme, the Duty Remission Programme, and the Export Compensation Scheme.

The Export Compensation Scheme (ECS) was established in 1974 to provide exporters with a subsidy for a percentage of the costs of their exports. Careful analyses of successful participants in the ECS reveal actual beneficiaries to be very limited. This implies both a bias toward particular exporters as well as a fairly extensive set of requirements to qualify for export compensation. Compensation payments under the ECS currently take over 12 months, adding a further disincentive to exporters applying for assistance under the Scheme.

The Manufacturing Under Bond (MUB) Scheme was set up in 1984. MUB essentially consists of incentives to produce goods for export. In principle, all inputs for MUB production and packaging are imported duty free and all goods produced under MUB are exported duty free.

In practice, the MUB Scheme has not been a success. Only four producers are operating under MUB, which amply demonstrates the difficulties the MUB Scheme poses. Producers complain of extensive delays in MUB certification, and lengthy delays in obtaining certified duty-free imports.

The Export Promotion Programmes Office of the Ministry of Finance is charged with implementing the GOK's new Duty Drawback Programme (DDP) as part of its mandate. Thus far, several firms have been provided relief through the program. The Duty Drawback Programme essentially is a streamlined version of the ECS. It differs from the ECS in that under DDP the Ministry of Finance (MOF) draws up a list of "qualified" imported items which are used to produce or package exports. This preselected list ostensibly allows an exporter to go to Finance and claim an ex post repayment of duty paid on imported items which were used for exports. Like the ECS, all payments are made in local currency.

In addition, the Ministry of Finance, through the EPPO, operates a new program called the Duty Remission (Exemption) Programme. This is the only ex ante customs program operating in Kenya. In principle, a list of items for duty exemption is approved by the MOF. These should conform to goods known to be imported specifically for producing or packaging export items. An application is made by the exporter for duty exemption on these items. The CED should, theoretically, accept the EPPO documentation and, when the imports arrive, let the goods pass to the exporter duty free.

The Duty Remission Programme has only been in operation since January 1991, and only a few applications have been processed. The EPPO legislation calls for processing and approval (or rejection) of an application for duty exemption within 7 days of submission. If a good does not appear on the MOF's list, a maximum of 30 days are allowed either to approve duty exemption or to reject the application. The Duty Remission Programme, as the MOF's only ex ante mechanism for encouraging exports, marks a significant change in historic GOK attitudes toward exporters.

The EPPO was established both to expedite the speedy processing of ECS and MUB documentation as well as to raise key issues regarding the two programs to senior government levels. In principle, the EPPO should serve as a conduit for the private sector to express concerns and issues concerning the ECS and MUB programs at more senior levels than has been possible, except on an ad hoc basis, in the past. The EPPO should also, from an implementation point of view, be responsible for facilitating utilization of the ECS and the MUB programs, thereby making it easier for businesses to qualify and receive export compensation for eligible exports.

Private businessmen point to historical problems with these schemes as symptoms of the Customs and Excise Department's (CED) anachronistic attitude toward exports. The numerous bureaucratic requirements reflect a distinct anti-export bias at the implementation level. Businessmen point to CED corruption as a further impediment. Overall, they see a strong need for a transformation in Customs officials' attitudes if the GOK's encouragement of exports is to be translated from rhetoric into reality.

A further move toward trade liberalization occurred in late 1990 when legislation established the Export Processing Zones Authority (EPZA) to license, facilitate and oversee investments in Kenya's new export processing zones. The core functions of the EPZA include designating zones, approving investor applications, monitoring compliance, "trouble-shooting" problems, compiling and analyzing statistics of EPZ growth, and identifying opportunities for future policy enhancement. The Authority's Board of Directors will consist of 14 members, of which 12 are selected by the GOK, including 4 from the private sector.

Many observers view the EPZs as a crucial test of the GOK's commitment to a more open trade regime. They see the EPZs as a means to demonstrate to Kenyans that a freer foreign exchange system will lead to more investment rather than capital flight. They view the joint participation of Kenyans and foreigners in EPZ investments as a way to show the GOK that both local and foreign capital can combine to provide further expansion of Kenya's exports. The potential employment benefits of the export processing zones are cited as one of the more critical benefits of the zones.

The Mission, for these reasons, believes it is important to assist the GOK and private sector institutions in this formative stage, and to demonstrate the favorable economic impact of export sector growth. The KEDS Project will provide technical assistance, training and limited commodities to support the GOK and the private sector in these endeavors. KEDS will provide a crucial complement to the World Bank's $100 million Export Development Project.

2. Private Enterprise Component

There is consensus among the business community, the GOK and donors that enterprise assistance is an essential prerequisite for overcoming constraints to export-led growth. This is especially relevant in Kenya's non-traditional sectors where the private sector has had limited international business experience.

USAID has identified critical constraints to export development through surveys, studies and its ongoing private sector programs. For instance, many firms have expressed skepticism about overcoming impediments to efficient export development. They have pointed to the unavailability of technical export services, the lack of technical knowledge, unfamiliarity with foreign markets, and high product development and promotion costs as major obstacles to stronger export orientation.

The absence of general information on new business opportunities, excessive regulatory controls and documentation procedures, and an inefficient incentive regime are also critical impediments to export-led growth. KEDS firm level assistance to alleviate these constraints will be the first deliberate step by any donor in Kenya to establish a sustainable capability to increase non-traditional exports.

USAID believes that the most focused means of overcoming operational and expansion constraints is to deliver direct assistance and technical support to present and potential non-traditional export enterprises. Because the environment for overseas exports is more favorable than for regional trade, firms poised to enter or expand into European, Middle Eastern, Far Eastern and North American markets will receive more emphasis during the initial phases of KEDS. This strategy will lead to faster rates of foreign exchange generation and employment creation in Kenya than concentration on enterprises with a less developed export base.

Demand for private enterprise assistance will come from a broad cross section of enterprises. Based on trade association data, there are between 700 and 800 potentially eligible companies, exporters and producer groups in Kenya. KEDS-targeted firms will be drawn initially from 600 manufacturers (including agro-processors and textile companies), from 100 horticultural exporters, and from approximately 100 small enterprises, such as handicraft producers, and microenterprise groups with viable overseas market niches or strong export potential. USAID estimates that KEDS, by drawing upon this base, will deliver direct firm level assistance to 25-60 enterprises during the first five years of the Project. Horticultural and agro-processing enterprises represent the most promising areas to achieve maximum KEDS impact in the short to medium-term.

The strategy of directly promoting firm level assistance to enterprises was selected for two reasons. First, there are presently no suitable mechanisms through which a comprehensive assistance program can be quickly channelled to Kenya's non-traditional exporters. Second, there is a need to maintain an objective and impartial decision-making process when providing technical assistance to firms.

The purpose of KEDS institutional support is to facilitate enterprise expansion and export development in Kenya. The most efficient and cost-effective way to accomplish this is to provide support to trade institutions representing and serving private Kenyan enterprises. This support will be used to help the institutions to develop the capability to identify and promote new business opportunities, to disseminate international product information, to focus on export policy reform, and to promote products in foreign markets. In keeping with our strategy for achieving maximum impact up front, KEDS will concentrate its initial institutional support on associations which are capable of immediately using KEDS technical assistance to deliver improved export-related services, primarily those in the horticulture and agro-processing firms sub-sectors.

KEDS will address the issue of sustainable firm level assistance and export services by trade associations in the following two ways. First, the PEMU will use the cost-sharing system under the EDF to demonstrate the cost-effectiveness and operational improvements and financial rewards of using technical services to firms accessing the Fund. Second, the PEMU will use technical assistance to transfer export analytical capabilities to KAM, HCDA and FPEAK. Through participation in the process of developing export databases, preparing for trade fairs and identifying target groups and topics for seminars and workshops, these institutions will internalize the capabilities to offer these services over the life of project.

Coordination with other KEDS components will be facilitated through the KEDS Advisory Committee (KAC). The PEMU will participate in bi-monthly Project reviews and will incorporate relevant issues under its quarterly work plans.

3. <u>EPZ Swap Facility</u>

Under Kenyan law, investments in EPZs must be financed in foreign exchange. This encompasses not only fixed investments in capital equipment, but also all working capital expenses including the purchase of raw materials, rental of facilities and utilities, and salaries and wages, prior to receipt of export earnings.

The prevailing exchange control regime constitutes an obstacle to the Kenyan firm wishing to establish operations in EPZs. Kenyan residents are prohibited from holding foreign exchange inside Kenya. All foreign exchange receipts whether earned, borrowed, or from transfer payments, are required to be surrendered promptly to the Central Bank. In addition, commercial banks, while allowed to maintain hard currency current accounts (external accounts) for Central Bank-approved depositors in Kenya, are not allowed to lend hard currency to domestic investors from those accounts.

This makes it virtually impossible for a Kenyan firm to obtain foreign exchange to operate in the EPZs and biases investment in the EPZs in favor of foreigners. If Kenyan firms are to participate actively in the zones, a mechanism must be established to permit them to purchase foreign exchange to cover all requirements to establish and operate in the EPZs. The benefits of opening the EPZs to domestic firms include generating employment and foreign exchange through backward and forward linkages to domestic firms operating outside the EPZs, liberalizing the foreign exchange regime and enticing foreign investment into the EPZs.

4. Studies Component

USAID has been active over the past several years in funding discrete studies to set the agenda for trade policy reform. These have included studies funded under the PED Project through the Kenya Association of Manufacturers (KAM) and the Investment Promotion Centre (IPC). Analyses from these studies, and subsequent discussions with the GOK, have helped to improve Kenya's trade environment.

A significant feature of A.I.D.'s approach to policy issues in Kenya is to strengthen the ability of intermediaries, such as the KAM and IPC to make recommendations on policy matters. That is, policy dialogue is carried out by indigenous intermediary organizations that develop their own policy agendas and carry out policy studies by contracting outside consultants with A.I.D. financing. A 1989 evaluation of the USAID/Kenya private enterprise program considered this approach to policy dialogue to be extremely effective.

USAID has liaised closely with the World Bank and other donors to establish a strong policy dialogue with the GOK. The Bank's policy agenda focuses on shifting exchange rate management policies to focus more specifically on trade and on maintaining Kenya's competitiveness. The World Bank seeks further to reduce the overall level of tariff protection, to streamline and expand the "manufacturing under bond" scheme, and to replace the export compensation scheme with a duty exemption scheme. The latter would remove all tariffs on inputs for the production of goods that are subsequently exported.

USAID has carried out considerable analyses with the GOK in an effort to liberalize the overall economy. The Mission has several projects underway which focus on topics ranging from improving the efficiency of grain marketing, to eliminating price controls, to establishing export enclaves, to fertilizer deregulation. USAID-funded studies have further examined the benefits of establishing a duty drawback (duty exemption) scheme (since approved by the GOK), and preparation of an annual public investment budget (which is now a condition for further World Bank assistance).

USAID believes the GOK export strategy cannot succeed without several additional policy changes that have not been specifically announced in the recent export package. The policy analyses funded through KEDS are expected to result in additional liberalization of Kenya's export policies leading to a substantial increase in non-traditional exports.

B. Social Soundness and Gender Analysis

KEDS initiatives in export processing zones, and the manufacturing and agricultural sectors will generate additional employment opportunities and stimulate the growth of Kenya's economy. However, KEDS is unlikely to have direct impact on the most disadvantaged groups in Kenyan society because of the probable educational requirements of firms operating in the EPZs, the low level of female participation in the manufacturing sector, and landholding requirements in agriculture.

Given the relatively small share of the modern wage sector in total employment (16%), less than one fifth of the increment in urban employment needed over the next decade is likely to be provided by modern wage employment. However, considerable indirect benefits of non-traditional export-led private sector expansion are expected. These will have to be quantified and the backward and forward linkages created examined in order to determine the true extent and impact of KEDS.

Of the total number of firms operating in the private sector, 700-800 are currently eligible for KEDS support. Of these 25-60 will be directly assisted in the first five years. In addition some 600 members of KEDS supported associations will receive training in export related topics. Jobs will be created for one million of the estimated 4.25 million new entrants into the labor force this decade.

KEDS initiatives are primarily focused upon medium-scale enterprises and the horticultural sector. The horticultural sector has the broadest base, both in terms of geographical location and socio-economic groups involved. However as with other assisted sectors, there is a strong possibility that access to KEDS services will be restricted for most smallholders, women and smaller enterprises unless special efforts are made to include them.

There is a need for KEDS to balance social and political equity with economic efficiency. Also, because policy reform has different implications for different groups, there is a need to study the effects of KEDS on all sectors of the economy and society, especially the informal sector, small and microenterprises and the least privileged, to avert any unintended negative consequences.

C. Economic Analysis

There are two objectives of this economic analysis. The first is to analyze the growth rate necessary in non-traditional export earnings to maintain an overall economic growth rate of over five percent annually in the 1990-2000 period. The second is to determine the role, and attribution, of KEDS in meeting these export growth targets. The KEDS Project targets specific constraints to export growth, which if not overcome, will substantially limit export growth in the coming decade. These project activities are necessary though not alone sufficient to meet export growth targets. As such, this analysis assumes that implementation of KEDS is critical to the achievement of the Government's export growth targets but, at the same time, full implementation of the Bank's export program is necessary. KEDS will assist the GOK in increasing non-traditional export earnings by $340 million annually by the year 2000. In terms of benefit to the economy, KEDS will contribute to an additional $640 million in export earnings over the 1991-2000 period at a cost of $25 million to the project.

TABLE V.

	Average Real Shilling Growth Rate a/	
	1985-89	1990-95
Total Merchandise Exports	2.8	6.1
Of Which:		
Traditional		
Coffee	-4.5	3.6
Tea	6.9	4.7
Non-Traditional		
Horticulture	6.4	9.3
Manufacturing	6.0	9.0

a/ USAID growth rates quoted earlier are in nominal dollar terms and differ slightly from World Bank estimates of growth in real shilling terms.

The purpose of KEDS is to increase non-traditional exports over the life of the Project by over seventy percent. For this analysis, we assume that nontraditional exports increase in nominal dollar terms from a base in 1990 of an estimated $430 million dollars to $770 million by 2000. This analysis is based on the assumption that non-traditional export earnings can increase by approximately 6 percent annually in nominal dollar terms, increasing by 50 percent the rate of growth over recent years of approximately 4 percent annually.

Growth in non-traditional exports of at least 6 percent per annum is necessary to meet the GOK's overall economic growth targets. The medium-term growth projections for the 1991-2000 period assume normal weather patterns (instead of better than average rains experienced in the 1985-89 period) and lower growth in coffee and tea exports. As such, the manufacturing sector must become the sector which grows rapidly to keep the overall economy growing at 5.6 percent.

KEDS activities provide a critical link in the World Bank program, i.e. assistance for the actual implementation of policy reforms. As such, USAID/Kenya's interventions are necessary to the achievement of the overall GOK/World Bank/USAID program objectives but are not alone sufficient. Implementation of KEDS second tier reforms and technical assistance will ensure a successful transition to an open economy. Given the above approach, with a focus on the enabling environment and implementation of announced reforms and a program that is interlinked with the GOK and World Bank, the economic and financial analysis is more of a macroeconomic analysis than is typical in a project activity.

<u>KEDS Impact on Export Growth</u>

The purpose of KEDS is to increase non-traditional exports, both in value and volume terms. The rate of growth in non-traditional exports (nominal dollars) is assumed to increase to 6 percent annually in the 1991 to 2000 period based on successful implementation of KEDS and the World Bank program. A ten year time horizon for this benefit-cost analysis has been selected because the full impact of policy changes and infrastructure support will likely take ten years to achieve.

Other key assumptions in the analysis are that baseline export growth (without implementation of KEDS/World Bank program) in the 1991-2000 period is 4 percent and that 1990 non-traditional export earnings were $430 million.

Under these assumptions, and the more general sector and macro assumptions outlined above, total non-traditional export earnings for the period 1991-2000 are estimated to be $6,007 million. Total non-traditional export earnings are estimated to be only $5,369 million in the baseling (4 percent) scenario and only $4,300 million under a no growth scenario.

TABLE VI.

Non-Traditional Export Earnings

(Estimated in Nominal Dollars Mil.)

	Base	2000	Period Total 1991-2000
I. Export Scenario:			
6 percent growth	430	770	6,007
4 percent growth	430	637	5,369
0 percent growth	430	430	4,300
II. Additional Export Earnings:			
Scenario 1: 6 percent growth vs. 4 percent baseline	---	+133	+638
Scenario 2: 6 percent growth vs. 0 percent baseline	---	+340	+1,707

KEDS Impact on Employment

KEDS will have both direct and indirect impacts on employment through increased employment in the export sector and through employment increases associated with increasing overall domestic demand as well as through backward linkages into the informal sector. The employment analysis focuses specifically on the direct effect of export expansion on employment.

The analysis is based on the following recent studies: World Bank Report on Employment and Growth in Kenya (1988), GOK Employment Policy Overview (1990), and A Survey of Results from the Recent Labor Force Surveys in Kenya (1990).

The analysis suggests that the impact of opening the economy to greater export promotion and decreased domestic protection will lead to increased labor productivity as well as increased sector economic growth rates. Both of these factors will lead to increased employment for the Kenyan economy over the 1991-2000 period. Results of this analysis show that increasing agricultural and private sector productivity as well as increasing the overall growth rate will lead to the creation of one million additional jobs in the economy over the 1991-2000 period. The employment analyses below focus on agriculture, manufacturing and the EPZs.

TABLE VII.

EMPLOYMENT ASSUMPTIONS AND PROJECTIONS

	Actual Employment 1985 '000	Trend Growth Rate 1978-85	Elast. Growth WRT GDP 1978-85	Est. Growth Rate 91-2000	Est. Elast WRT GDP 91-00
Modern Wage Sector	1,175	3.3	.94	2.5	.5
Private	588	1.7	.49	3.5	.7
Public	346	5.1	1.48	0.0	0
Large Agriculture	241	-1	n.a.	0.0	n.a.
SmallHolder Agriculture	5,542	3.0	.3	2.5	.6
Urban Informal	504	10.1	n.a.	9.5	n.a.
Rural Nonfarm	213	6.7	n.a.	6.7	n.a.
Unemployed	236	n.a.	n.a.	n.a.	n.a.
Total Labor Force	7,620	n.a.	n.a.	3.7	n.a.
Urban		n.a.	n.a.	6.5	n.a.
Rural		n.a.	n.a.	2.2	n.a.

Agriculture

If we assume that the labor intensity of smallholder agriculture increases (in terms of employment per unit increase in value added in agriculture) from .3 to .6 and that the growth rate for smallholder farmers stays the same (4 percent annually), then the rural-based smallholder agricultural sector will generate an additional 667,000 jobs over the 1991-2000 period. These results are consistent with recent USAID analysis of the farm labor requirements for horticulture which confirm that horticulture crops utilize in many cases at least ten times the labor per hectare per crop year.

Manufacturing

If we assume that: 1) the labor intensity of private sector manufacturing increases slightly to the level attained in recent years (1.22); 2) manufacturing growth occurs in the private sector and not the public sector; 3) manufacturing exports increase by 9 percent, and 4) manufacturing as a whole increases by 7.4 percent, then approximately 127,000 additional jobs will be created in the private manufacturing sector.

Export Processing Zones

Using World Bank estimates, we assume that the Export Processing Zones (EPZs) will create approximately 90,000 jobs over the 1991-2000 period. These assumptions are consistent with recent data which show that the elasticity of employment with respect to sector value added for private manufacturing is more than double that of the public sector parastatals and that manufacturing exports will tend to be much more labor intensive than manufacturing for the domestic market. Parastatals in Kenya working under massive protection from imports, and having priority access to foreign exchange, have chosen capital intensive techniques while private companies have chosen to take advantage of Kenya's cheap labor pool.

D. Administrative Analysis

In developing KEDS, USAID has considered the administrative capabilities of GOK and private sector institutions in implementing the Project Components. Overall, these have been found adequate to carry out the proposed programs. An institutional review of the participating organizations is provided in Annex D.

The Project components will require that the newly-formed EPPO and other government bodies provide direct counterpart personnel support to the Project. The Project Design takes into consideration and builds upon the incipient operations of these counterpart organizations. Part of the technical assistance being provided is directed to strengthening the counterpart organizations response capabilities for Project activities.

Considerable USAID staff efforts will be required to manage this complex Project. The existing staff is to be augmented with an additional FSNDH. A review of the current staffing pattern and plans to augment the Private Enterprise Office for this project conclude that the proper mix of direct hire and OE-funded personnel will be provided. Also, the use of a single institutional contract and provision of a KEDS Advisory Committee will enhance coordination within the Project and minimize the management burden on the Mission.

E. Environmental Analysis

The Initial Environmental Review for the Project recommended a Categorical Exclusion with regard to the components to be financed under the Project. The IEE, see Annex F, indicates how environmental considerations are being reviewed with the GOK. The grounds for exclusion were that this is principally a technical assistance project directed to existing firms and institutions. The IEE and Categorical Exclusion were approved on January 7, 1991 by the Bureau Environmental Officer.

VII. CONDITIONS AND COVENANTS

USAID/Kenya is proposing the following covenants and conditions precedent:

Covenants

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

- o The Export Promotion Programmes Office will be elevated to a Department within the Ministry of Finance to enable it to influence other Ministries and to effectively implement trade promotion policies and export incentive programs.

- o The Export Promotion Programmes Office will be headed by a senior government official at the level of Deputy Secretary and fully staffed with at least three Chief Economists or Specialists in trade policy, export promotion and export incentives programs.

- o The Central Bank shall provide guidance on the legality of commercial banks placing liens on assets in the EPZs and the seizure of assets in the event of default.

Conditions Precedent

Prior to initial disbursement under the EPZ Swap Funding facility to the Central Bank of Kenya, or the issuance of any commitment documents pursuant to which such disbursement may occur, the Cooperating Country shall furnish to A.I.D., except as A.I.D. may otherwise aree in writing, evidence that:

- o The GOK has furnished all documents necessary to authorize and instruct the Central Bank to make disbursements up to $4,000,000 U.S. Dollars to the EPZ Swap fund;

- o The Exchange Control Notice Number 37, Article 10, has been amended to permit local commercial banks to on-lend hard currencies to domestic investors for EPZ investments and working capital;

- o The Central Bank of Kenya has issued a cuircular exempting allowing local investors to use their local currency resources to defray local costs associated with establishing export companies in the EPZs; and

- o The Central Bank of Kenya has issued a circular exempting all local currencies swapped for hard currencies to invest in the EPZs from commercial bank credit ceilings.

ANNEX A: TECHNICAL ANALYSES

I. PUBLIC SECTOR SUPPORT COMPONENT

A. OBJECTIVES

This Project Component will focus on two approaches to export promotion: improving Kenya's general export climate, particularly for non-traditional exports and developing successful export enclaves (export processing zones). The primary objectives of the KEDS Public Sector Component include improvement of the trade policy and regulatory regime, and promotion of continual dialogue between the private sector and policy makers in government. The Project will assist the GOK to improve Kenya's trade climate to encourage exports especially in horticulture, agro-processing and manufacturing.

The establishment and successful operation of export enclaves will enable Kenya to make better use of its comparative advantage in labor and its location relative to major international markets. USAID realizes that, in the short-term, export processing zones will address Kenya's employment crisis rather than the country's foreign exchange needs. However, functioning export processing zones will lead to a more open trade climate, provide important linkages to other firms operating in Kenya, and lead to improved foreign exchange earnings for the country.

B. BACKGROUND

USAID/Kenya has funded several studies over the past two years which highlight the need for improved GOK capabilities to analyze and implement trade policy reforms, and the need for better government promotion and encouragement of exports.[1] The Mission has worked closely with the World Bank and other donors to coordinate assistance to the GOK to address these needs. The World Bank, through the Export Development Project (EDP), is providing loan financing for the establishment of export processing zones (EPZs), and for studies and limited technical assistance to reduce trade barriers to non-traditional exports. The World Bank and USAID are promoting trade liberalization to

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[1]. See, for example, "The Enabling Environment for Kenyan Export Processing Zones", The Services Group, Mwaniki Associates Ltd. and SRI International, December 1989 (for the Investment Promotion Centre/MOF), "Price Controls: Experiences and Opportunities in Kenya's Manufacturing" through KAM (1988), and "Export Incentives for Kenyan Industry" for the KAM, by SRI International, Mwaniki Associates and the Services Group, August 1989.

accelerate job creation and to increase foreign exchange earnings.

Kenyan exporters face a number of hurdles imposed over the years by various agencies of government. Numerous line ministries issue licenses and approvals for eligible imports and exports. Once line agency approval has been granted, then other obstacles must be cleared. These include obtaining Customs and Excise Department (CED) approvals for exports or authorized imports, and transport clearance through the GOK's Kenya Ports Authority (KPA) if goods are shipped by sea, or through the parastatal Kenya Air Handling Limited facilities if goods are shipped by air.

Additionally, numerous taxes, levies and duties are applied to exports. These include local county council trading license charges and cesses, Ministry of Labour (MOL) industrial training levies, Kenya Bureau of Standards inspection levies, KPA port charges, among others. Price controls, although greatly reduced over the past two years, and labor laws can raise the real costs of production to uncompetitive levels. Many potential exporters, especially small and medium enterprises (SMEs), find these requirements so onerous that they simply do not bother to export.

1. <u>Governmental Export Promotion Activities to Date</u>

Over the years, the Government of Kenya has developed an array of indirect measures to overcome these export barriers. These include the Export Compensation Scheme (ECS), and Manufacturing Under Bond (MUB) Scheme. In addition the GOK has recently introduced the Duty Drawback and the Duty Exemption Schemes. The effects on exports of these programs have been mixed.

The ECS was established in 1974. The intent of the ECS was to provide certain exporters with an export subsidy for a percentage of the costs of their exports. Financial compensation is made in local currency up to a certain proportion of the total value of the exports. The ECS has proven to be fairly unwieldy over the years. Careful analyses of successful participants in the ECS reveal actual beneficiaries to be very limited, implying a bias toward particular exporters and fairly extensive requirements to qualify for export compensation. Compensation payments under the ECS can take years, adding a further disincentive to exporters applying for assistance under the Scheme.

The MUB Scheme was set up in 1989 and essentially consists of a producer designating a physical area to produce goods for export. All inputs for MUB production and packaging should be imported for approved production on a duty free basis. All goods produced under MUB should also be exported duty free.

In practice, the MUB Scheme has not been a particular success. Only four producers are operating under MUB, which amply demonstrates the difficulties the MUB Scheme poses. Producers complain of extensive delays in certification as manufacturers under bond. They complain of lengthy delays in obtaining certified duty-free imports.

The GOK's new Duty Drawback Programme essentially is a streamlined version of the ECS. It differs insofar as the Ministry of Finance (MOF) draws up a list of "qualified" imported items which are used to produce or package exports. This preselected list ostensibly allows an exporter to go to the MOF and claim an ex post repayment of duty paid on imported items which were used for exports. As with the ECS, all payments are made in local currency.

In addition, there is a new program called the Duty Remission (Exemption) Programme. This is the only ex ante Customs program operating in Kenya. In principle, a list of items for duty exemption is drawn up by the MOF. These should conform to goods known to be imported specifically for producing or packaging export items. An application is made by the exporter for duty exemption on these items. The CED should, theoretically, accept the documentation and, when the imports arrive, let the goods pass to the exporter duty free. The Duty Remission Programme has only been in operation since January 1991. As such, only a few applications have been processed. The Duty Remission Programme, as the MOF's only ex ante mechanism for encouraging exports, marks a significant change in historic GOK attitudes toward exporters.

Finally, the Export Promotion Programmes Office (EPPO) was established in late 1990 both to expedite the speedy processing of duty exemption, duty drawback, ECS and MUB documentation, and to raise key issues regarding the two programs to senior government levels. The EPPO should serve as a conduit for the private sector to express concerns and issues concerning these export promotion programs at more senior levels than has been possible. The EPPO will also be responsible for facilitating utilization of the ECS and the MUB programs, thereby making it easier for businesses to qualify and receive export compensation for eligible exports.

2. Donor Assistance for Export Promotion

The GOK has agreed to a number of reforms included in the IMF's and World Bank's recent Policy Framework Paper and the Bank's Export Development Project (EDP), a $100 million credit facility. The UNDP is funding two important elements in the GOK's export promotion program, tax modernization and assistance to the new EPZA.

The UNDP is financing (with USAID cofinancing) a major Tax Modernization Program with the MOF's Fiscal and Monetary Unit. This joint program is funding several long-term advisors working with the MOF on policy matters, tax consolidation (for both income tax and VAT), enhanced tax collection and improved computerization of records. Short-term assistance is being provided in a number of specialized areas. The Mission's direct assistance to MOF, funded through a PASA with the United States Treasury, will initially be coordinated through the Tax Modernization Programme (TMP). The U.S. Treasury official working with the TMP will help to establish verification procedures for the various export incentives programs administered through the MOF.

The GOK has requested long-term technical assistance from the UNDP to work closely with the Export Processing Zones Authority (EPZA). Two long-term UNDP advisors will be provided to work with the EPZA. The Government of Kenya is anxious to see the EPZA established and operational, and views both UNDP and USAID assistance as crucial to the success of the export enclaves.

The GOK and donors have recognized that a major constraint to export development in Kenya is the lack of a modern, efficient tax system. Tax modernization and tax reform can be a key instrument to encourage exports, and promote expansion and additional investments in export enterprises. Toward this end, the African Development Bank (AfDB) is providing approximately $4.7 million in institutional support to the MOF for several components under the UNDP Tax Modernization Program.

The AfDB grant will provide three long-term experts to the Customs and Excise Department (CED/MOF) for two years in systems development, control and auditing, and computer system set up and management. There also will be short-term consultancies to the CED for training in systems development for export promotion, development of computer-based tax models, and computer system development. Assistance to the CED, which is responsible for administering the Export Compensation Scheme, is an integral component of current GOK efforts to stimulate export growth under the IMF's structural adjustment program.

The British Overseas Development Administration (ODA) is assisting the CED in conjunction with the UNDP Tax Modernization Programme. Two long-term advisors are working with the Income Tax and Value-Added Tax (VAT) departments under the Directorate of Fiscal and Monetary Affairs.

The Kenya Ports Authority (KPA) has received a grant of approximately $20 million in technical assistance and commodities from the ODA. The objective of the ODA project is to reverse the deterioration in the efficiency of Mombasa Port's operations. The project seeks to lower the cost of transport which inefficient port operations entail. Port operations, especially container handling, will be improved and delays will be reduced.

The Kenya External Trade Authority (KETA), of the Ministry of Commerce, is undergoing an institutional review by the Japanese International Cooperation Agency (JICA) in order to improve its export promotional capabilities through Kenya's overseas diplomatic missions. KETA hopes to develop a "Masterplan for Exports" with Japanese assistance. It is expected that the Japanese will provide promotional assistance to KETA which will complement KEDS export promotion efforts directed through the private sector. KETA has received European Community (EC) technical assistance in the past.

3. Export Promotion Programmes Office (EPPO)

Establishment of the EPPO and the legislation for duty remission and duty drawback were conditions to the World Bank's Export Development Project (EDP). The EPPO was established in late 1990. It is charged with facilitating exports by approving duty exemption applications within seven days if the intended import is on a pre-approved list. If the imported items are not on the pre-approved list, then the EPPO is charged with approving or disapproving the requests within 30 days. The process includes obtaining the approval of other GOK agencies such as the Ministry of Commerce. Other EPPO responsibilities include entering data for statistical and report generation, and verifying duty exemptions, duty drawbacks and export compensation payments.

The EPPO is also charged with providing technical support to the Ministry of Finance by estimating value coefficients by type of export, developing eligibility lists of imports, maintaining statistics on export firms, generating value and physical input-output ratios by product and exporter, analyzing export incentives, and liaising with export sectors on developments and issues in specific export sectors.

The EPPO currently falls under the Fiscal Unit of the Division of Fiscal and Monetary Affairs (Figure 7). The EPPO currently operates with staff seconded from other offices within the MOF. The Ministry intends to elevate the EPPO to the level of a separate department withing the Ministry of Finance. Such a move would assure the EPPO more administrative authority. This will be necessary if it is to raise various trade issues to a high enough level within the MOF, and if it is to interact effectively with other ministries in government. KEDS assistance to the EPPO will help to develop its capabilities to discharge the duties set out for it through the EPPO legislation.

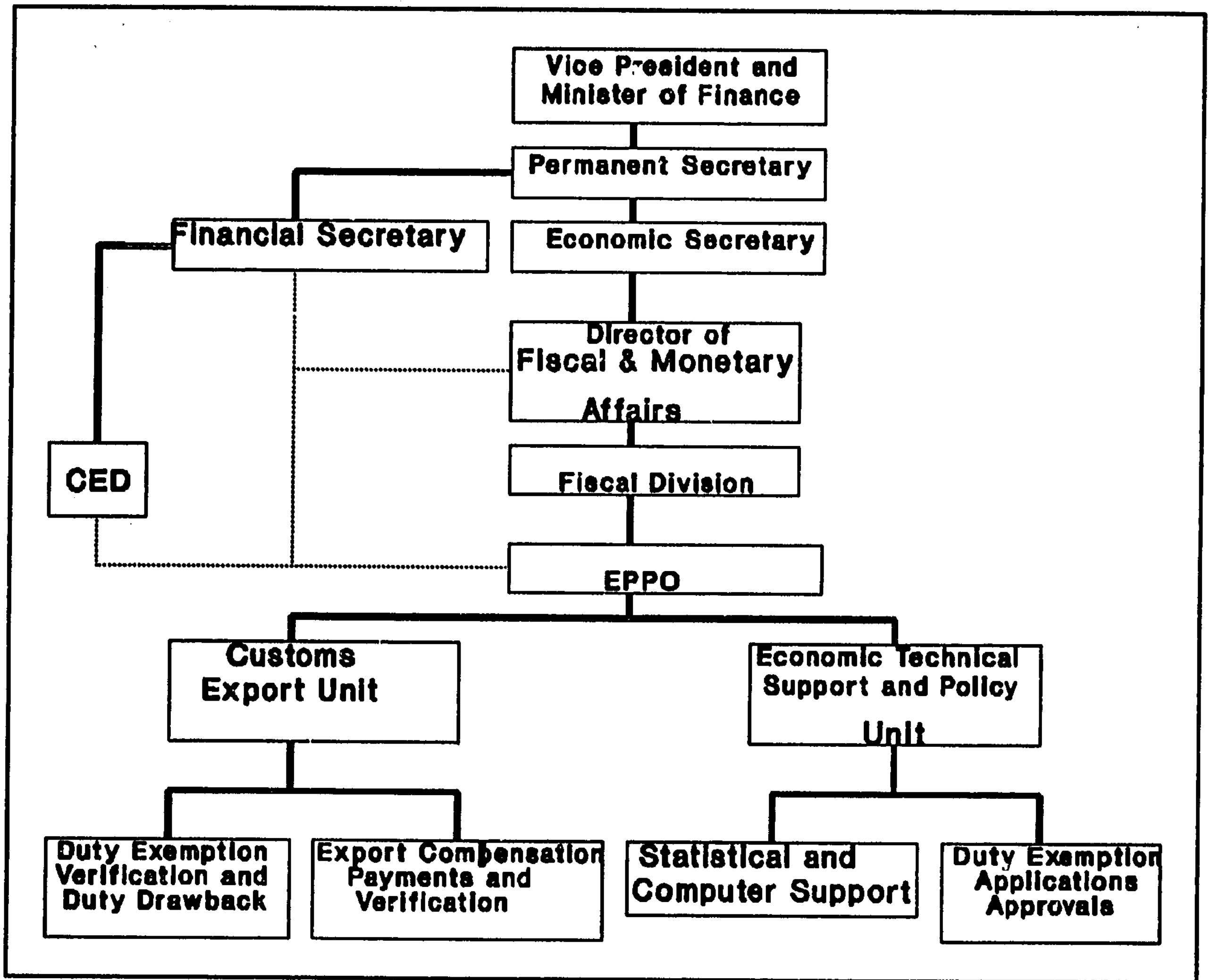

Figure 7: CURRENT EPPO ORGANIZATION FRAMEWORK

4. <u>Export Processing Zones Authority (EPZA)</u>

A further move toward trade liberalization occurred in late 1990 when legislation established the Export Processing Zones Authority (EPZA) to license, facilitate and oversee investments in Kenya's new export processing zones. The core functions of the EPZA include designating zones, approving investor applications within 30 days, monitoring compliance, "troubleshooting" problems, compiling and analyzing statistics of EPZ growth, and identifying opportunities to improve the policy environment with regard to export enclaves.

The Authority's Board of Directors will consist of 14 members. Twelve members of the Board will be selected by the GOK, including 4 representatives from the private sector. The other two Board members will represent the Kenya Association of

Manufacturers and the Kenya National Chamber of Commerce and Industry.

The EPZA legislation provides the regulatory framework for all investments in the EPZs. EPZ incentives include 100 percent exemption from corporate tax for the first ten years, no restrictions on capital or profit repatriation, and total exemption from duties on all imports and exports. Incentives included in the legislation compare favorably with those found in export enclaves in other countries.

Many observers view the EPZs as a crucial test of the GOK's commitment to a more open trade regime. They see the EPZs as a means to demonstrate that a freer foreign exchange system can lead to more investment rather than capital flight. They view the joint participation of Kenyans and foreigners in the export processing zones as a way to show the GOK that both local and foreign capital can combine to provide further expansion of Kenya's exports. Finally, the potential employment benefits of the export processing zones are cited as one of the more critical benefits of the zones.

C. DESCRIPTION

The KEDS Project Public Sector Assistance Component will consist of a long-term Export Promotion Advisor, a long-term Export Policy Advisor, a long-term Export Programs Advisor (US Treasury PASA Customs Officer), short-term technical assistance, commodities and training.

1. Implementing Agencies

The KEDS Public Sector Component technical assistance team will be located within the MOF, working directly with counterparts in the EPPO and the EPZA. The team will work with other relevant officers and advisors in the MOF, particularly those working on the Tax Modernization Project, in all aspects of export promotion to strengthen the EPPO as the MOF's key export promotion agency. The Public Sector Component technical team will also coordinate technical assistance for the EPZ Swap Facility with the Central Bank and commercial banks, and manage the KEDS Studies Component.

A KEDS Advisory Committee (KAC) will be formed under the auspices of the Project. The KAC will be composed of private sector representatives and associations involved in exports, key government officials, representatives of the KEDS technical assistance team, and USAID/Kenya personnel. The KEDS Public Sector Component team leader will serve as the Secretariat to coordinate meetings and prepare agenda. KAC meetings will ensure periodic interaction between the KEDS Public Sector Component team, the Firm Level Assistance Private Enterprise Management

Unit (PEMU), counterparts in the EPPO and the MOF, officials of other GOK agencies, and private sector representatives. This will create a forum for effective policy dialogue and high level discussion that will lead to policy and implementation improvements.

A Public Sector Component Technical Advisory Committee (TAC) will be set up once the technical team is in place. This Committee will provide regular guidance to the technical team for the implementation of the Component. Members will include representatives from the EPPO and the EPZA, the technical team and USAID. The Technical Advisory Committee will review and approve technical consultancies and training funded through the Public Sector Assistance Component. The TAC will also review work carried out under the Studies and EPZ Swap Facility Components.

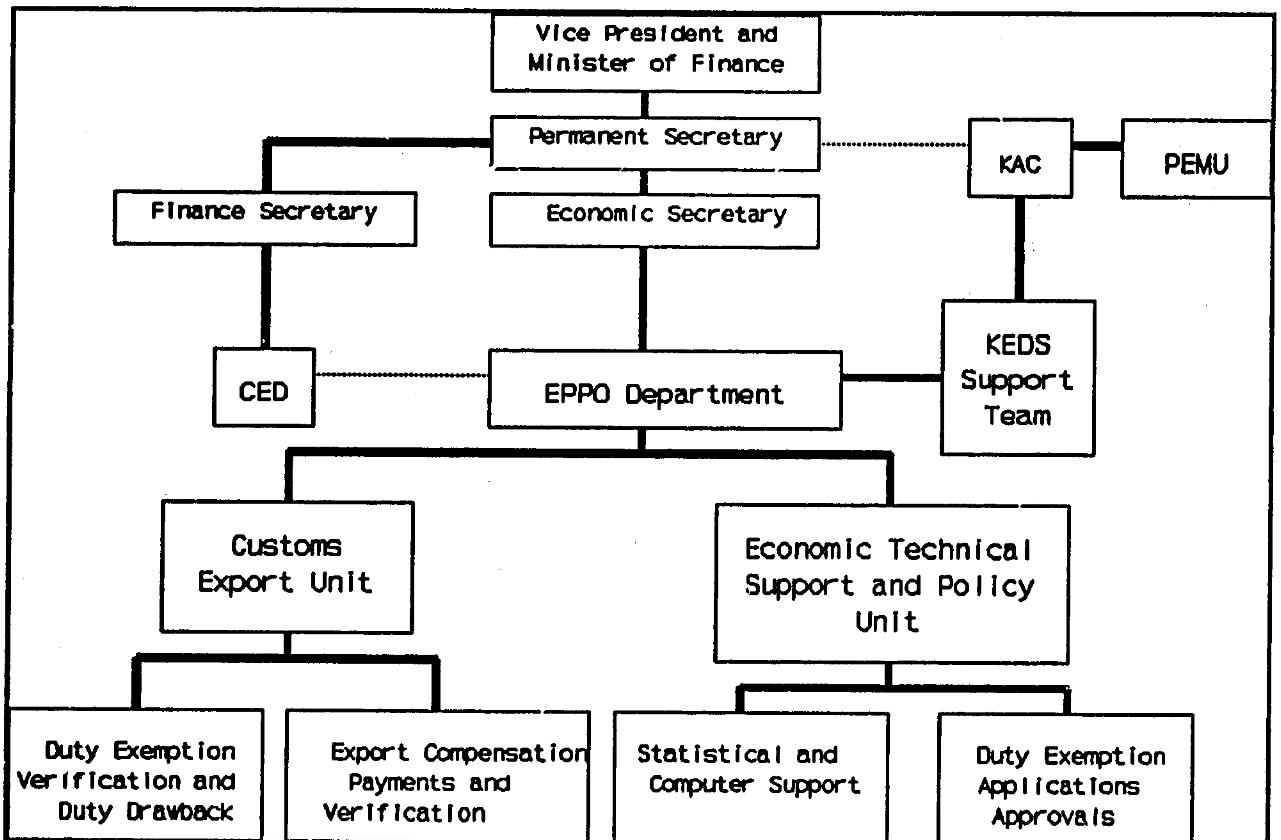

Figure 8: PROPOSED EPPO ORGANIZATIONAL DIAGRAM

The Public Sector Chief of Party will liaise with USAID, and will be responsible for submitting quarterly and other reports, including all studies funded through the Studies Component, to USAID. The Export Promotion Advisor will be responsible for drawing up, in conjunction with USAID, the MOF, the Central Bank, the PEMU and other relevant agencies, the terms of reference and

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scopes of work for the various studies funded under the Studies Component. The Chief of Party will also coordinate with USAID, the Central Bank and commercial banks in the delivery of technical assistance as part of the EPZ Swap Facility Component. Figure 8 illustrates the type of interaction at all levels that will take place under the KEDS Public Sector Assistance Component.

2. Technical Assistance

The EPPO will have both a functional and a policy role under KEDS. On a policy level, the EPPO should provide trade policy analyses and guidance to the Economic Secretary and other offices in the Ministry of Finance. The KEDS Public Sector technical team will also oversee the KEDS Studies Component. Technical analyses will include development of procedures in ratio estimation (imported inputs as a ratio of export value), analyses of export program performance, trade statistics, export incentives and export program development.

The Export Promotion Advisor (EPA) will coordinate the Public Sector Assistance Component activities. His/her overall objective will be to work with the GOK to promote the growth of non-traditional exports. Promotion will take several forms. These will range from ensuring that relevant GOK agencies and the private sector are aware of GOK export promotion programs to providing the GOK with up to date information and recommendations on means to streamline trade processing requirements.

The EPA will work with MOF counterparts to assure responsiveness to private sector needs and recommendations from the KAC. The EPA will recommend program changes and procedures, liaise with USAID/Kenya and other donors to coordinate export support activities, and prepare needs assessments, training activities, and scopes of work in both EPPO and EPZA activities. He/she will advise the EPPO and the MOF's Economic Secretary on policy changes designed to remove anti-export biases, establish technical guidelines and procedures on ratio estimation, analyze trade performance statistics, monitor export incentives and program development, develop relevant training programs for EPPO and other MOF staff, recommend staff members for additional academic education, and oversee the planning of studies.

The Export Promotion Advisor's GOK counterpart will be the Undersecretary (Head) of the EPPO. The EPA will ensure that appropriate GOK counterparts are available to work with all consultants in order to carry out short-term technical assistance. The Advisor will ensure that on-the-job training is provided to GOK counterparts as an integral component of all long- and short-term technical assistance provided through the Public Sector Component. The EPA will oversee the purchase of commodities, and coordinate the short-term EPZA and EPZ Swap Fund technical assistance provided under KEDS.

One of the initial tasks of the Export Promotion Advisor will be to design and carry out a baseline survey for the MOF on current policies, regulations and rules, and their effects on trade, with an eye on monitoring changes in the trade regime during the course of the Project. Additionally, this Advisor will work closely with the PEMU technical team to assist them with the Firm Level Assistance baseline survey and impact assessment monitoring mechanisms.

A Program Administration Advisor will be funded for one year under the KEDS Project as a continuation of USAID support to the Ministry of Finance. This PASA position with the United States Treasury will have been financed for the first year before KEDS start-up through other program funds. The Program Administration Advisor is charged with assisting the MOF to develop and administer verification procedures for the MOF's duty exemption, duty drawback and export processing programs.

Short-term technical assistance will be provided to the EPPO through the KEDS Public Sector Component. Part of this TA will examine various trade constraints in detail and recommend appropriate policy changes. Short-term assistance to the EPPO will include management information systems development, and training on the maintenance of program performance statistics, trade statistics, and monitoring and verification procedures. EPPO training and institutional needs assessments, and procurement of computer hardware and software will also be provided under this component of KEDS short-term technical assistance. A specialist will prepare recommendations on the coordination and sharing of database information among government entities and private sector associations on export-related data, and means for accessing international data relevant to the EPPO's export promotion programs.

A needs assessment for EPZA short-term technical assistance will be provided by the KEDS Public Sector team at the start-up of the Project. It will be difficult to define the specific types of short-term technical assistance required by the EPZA until the two long-term UNDP advisors to the EPZA are working with the EPZA. The Export Promotion Advisor will work closely with the UNDP advisors and the EPZA to set out the scopes of work for technical assistance to the EPZA.

At present, it is foreseen that KEDS will finance short-term technical assistance early in the Project to promote EPZs in Kenya, and to generate Kenyan and foreign investor interest in those export processing zones. Such promotion will entail workshops and seminars in Kenya and in other countries, development of international standard promotional and advertising materials, and assistance to the EPZA to develop a positive image as an efficient, receptive organization.

It is anticipated that short-term technical assistance will be required to help the EPZA set up proper procedures in all aspects of export processing zone administration. This technical assistance will also be used to help the EPZA remove impediments to EPZ development and growth, to develop a statistical and analytical base for monitoring zone development, to encourage investment in the EPZs, and to ensure rapid processing of investor applications.

3. Training

KEDS will provide short-term training courses both abroad and in Kenya. Such training could include courses on economics, public policy, public finance, export promotion and fiscal incentives for exports. In-country seminars and workshops will be held on topics ranging from promotion of GOK trade policies to streamlining GOK export approvals.

It will be essential for the Public Sector Assistance technical team to coordinate such training and workshops with their Firm Level Assistance counterparts. There will be several areas of training which will be of benefit to both the private and public sectors. Moreover, seminars and workshops designed around themes common to both sectors could prove invaluable tools for stimulating discussion and dialogue between the GOK and the private sector. The benefit of a single technical assistance team will enable coordination of training activities to avoid duplication or exclusion. The importance of interaction between the MOF Project counterparts and their private sector colleagues cannot be overemphasized.

D. PUBLIC SECTOR ASSISTANCE INPUTS

KEDS Public Sector assistance will consist of the following:

- Long-term technical assistance to the EPPO (54 person-months);
- Short-term technical assistance to the EPPO (an estimated 22 person-months);
- Short-term technical assistance to the EPZA (an estimated 9 person-months);
- 10 short term (avg 60 day) training courses for individuals in the U.S.A
- A series of ten 1-day seminars sponsored by the EPPO
- A series of ten 1-day seminars sponsored by the EPZA
- Commodities for the EPPO: 1) Three computers with modems and internal memory cards, plus one laser printer and 2 UPS; 2) Computer software programs; 3) One fax machine, one photocopier, one binding machine, 4) On-line access to

foreign data base systems; and 5) Subscriptions to export trade publications and other relevant publications on export promotion.

- Commodities for the EPZA: 1) One computer with modem and internal memory cards, plus one laser printer and UPS; 2) Computer software programs; 3) One fax machine, one photocopier, one binding machine; 4) On-line access to foreign data base systems; and 5) Subscriptions to publications on EPZ development, foreign direct investments and any other relevant publications on EPZ development and administration.

E. PUBLIC SECTOR ASSISTANCE OUTPUTS

The expected outputs of the Public Sector Component include:

- A functioning EPPO in the MOF export promotion drive;
- A staff well trained in trade policy analysis;
- A reduction of GOK controls ranging from licensing simplification to import and export liberalization;
- Increased export incentives provided by GOK;
- Strengthened GOK trade policy capabilities;
- A functioning mechanism for dialogue between the private sector and GOK entities;
- A functional EPZA providing timely inputs to two export processing zones; and,
- Coordinated technical assistance among the Private Sector Component, the Studies and the EPZ Swap Facility Components.

II. FIRM LEVEL ASSISTANCE COMPONENT

A. OBJECTIVES

The objective of the KEDS Firm Level Assistance Component is to increase foreign exchange from non-traditional exports and to increase employment in Kenya's private sector. KEDS will provide firm level assistance through a Private Enterprise Management Unit (PEMU). An overview of the Firm level Assistance Component is illustrated in Figure 9 below.

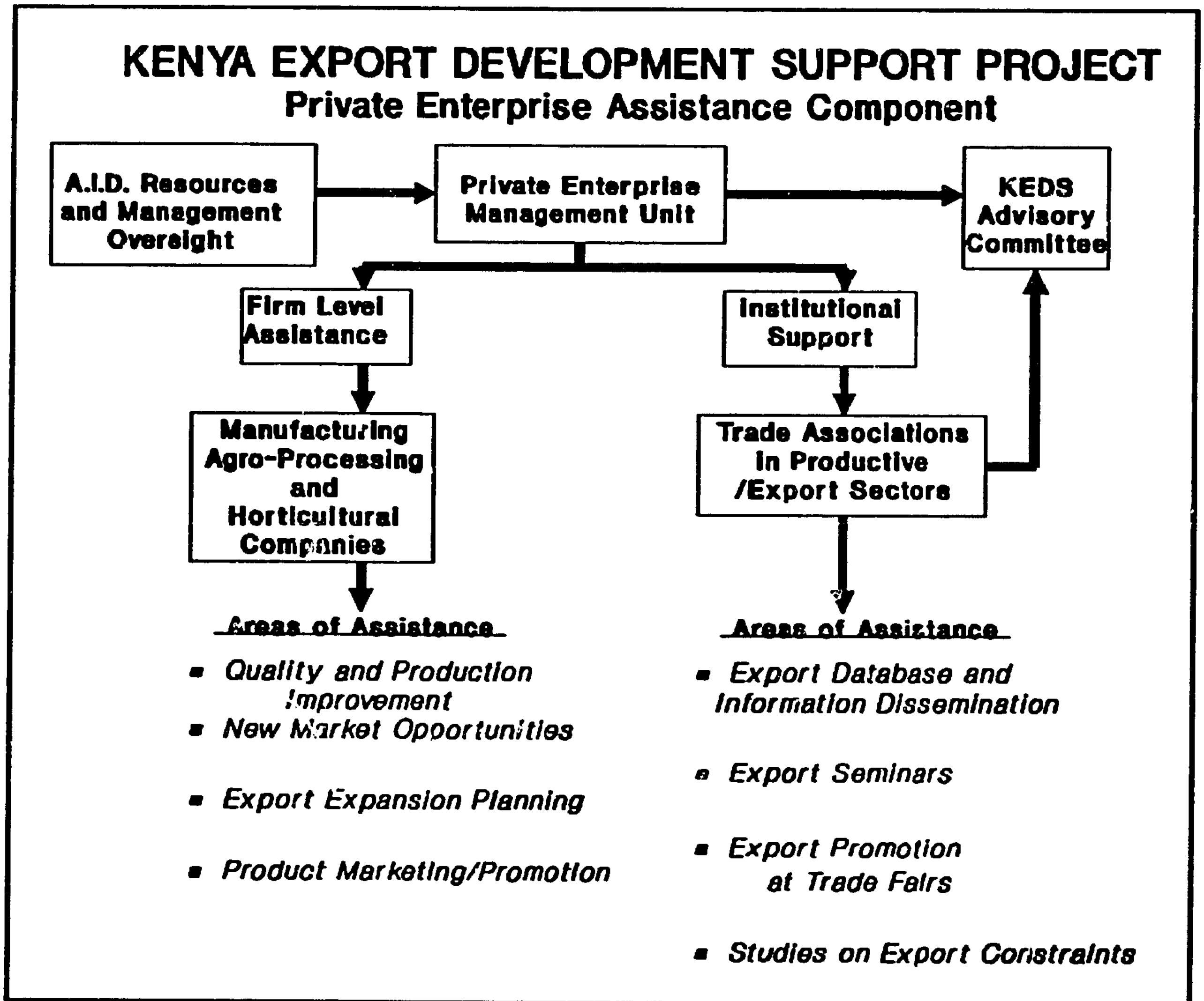

Figure 9: PEMU ORGANIZATIONAL FRAMEWORK

B. BACKGROUND

There is general agreement among the business community, the GOK and donors that enterprise assistance is an essential prerequisite for overcoming constraints to export-led growth. This is especially relevant in Kenya's non-traditional sectors where the private sector has had limited international business experience.

USAID has identified many critical constraints to export development through surveys, studies and its ongoing private sector programs. For instance, most firms have expressed skepticism about overcoming impediments to efficient export development. These companies have pointed to the unavailability of technical export services which they need to develop better quality products. They have pointed to their lack of up-to-date technical knowledge about new plant, equipment and processing methods. These firms point to their unfamiliarity with foreign markets, and the high product development and export market and product promotion costs as major obstacles to stronger export orientation.

The absence of general information on new business opportunities, excessive regulatory controls and documentation procedures, and an inefficient incentive regime have also been cited by many firms as critical impediments to export-led growth. KEDS firm level assistance will alleviate these constraints as the first deliberate step by any donor in Kenya to establish a sustainable capability to increase non-traditional exports.

The environment for overseas exports is far more favorable than for regional trade because of the stronger purchasing power in overseas markets and because of the shortage of foreign exchange which impedes trade within Africa. Therefore firms poised to enter or expand into European, Middle Eastern, Far Eastern and North American markets will receive more emphasis during the initial phases of KEDS implementation. This strategy will lead to more reliable growth prospects, faster rates of foreign exchange generation, and sustainable employment creation in Kenya than concentration on enterprises with a less developed export base or on markets with limited export potential.

The need for firm level assistance comes from a broad cross section of enterprises. Based on trade association data, there are between 700 and 800 potentially eligible companies, exporters and producer groups in Kenya. KEDS-targeted firms will be drawn initially from 600 manufacturers (including agro-processors and textile companies); from 100 horticultural exporters; and from approximately 100 small enterprises, such as handicraft producers, and microenterprises with viable overseas market niches or strong export potential.

Horticultural and agro-processing enterprises represent the most promising areas to achieve maximum KEDS impact in the short to medium-term because of their high levels of net foreign exchange generation, high value added, greater employment generation than in other productive sectors and extensive income distribution effects in the agricultural sector.

The strategy of directly promoting firm level assistance to enterprises was selected for two reasons. First, there are presently no suitable mechanisms through which a comprehensive assistance program can be quickly channelled to Kenya's non-traditional exporters. Second, there is a need to maintain an objective and impartial decision-making process when providing technical assistance to firms.

C. DESCRIPTION

Firm Level Assistance will be delivered through a Private Enterprise Management Unit (PEMU) financed by KEDS. The Unit will be responsible for implementing both firm level assistance and institutional support grants. It will have independent offices and administrative support staff in Nairobi and will work closely with the leading export trade institutions in Kenya.

Firm level assistance will be used to provide Kenyan exporters with market assessments, quality and production assistance, planning for business expansion and export promotion through short-term consultancies. Institutional support will consist of database development, dissemination of export market information, seminars and trade fair participation in overseas markets.

The Firm Level Assistance Component consists of three sets of activities to be financed under the Project. These are: (a) direct firm level assistance, (b) institutional support for export related institutions, and (c) assistance to the International Executive Service Corps (IESC).

1. Direct Firm Level Assistance

Firm Level Assistance will be provided under three categories of activities: Export Development Assistance; Specialized Technical Assistance; and an Export Development Fund (EDF).

a. Export Development Assistance. The PEMU technical team, in collaboration with KEDS-assisted trade associations, will establish a strategic action plan for identifying enterprises with direct and indirect export potential. The action plan will define criteria for selecting eligible firms such as product development opportunities, financial performance, expansion capability, export experience and employment potential.

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Preliminary discussions with firms, evaluations of export markets for available products, and examination of opportunities for similar product lines in overseas locations will be initiated by the PEMU technical team.

The PEMU will utilize short-term consultants to design market-oriented promotional strategies and identify specific product development opportunities for Kenyan export groups. The PEMU team will forge input linkages between intermediate producers and larger exporters, explore EPZ supplier links on behalf of indirect exporters, establish contacts with buyers, and develop systems to access information on entry-level trade requirements in foreign countries.

This methodology will be repeated on an enterprise-by-enterprise basis and will be used to design an introductory program for non-traditional exporters and established firms. The PEMU will use its preliminary findings to encourage firms to make more extensive assessments of their export potential. In this way the Unit will help targeted firms to follow through with stronger commitments to new product development. KEDS will provide guidance through the core contract to assist each firm with its preliminary export plans. KEDS will fully finance the preliminary activities, consulting assignments and each series of "first contact" interventions with firms. Thus, initial advice will be free of cost to exporters.

b. <u>Specialized Technical Assistance</u>. Export-related expansion activities often occur via a number of phased technical improvements, combined with promotional visits, as new products are developed and tested in alterative markets. Specialized services will be marketed to companies to help them through each stage of their export development process.

c. <u>The Export Development Fund</u>. An Export Development Fund will be established to provide cost shared financing for specialized technical assistance. The Fund will help private sector firms pay for the following types or services:

- Services to obtain specific market and product information, to finance technical assistance for firm expansion, and for test marketing and follow up advice through PEMU; and,
- IESC production and quality improvement assistance to KEDS-targeted firms.

The PEMU will access the Fund to provide technical services to new exporters to help each firm enter new markets, obtain specific market knowledge, and develop detailed financing and expansion plans. The Project will offer firms EDF cofinancing to cover eligible consultancy and exploratory market visits and to promote and test market new products. For established exporters, EDF funds would finance follow up services to refine products or re-examine markets and production limitations and identify solutions to serious firm level constraints which would hold back export expansion.

EDF eligibility requirements for targeted firms will consist of:

1) Business development capacity of the firm;
2) Export expansion potential;
3) The type of enterprise;
4) The financial capacity of the beneficiary firm; and,
5) Preliminary evaluations of the firm's export capacity and opportunities.

Eligible activities for EDF funding will include:

1) Product upgrade;
2) Packaging redesign;
3) Quality improvements;
4) Travel to export markets;
5) Acquiring design and processing knowledge;
6) Technical in-house training; and,
7) Expansion planning.

While the PEMU will focus on a broad range of direct export development services, the Unit will also buy into a limited number of specialized business assistance programs to address specific firm level production and quality constraints. KEDS will obtain these services after the PEMU's preliminary assistance has been completed as part of its first series of pre-export development interventions. The PEMU will provide direct firm level assistance in identifying new market opportunities, export expansion planning and in export marketing and promotion.

IESC activities will focus on production and quality improvement assignments. The objective of the IESC involvement is to leverage KEDS to improve the export capabilities of targeted horticulture, agro-processing and manufacturing enterprises in Kenya. The PEMU institutional contractor will enter into a sub-contract with IESC to deliver quick and cost effective short term interventions as an effective follow up to the PEMU's preliminary evaluations of new product opportunities and export capabilities of targeted firms.

The PEMU will be responsible for identifying KEDS-targeted client firms and for brokering IESC assistance for firms under the cost-shared Export Development Fund. EDF disbursements will allow for a maximum of three cofinancing interventions per company up to a ceiling of $15,000 per intervention on a cost reimbursable and declining scale. That is, KEDS will pay for 60 percent of the first intervention (assistance), 40 percent of the second, and 20 percent of the third. On average, KEDS will fund between 40-50 percent of this type of assistance. Each client firm will be permitted to access up to a maximum of $45,000 of EDF funds.

Decisions regarding technical assistance, IESC programming, and administration of the Export Development Fund will be made by the Private Enterprise Management Unit, under guidance from the Technical Advisory Committee and USAID. The PEMU will establish annual work plans which will define expected level of effort, utilization of the Export Development Fund, technical assistance to export support institutions and IESC's role and level of effort for each work period. The PEMU team will select firms by using a combination of eligibility criteria described above and consultations with trade associations, other donors and the companies themselves. EDF grant approval will be made on the basis of the PEMU team's preliminary evaluation of the export capability of targeted firms.

In the development of its annual work plans the PEMU will work in close collaboration with the export support institutions and IESC to establish each organization's annual KEDS targets and to help them develop implementation plans for PEMU-financed activities.

The PEMU office, its operation, and the activities directed by PEMU will be the institutional contractor's responsibility. General guidelines regarding PEMU activities will be conveyed to the institutional contractor in the Request for Proposal (RFP). Additional guidance will be provided through Implementation Letters. USAID will inform the institutional contractor of changes in PEMU operations and guidelines as it deems necessary.

2. <u>Export Related Institutions</u>

The objective of the Export Support Institution Sub-Component is to strengthen the capability of export support institutions to deliver trade information, training and export promotion services to Kenyan agro-processors, horticultural producers, and manufacturers.

Initially, assistance will be given to current export support institutions which a) already have an institutional framework in place to use KEDS resources to deliver improved export-related services or b) represent non-traditional exporters' interests in Kenya. The institutions selected for KEDS institutional support criteria are the Kenya Association of Manufacturers (KAM), the Horticultural Crops Development Authority (HCDA), and the Fresh Produce Exporters Association of Kenya (FPEAK).

a. <u>Kenya Association of Manufacturers</u>

KAM was formed in 1958 to encourage private investment and to develop the industrial potential of Kenya. It is a non-political and non-profit making organization. The Association's main objectives are to:

- Promote and protect the interests of industrialists and manufacturers in Kenya;

- Initiate and encourage discussions among its members on all problems concerning industries in Kenya;

- Advise the Kenyan Government on policy measures considered by the Association to be necessary from time to time for the establishment and support of industries in Kenya;

- Promote the sales, both inside and outside Kenya, of Kenyan products and the attainment and maintenance of proper quality standards; and,

- Collaborate with any other organization having objectives altogether or in part similar to those of the Association.

Membership is restricted to persons, companies, or auxiliary bodies engaged in manufacturing, processing, or other productive activities within Kenya. KAM also offers Associate Membership to businesses which have direct interest in the expansion of Kenya's industrial potential. Since inception, the Association's constituency has grown to over 600 companies in 1990. Current membership represents a broad cross-section of industrial sub-sectors and enterprises with direct interest in industrial expansion. KAM has an explicit non-discriminatory membership policy but has not maintained gender-specific data (such as male/female ownership or company management information) on its members. KAM's main source of funds is annual membership subscriptions.

KAM's Executive Committee consists of 17 leading industrialists who are the chief executives of their firms. This group meets monthly to review industrial trends in Kenya. The Association has categorized its membership into 20 sectors. In this way a group of companies manufacturing, processing or assembling the same type of products can come together to discuss specific problems affecting their sector. Problems are analyzed and recommendations disseminated to the relevant Government Departments for record and implementation.

KAM has emerged as a clearinghouse for enquiries from export markets through USAID support under the PED Project. It has expanded its services through technical seminars for its various industry groups and has become an effective proponent of policy reform for its members. For instance, KAM has carried out studies on rural industrialization, export incentives and the effects of the Price Control Act. The Association has used findings and recommendations from these studies to successfully lobby the GOK to eliminate bureaucratic impediments to export development and to remove price controls on a number of locally manufactured goods.

b. <u>The Horticultural Crops Development Authority (HCDA)</u>

HCDA was established in 1967 by the GOK as a parastatal authority to facilitate and regulate the development of Kenya's horticultural industry. It operates under the aegis of the Ministry of Agriculture's (MOA) Horticultural Division. The HCDA's key responsibilities are to:

- Provide specialized extension services to farmers and advisory services to the government;
- Provide market information to farmers and exporters;
- Organize the provision of vital inputs to small farmers and assist in grading, storage, collection, transportation, and warehousing of produce;
- Assist smallholders with marketing their crops by providing contacts with traders, processors and exporters;
- Monitor export prices and foreign exchange remittances to Kenya;
- Regulate the industry by licensing and application of rules;
- Regulate and control cultivation, picking, transportation and marketing of horticultural crops; and,
- Establish, acquire and operate processing factories and to impose levies, fix prices and fix loans.

HCDA has worked successfully to increase the share of total horticultural exports by small scale exporters from 45 percent in 1985 to 60 percent in 1989. HCDA provides small farmer groups with extension services and information on international market prices. Between January and March 1991, HCDA issued Export Certificates which certify produce quality and the reasonableness of export (invoice) prices on a fee basis, to 177 exporters of fruits, vegetable and cut flower products.

The organization is financially autonomous of GOK subsidies. Its activities are funded through a direct export levy of Khs.0.11/kg. on produce. HCDA uses its Export Certificates to maintain records of all horticultural exports from Kenya but does not maintain gender specific information. HCDA, like KAM, is well respected for its professional approach to institutional support to the export sector. USAID believes that it is the most effective mechanism for channelling export assistance to the small farmers who have emerged as a major export resource in Kenya.

c. <u>The Fresh Produce Exporters Association of Kenya</u>

The Fresh Produce Exporters Association of Kenya was formed in 1975 but became active in 1984. The chief objectives of the association are to:

- o Promote horticultural exports from Kenya and to do all things that may be incidental and conducive thereto with particular regard to the interests of its members;
- o Establish standards for the trade in order to enhance the reputation of those engaged in the trade and the reputation of Kenyan products in general;
- o Consider and, if necessary, to advise on all questions connected with the export of horticultural products;
- o Promote or oppose Bills in Parliament and to negotiate with the Kenyan Government or any Ministry on matters relating to export of horticultural products;
- o Collect and circulate commercial and other useful information regarding the horticultural export trade; and,
- o Help members obtain all permits, licenses and sanctions that may be required for the export of horticultural products.

About 60 percent of Kenya's horticultural exporters are members of FPEAK. The Association started with 66 members and to date has registered 110 members. To date, its only source of funding is annual subscriptions from members. FPEAK's total dues fell far short of revenues needed to support a permanent secretariat and the Association has had to function without such facilities or personnel.

FPEAK's major function is to analyze constraints to increasing horticultural exports and to make recommendations to the GOK for improvements and export incentives for its members. The Association works closely on a number of constraints with HCDA and, in the process, has proven to be a vigilant watchdog on GOK policies which affect the competitiveness and profitability of the horticultural sector. The Association has also sponsored, albeit intermittently, seminars on new technology for its members. There are three reasons why USAID has decided to commit

KEDS resources to institutional support activities to these export support institutions.

First, the Kenyan agro-processing and horticultural sectors are the two primary target areas for sustainable export growth. KAM, HCDA and FPEAK represent the majority of enterprises in these sectors. These organizations are therefore well placed to provide institutional assistance to these businesses. Second, through institutional support, KEDS will help export associations to develop the administrative capability to address business and policy constraints to export investment and expansion. Finally, USAID's experience under the PED Project has shown that business associations are effective agencies for policy change.

The KEDS strategy is to continue the PED approach towards (export) policy reform, and ensure sustainability of this process by helping export institutions to supply essential export services to the private sector. The KEDS firm level assistance component will deliver institutional support in four areas including: database development and information dissemination; export seminars and workshops; trade fairs and export promotion; and development support.

Database Development and Information Dissemination

The PEMU will provide management assistance and computer equipment for start-up of export database development on markets, industry and product information. PEMU will supply assistance to KAM, FPEAK and HCDA to improve their capability to access and deliver publicly available information on foreign markets. Short-term technical assistance will be used for upgrading database management skills at KAM and HCDA.

Institutional development assistance will be used to help FPEAK put in place the personnel and administrative systems to access similar database libraries for horticultural producers. In addition, the PEMU will help KAM, HCDA and FPEAK broaden their local information bases by obtaining and using analytical statistics such as exports by product categories and gender-specific classifications of local manufacturers and exporters.

Seminars and Workshops

The PEMU will use market feedback such as import requirements from North America, Europe, Middle East and Asia markets and buyer priorities and product specifications to identify export training needs for KAM, FPEAK and HCDA. The Unit will then utilize professional resources to help KAM, HCDA and FPEAK develop the capability to upgrade their members' business skills. Training will be grouped by Kenya's industry classifications and on sector-wide needs assessments to be conducted by the PEMU.

KAM, HCDA and FPEAK will identify trainers to be used and conduct export seminars over the life of the Project. Each organization will receive limited grant funding to cover export seminar costs. An average of 20 participants will attend each seminar. In total, 300 participants are expected to receive export-related training.

Through PEMU grants to KAM, HCDA and FPEAK, the Project will finance training costs, rental of course facilities, course material, and local travel and per diem expenses.

The institutions will collect fees from participants. The fee structure will depend upon the nature of the seminar. It is expected that for the majority of seminars involving the broad range of association membership, approximately one-third of the participants will pay the full cost of the seminars and participants from medium-sized organizations (approximately two-thirds of the participants) will pay 50 percent per participant.

Each organization will present to the PEMU, prior to each seminar, a proposal which contains an outline of the subject matter, expected results and anticipated seminar costs for KEDS funding. Particular attention will be given to institutional efforts to minimize costs, particularly for seminars involving smaller exporters/participants where A.I.D.'s proposed share of the costs may be higher.

<u>Trade Fairs and Export Promotion</u>

The PEMU will help KAM, HCDA and FPEAK to prepare for and participate in overseas trade fairs. The Unit will access sector-specific trade and market information and will help associations and emerging exporters pre-screen exhibitions and organize attendance programs. The Associations and HCDA will draw on short-term specialists for advice on promotional methods, effective follow-up techniques and logistical arrangements to ensure that maximum results are achieved through business involvement at overseas fairs.

Institutions will receive grant funding for participation at three trade fairs per year. These expenses may consist of registration fees, foreign country administration costs, booth rentals, promotional material, transportation, import duties and storage costs of exhibition samples.

<u>Development Support</u>

The Firm Level Assistance Component will provide FPEAK with organizational development advice to conduct a membership needs assessment, and to establish funding and staffing requirements for its administrative secretariat. On the private sector side, the PEMU and the KEDS-supported institutions will raise key issues for analysis and evaluations. Additionally, they will establish agenda for conducting related studies and for following up on GOK and private sector implementation of recommendations which are adopted from those studies through the KEDS Advisory Committee (KAC).

Development support will consist of grant funding support for each of the three institutions. This will consist of an administrative staff's salaries and the annual costs of corporate (export) brochures for each institution.

Studies on regulatory and fiscal constraints to private sector export growth, such as the impact of taxation, and sales taxes on Kenya's competitiveness in export markets, will be identified by KAM, HCDA, FPEAK through interaction with and feedback from members. Studies and analyses of these constraints will be undertaken with funding through the KEDS Studies and Public Sector Components.

KEDS funds will be obligated to the export support institutions through PEMU semi-annual budget allocations to KAM, HCDA and FPEAK. Proposals for each seminar or policy study will be submitted to the PEMU for advance approval. Each proposal will include a detailed budget and will identify the proposed funding sources (e.g. the institution, PEMU and participants), in addition to information on scope, objectives and participants.

Payments for seminar costs will be made by each organization on a cost reimbursable basis. The PEMU will provide reimbursements for seminars at a level agreed upon in advance. Reimbursement will be made upon completion of each seminar and submission of a report by each institution to the PEMU on the proceedings of the seminar.

Because participation costs of overseas trade fairs will require prepayments and up front financial commitments in foreign currency, the PEMU will make direct payments on each institution's behalf, to the organizers of such events. All local currency costs for trade fair preparation, such as brochures and freight costs for samples, will be incurred by the respective organizations and funded by PEMU on a cost reimbursable basis.

D. Firm Level Inputs

1. <u>KEDS Direct Firm level Assistance inputs</u>:

- A technical team of two expatriate export development advisors; assistance; PEMU office support;

- Project office, two project vehicles, computers, office equipment;

- Three computer systems, one each for KAM, HCDA and FPEAK plus database software, communications equipment, database rental, association publications, limited travel and support funds for attendance at trade fairs;

- A $750,000 Export Development Fund (EDF) over 5 years for special cost-sharing technical assistance programs to export enterprises; and,

- 288 person-months of TA contracted over seven years (108 person-months of two long-term professionals, 33 person-months for short-term assistance, and 147 person-months of PEMU office support).

2. Institutional Support Inputs

- Technical assistance for data base development;

- Organizational development support; and,

- Technical assistance across component areas.

E. Firm Level Outputs

1. KEDS Direct Firm level Assistance outputs:

- A fully staffed Private Enterprise Management Unit including four professionals, accountant/administrative support manager and secretarial support;

- Direct technical assistance delivered by PEMU to 15-40 exporting firms over the first five years of project implementation;

- Indirect technical assistance delivered by IESC to 10-20 firms over the first five years of project implementation;

- Attendance by trade associations at 15 international trade fairs over the first five years of project implementation;

- Increased employment in KEDS-targeted firms (after utilizing PEMU-funded TA) by at least 5 percent per year over life of Project;

- Increased exports to international markets by KEDS targeted firms (after utilizing PEMU-funded TA) by at least 10 percent per year over life of Project.

2. <u>Institutional Support Outputs</u>:

- Access by exporters to at least three on-line database libraries on overseas export markets;

- Completion of 15 two-day seminars or training courses over the life of the Project;

- 300 participants (20 per seminar on 15 seminars) receive training in business improvement subjects over the life of the Project;

- KAM, HCDA and FPEAK attendance at 3 trade fairs per year and a total of 15 fairs and exhibitions in international overseas markets;

III. STUDIES COMPONENT

A. OBJECTIVES

The objectives of the studies will be to improve the trade environment by raising critical issues to senior levels in the GOK and in the private sector. Studies will be in line with the Project's objectives to increase foreign exchange earnings and employment. They may be sector-specific to respond to direct needs in the private sector, or to address issues raised by various agencies in government. Key study areas will include export bottlenecks and trade policy improvements, trade finance, and new areas for exports.

B. BACKGROUND

One of the key elements of the success of USAID's private sector program has been the continual feedback provided by A.I.D.'s different projects and program elements. This has increased A.I.D's ability to engage the GOK in a credible policy dialogue. This system of continual feedback and monitoring will be an integral element of KEDS and will lead to improved policy reform. The KEDS Studies Component is designed to examine critical issues which affect the trade environment, and through analyses from those studies, to increase the level of Kenya's non-traditional exports.

A significant feature of A.I.D.'s approach to policy issues in Kenya is to strengthen the ability of intermediaries, such as the Kenya Association of Manufacturers (KAM) and the Investment Promotion Centre (IPC), to make recommendations on policy matters. That is, policy dialogue is carried out by intermediary organizations that develop their own policy agendas and carry out policy studies by contracting outside consultants with A.I.D. financing. The 1989 evaluation of the private enterprise program considered the policy dialogue activities to be extremely effective.

Studies conducted by KAM, for example, have provided a basis for GOK decisions to streamline and eliminate regulatory and price controls on businesses. USAID has been directly involved in discussions between the World Bank, KAM and the GOK on improving Kenya's trade climate. These discussion have led to the complementary development of the KEDS Project and World Bank's Export Development Project (EDP).

USAID has liaised closely with the World Bank and other donors to establish a strong policy dialogue with the GOK. The Bank's policy agenda focuses on shifting exchange rate management policies to focus more specifically on trade and on maintaining Kenya's competitiveness. The World Bank seeks further to reduce the overall level of tariff protection, to streamline and expand the "manufacturing under bond" scheme and to replace the export compensation scheme with a duty exemption scheme. The latter would remove all tariffs on inputs for the production of goods that are subsequently exported. USAID and the World Bank are working with the GOK to remove export biases.

The World Bank is pursuing a wide-ranging structural adjustment program with the GOK, based on sector adjustment and an overall budget rationalization/public investment program. The Bank is also providing a credit of approximately $100 million for Kenya's EDP. The focus of the EDP is a series of policy reforms to diversify and expand Kenya's non-traditional exports. These include import liberalization and tariff reform, improved access for exporters to inputs at international prices, and appropriate exchange rate management. The EDP will fund a series of five studies which must be completed by the end of 1991 as a condition of the Bank's credit.

The GOK has attained considerable success in the last several years in both stabilizing fiscal and monetary policy and in providing incentives for private enterprise growth. This has been accomplished in conjunction with the World Bank, the International Monetary Fund and several bilateral donors, including A.I.D. Government macroeconomic reforms which have improved the general business and export environment include price decontrol, flexible exchange rates, improved import climate, deficit reduction, and banking system reforms.

USAID has encouraged these efforts. It has carried out considerable analyses with the GOK in an effort to liberalize the overall economy. The Mission has several projects underway which focus on topics ranging from improving the efficiency of grain marketing, to eliminating price controls, to establishing export enclaves, to fertilizer deregulation. A.I.D.-funded studies have further examined the benefits of establishing a duty exemption scheme, and preparation of an annual public investment budget (which is now a condition for further World Bank assistance).

The GOK has announced a number of reforms (included in the Policy Framework Paper between the GOK, the IMF and the World Bank) which should further enhance the environment for private sector export-led growth. These include improving the efficiency of the National Cereals and Produce Board (NCPB), restructuring state-owned corporations, and increasing cost sharing in social sectors, particularly health and education.

USAID believes the GOK/World Bank strategy cannot succeed without several additional policy changes that have not been specifically announced in the recent export package. As past experience has shown, timely studies and analyses of key policy issues can result in extensive dialogue between the GOK, USAID and other donors. This, in turn, can lead to positive changes at the highest levels. KEDS will utilize the Studies Component to fund discrete analyses of critical areas related to trade and trade finance to complement the World Bank's program and implementation activities being funded under other components of the KEDS Project.

C. DESCRIPTION

The KEDS Studies Component will be administered through the KEDS Public Sector Component technical unit. The KEDS Public Sector Technical Advisory Committee (TAC) will approve all studies funded under KEDS. Most studies will be undertaken through the newly-formed Export Promotion Programmes Office (EPPO) of the Ministry of Finance under the guidance of the Trade Policy Advisor. However, specific studies will be carried out with the Central Bank of Kenya, the Private Enterprise Management Unit (Firm Level Assistance Component) and at the initiative of USAID. Findings from studies will be distributed extensively to reach as wide a range of decision makers in the GOK and the private sector as possible.

Study Areas

Baseline data will need to be collected in several areas of the KEDS Project to measure progress and outputs achieved. For example, baseline data will need to be assembled on GOK agencies working with the Project (see Public Sector Assistance Component). Data will also need to be assembled on current level of exports, tax revenues from exporters, customs receipts on imported inputs for exports, local taxes applicable to exporters, among other topics. These data will be essential for monitoring exports, changes in GOK policies and the effects of KEDS.

Baseline data will also need to be assembled on current non-traditional export sectors. Information on trade associations and firms which will be directly assisted under the Project will need to be assembled. This will be important to determine the areas of Project focus. It will also be utilized to determine level of exports, value-added in targeted sectors, general import requirements and expenditures, level of employment, direction of trade, and other information over the life of the Project. This will help both the GOK and USAID to determine the impact of Project interventions, and could prove valuable in supporting policy initiatives on the GOK's part.

These data will enable the Project to focus on areas which have the highest export potential. These will include both producers who are poised to increase exports as well as those which show good potential for exports in the medium- to long-term. Studies will help identify the latter, and set out the conditions under which Kenya's export base can be diversified and improved.

One of the key elements to improve Kenya's export climate is improving the foreign exchange regime. This includes reducing the anti-export bias inherent in an overvalued exchange rate. Additionally, the allocation of foreign exchange is a critical area to examine in order to encourage more exports, particularly non-traditional exports. It is anticipated that this will be one of the major areas of study during the KEDS Project.

KEDS will also conduct at least one study on the effects of Kenya's regulatory environment on non-traditional exports. The regulatory environment should be examined in order to determine how both export and import policy can be improved. Licensing, establishment criteria, marketing requirements and other areas of regulation need to be examined within this context to suggest sound policy recommendations to improve Kenya's export climate.

Labor costs should also be examined within this context. While Kenyan labor is reputed to be inexpensive relative to other countries, the amount of legislation regulating the use of labor is extensive. Competitive labor is one of the most important elements of a successful export regime. It may be necessary to examine how labor can be made more competitive.

Fiscal policy plays a major role in determining the competitiveness of Kenya's exports. The Project will build upon work being undertaken within the Ministry of Finance through the UNDP Tax Modernization Programme (which USAID is co-sponsoring). The effects of various taxes, including local cesses, customs and excise taxes, and indirect taxation need to be analyzed, particularly to determine how these taxes affect Kenya's exports vis-a-vis her competitors. This will be of particular importance to Kenya's horticulture sector.

KEDS should also examine the overall Kenyan investment climate, especially with regard to investments in non-traditional export sectors. Mobilization of both local and foreign capital requires a thorough understanding of the incentives and disincentives to investment in target sectors.

The total costs of delays from point of production to actual international shipment need to be examined with an eye to recommend where the GOK can remove critical bottlenecks. Delays are experienced at the ports, on the railways, on roads, through Customs, and through other GOK enforcement agencies. Rents are often collected at these points which increase the cost of inputs to the export sector and reduce Kenya's advantages vis-a-vis her competitors. These delays will have to be drastically reduced if Kenya's competitive advantage is to be realized. Studies will be undertaken in these areas to determine how best Kenya can reduce these bottlenecks and improve its export environment.

The Project should examine the prospects for pre-export finance and subsidized credit (ex ante) to exporters. Virtually all industrialized countries, and most newly industrialized countries (NICs) have develcped extensive credit schemes to finance their exports. These include pre-export guarantees, easy credit on concessional terms (or interest free), and export insurance for targeted sectors. The Project will examine the potential for utilizing one or several of these mechanisms to stimulate exports.

The KEDS Studies Component will also fund "other" studies during the life of the Project. Topics for such studies will generally focus on direct implementation issues relevant to the Project. These could include direct market analysis for specific sub-sectors; targeted surveys to gauge the impact of the KEDS Project; and studies of the impact of particular policy interventions which occur during the Project.

The EPPO is anticipated to be the primary policy studies department under KEDS. Topics of importance to Kenyan trade policy which could be funded through the EPPO KEDS Public Sector Component include:

- Effects of eliminating sanctions on South African exports on Kenyan investment and exports;
- Value-added in specific export sectors compared to others;
- The role of Kenyan indirect exporters to determine their importance to exports and whether or not they should enjoy some of the tax, duty and other benefits of the export sector;
- Agri-business export marketing requirements; and,
- EPZA should generate studies on employment creation, effect on local investment by EPZs, etc.

The Central Bank will participate in the Project through the EPZ Swap Facility. Topics which could be useful to explore through the KEDS Project include:

- Effects of movement towards an open foreign exchange regime;
- Effects of liberalization of foreign exchange regimes in relation to neighboring countries (eg, Uganda and Tanzania);
- Liberalized procedures for foreign exchange allocation for both dedicated exporters and firms with production for both domestic and foreign markets;
- Effects on foreign exchange allocation of allowing domestic firms full access to foreign exchange for investment in EPZs; and,
- Effects on the local market of permitting banking and other services within the EPZs (including effects of international firms borrowing local currency through bank branches within the EPZs).

D. Studies Component Inputs

The KEDS Studies Component inputs will be:

- o Short-Term Technical Assistance for Studies (15 person-months);
- o. Workshops and Seminars (10 2.5-day workshops;

E. Studies Component Outputs

The KEDS Studies Component will fund:

- o Between eight and twelve studies;
- o Seminars and workshops to discuss studies and policy issues raised from studies; and,

IV. EXPORT PROCESSING ZONE SWAP FACILITY COMPONENT

A. OBJECTIVES

The aim of the KEDS Export Processing Zone Swap Facility Component is to provide assistance to medium-sized Kenyan entrepreneurs to operate in the newly-created export processing zones (EPZs). This is an important aspect for consolidating domestic support for the GOK's export expansion strategy. The KEDS Project will help overcome barriers to entry into the EPZs by Kenyan investors and provide opportunities for Kenyans to invest in the new export processing zones.

The objectives of this Project Component are to:

- Establish a foreign currency swap fund in the Central Bank to assist medium-sized Kenyan firms to gain access to the EPZs;
- Assist in providing foreign exchange for ten to fifteen domestic enterprises to operate in the EPZs;
- Contribute to the development of the export sector; and,
- Assist medium-sized Kenyan firms deal with a lack of collateral to obtain a foreign currency loan in order to operate in the EPZs.

KEDS will finance the creation of an Export Processing Zone Swap Fund ("Swap Fund") that will provide medium-sized Kenyan investors with access to foreign exchange to allow them to set up operations in the export processing zones. The EPZ Fund will be a revolving account, not a credit program. The KEDS Project will provide technical assistance to the Central Bank and commercial banks to establish and monitor the Swap Fund. A/PRE will establish a guaranty facility covering 50 percent of the credit risk of the foreign currency loan to address the constraint of lack of collateral by Kenyan firms in securing a foreign currency loan.

B. BACKGROUND

In November, 1990, the GOK enacted The Export Processing Zones Act (the EPZA Act), which sets out the basic regulatory and institutional parameters of export processing zones. Under the EPZA Act, investments in EPZs must be financed in foreign exchange. This encompasses not only fixed investments in capital equipment, but also all working capital expenses, including the purchase of raw materials, rental of facilities and utilities, and salaries and wages, prior to receipt of export earnings. The establishment of the EZPA was due, in part, to work USAID funded through the Investment Promotion Centre (IPC). It was argued that local investment should be encouraged in export processing zones, both from an equity point of view as well as from a developmental perspective. The GOK is strongly supportive of local investment in the EPZs, and the "swap" mechanism has been discussed with GOK officials and commercial banks.

The prevailing exchange control regime constitutes a major obstacle to the Kenyan investor desiring to establish operations in EPZs. Kenyan residents are prohibited from holding foreign exchange inside Kenya. All foreign exchange receipts, whether earned, borrowed or obtained from transfer payments, must be surrendered promptly to the Central Bank. In addition, commercial banks, while allowed to maintain hard currency current accounts (external accounts) for Central Bank-approved depositors in Kenya, are not allowed to lend hard currency to domestic investors from those accounts.

This makes it virtually impossible for a Kenyan investor to obtain foreign exchange to operate in the EPZs and biases investment in the EPZs in favor of foreigners. The GOK would like to encourage Kenyan investors in the zones, but is concerned about permitting investment directly in Kenya Shillings. The government is anxious that such a mechanism could be used as a way to take foreign exchange out of the country.

However, if Kenyan investors are to participate actively in the zones, some mechanism must be established to permit them to purchase foreign exchange to cover all requirements to establish and operate in the EPZs. The proposed EPZ Swap Fund is such a mechanism. Financing EPZ investments through the Fund will ensure that the investments are approved by the EPZA, that normal commercial bank credit screening criteria are applied, and that requirements for Fund use satisfy A.I.D. and Central Bank of Kenya objectives.

The original intent for establishing the EPZA and authorizing export processing zones centered on the desire, by the GOK and its supporters, to increase employment and to generate additional foreign exchange for Kenya. Foreign exchange will only be generated if investors in the zones obtain a good portion of their goods from Kenya. Thus, the development of linkages between the zones and Kenyan firms is of paramount importance to the success of the EPZ concept.

Moreover, the effective development of the zones should lead to a more open trade environment in Kenya. This will further lead to an expansion of exports, with a concomitant increase in Kenya's foreign exchange revenues. Kenyan firms are better placed to develop these important linkages, to take advantage of the geographic proximity of the zones, and to capitalize on Kenya's comparative advantage of low labor costs, and a well-developed and diversified agricultural sector. Additionally, the presence and successful operation of Kenyan firms in the zones should encourage foreign companies to invest in the EPZs, thereby ensuring the success of the export enclave concept.

C. DESCRIPTION

USAID will make a grant of $4.0 million to the GOK through KEDS to create the EPZ Swap Fund. This will serve as a pilot project to demonstrate the usefulness of making foreign exchange available to domestic firms to invest in EPZs. The GOK will match USAID's contribution to the fund on a pari passu basis. Thus, the initial capital for the Swap Fund will be $8.0 million. The size of the Swap Fund will be sufficient to assist eight to eleven medium-sized firms, and serve as a demonstration project to encourage greater availability of foreign exchange for investment in the zones.

The purpose of the Swap Fund is to liberalize the foreign exchange regime, get more Kenyan firms involved with exports, raise the comfort level of the GOK in allowing domestic companies to operate in the EPZ, and induce foreign companies to invest in the EPZs. The pilot project will produce a rapid and visible response in the numbers of companies operating in EPZs. By illustrating the profitability of exports, these EPZ enterprises will provide a powerful demonstration effect to producers who have been oriented historically towards domestic markets and help mobilize domestic support for implementation of more comprehensive reforms in the trade regime. Furthermore, firms operating in the EPZs will send a signal to foreign investors that the EPZs are functioning and serve to attract foreign investment in the EPZs. The pilot project will demonstrate the need for continued availability of foreign exchange for domestic companies to operate in the EPZs and encourage other donors to contribute to the Swap Fund.

Target Group

The EPZ Swap Fund will be directed at medium-sized firms which would otherwise find it difficult to acquire the necessary foreign exchange to enable them to operate in the zones. Access to the EPZ Fund will be available to any privately-owned business operating in Kenya with a net asset value of under $1 million (Kenya Shilling equivalent), excluding property and buildings. All of the domestically owned firms located in the EPZ will be export companies involved in non-traditional products.

The foreign currency required by each borrower will be determined by the type of investment and the size of the investment. In order to maximize the number of borrowers using the EPZ Fund, yet not unduly restrict the amount each borrower can access, the EPZ Fund will have a limit of US$1 million per borrower. It is expected that the loans will range in size between US$750,000 and US$1,000,000. The ability of firms operating in the EPZ to retain foreign currency is expected to generate strong demand for the EPZ Fund.

Operation of Swap Fund

The Swap Fund will be created in the Central Bank. The Central Bank will establish a separate US dollar fund dedicated to medium-sized domestic firms to establish an operation in an export processing zone. The Swap Fund program will be administered through the Central Bank of Kenya in cooperation with commercial banks.

Mechanics of Swap Fund

The steps in the investment process for medium-sized domestic firms to operate in the EPZ and access the EPZ Swap Fund are as follows:

1. The Kenyan firm applies to a commercial bank for a US dollar loan to operate in the EPZ. The loan request will cover both capital equipment purchases of the EPZ enterprise as well as working capital requirements for an initial start-up period before export earnings can be used to finance working capital needs.

2. The commercial bank uses standard credit procedures to analyze and evaluate the loan. A.I.D. will not participate in the credit approval process.

3. As part of the credit approval process, the commercial bank will require collateral for the loan. It is anticipated that Kenyan firms in the EPZ (particularly medium-sized firms) will face a major problem in obtaining sufficient collateral for a US dollar loan. The domestic assets of the Kenyan firm will most likely be pledged to a financial institution in order to finance existing operations. Therefore, the Kenyan firm will have limited resources to pledge to a commercial bank for collateral.

   A/PRE will create a guaranty facility which will help address the collateral constraint of Kenyan firms by providing the commercial bank with a 50 percent guaranty of the US dollar loan on behalf of the newly formed EPZ enterprise. Collateral for the commercial bank will consist of a Kenya Shilling cash deposit, or security equivalent, by the Kenya firm equivalent to 50 percent of the loan amount and a guaranty by A/PRE for 50 percent of the loan amount.

4. Upon approval of the shilling loan, the commercial bank gives a commitment letter to the Kenyan firm that conditional upon the Kenyan firm establishing a company in the EPZ, the commercial bank will make a US dollar

equivalent loan to the EPZ company. The commercial bank establishes the repayment schedule and sets the interest rate for the US dollar loan.

5. The commitment letter in hand, the Kenyan firm applies to the EPZA for an EPZ enterprise license to establish a company in the EPZ. Although not yet formed, the EPZA is tasked with the responsibility of approving all investments in the EPZ, foreign or domestic. The EPZA will vet the application for, among other things, assurance of sufficient financial resources to implement the investment.

6. After obtaining an EPZ license, the Kenyan firm forms a company in the EPZ (i.e. legally registers a company) using Kenya shillings to finance the formation expenses.

7. When the EPZ company is formed, the commercial bank (to fulfill the commitment made under step #3 to make a US dollar loan to the EPZ company) obtains foreign currency for the loan by accessing the EPZ Fund in the Central Bank. The commercial bank will swap, or exchange, Kenya Shillings for US dollars from the EPZ Fund.

8. The commercial bank will make a US dollar loan to the newly-formed enterprise in the EPZ because companies operating in the EPZ are considered by the GOK as operating extra-territorially and, as such, are not bound by Kenya's exchange regulations.

   Since Kenyan citizens and companies operating in Kenya cannot legally hold foreign exchange, the loan will be made to the EPZ enterprise which, being an extra-territorial entity, will be permitted to hold foreign currency. The US dollar loan will cover both capital equipment purchases needed by the EPZ enterprise as well as working capital requirements for an initial start-up period before export earnings can be generated to finance working capital needs.

9. The commercial bank will use standard procedures to disburse the loan proceeds through letters of credit for capital equipment and raw materials. The EPZ Act states that "all transactions including payments of salaries and wages between export processing enterprises and persons resident in Kenya shall be carried our through authorized bank accounts." Thus, working capital needs will also be disbursed through the commercial banks. In short, the commercial banks will tightly control the disbursement of funds and little, if any, of the loan proceeds will be directly handled by the borrower.

Figure 10 depicts how a medium-sized domestic firm applying for a U.S. $1,000,000-denominated loan will make use of the EPZ Swap Fund in the Central Bank to obtain US dollars to operate in the EPZ. (The illustration assumes a conversion rate of $1 = Ksh 25)

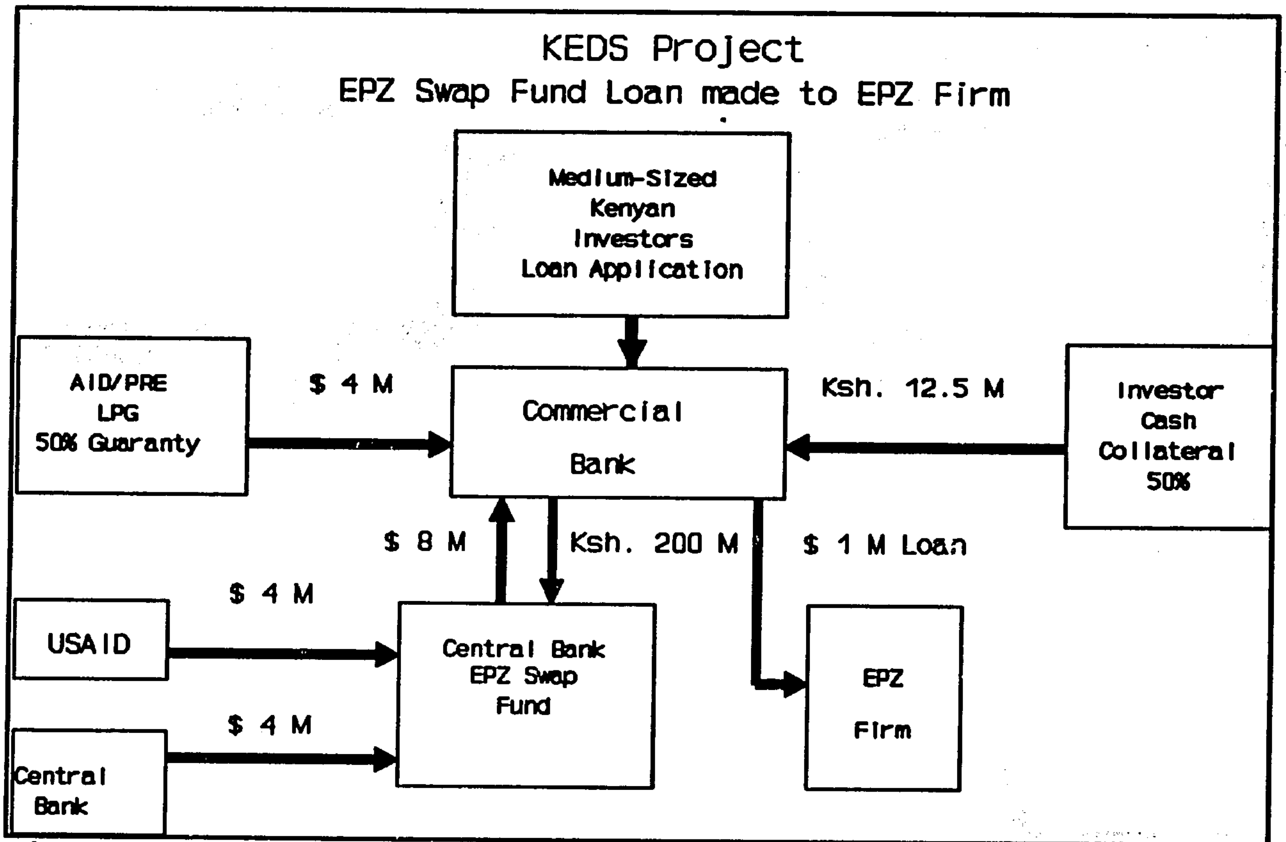

Figure 10: SWAP FUND OPERATIONAL FRAMEWORK

Repayment of Loan

Part of the swap arrangement between the commercial bank and the Central Bank will include an agreement by the commercial bank to "reswap" all US dollar proceeds from loan repayments of the EPZ borrower into Kenya Shillings. The reswap takes place when loan repayment is made by the EPZ enterprise. The steps in the loan repayment and reswap process of the EPZ Swap Fund are as follows:

1. Based on operations, the EPZ enterprise generates income to repay the US dollar loan from the commercial bank according to the loan repayment schedule established by the commercial bank at the time of the loan approval. As the loan includes both capital equipment and working capital components, the loan will be repaid over time (probably three to five years).

2. The commercial bank accesses the EPZ Fund in the Central Bank and swaps the US dollars from the loan repayment proceeds for Kenya shillings. This reswap of US dollars for Kenya Shillings is to settle the "obligation" entered into by the commercial bank with the Central Bank at the time of the original swap of Kenya shillings for US dollars. The Central Bank would exchange the foreign currency for Kenyan shillings at the prevailing market rate. Gains or losses in Kenyan shillings (compared to the original conversion rate) would accrue to the EPZ firms.

3. When the loan is fully repaid, the A/PRE guaranty falls away, the cash deposit, (or security) of the Kenyan firm is returned, and the Swap Fund has been replenished with US dollars.

This reswap feature will allow the Swap Fund to become a revolving facility whereby the commercial bank swaps Kenya Shillings for US dollars (which the commercial bank lends to the EPZ firm), then US dollars reswapped back into Kenya Shillings (at repayment of a loan installment) and then swapped again for US dollars (for a new loan).

Figure 11 illustrates the processes of a US$1,000,000 loan repayment by a EPZ firm and the commercial bank reswap with the EPZ Swap Fund in the Central Bank. (The illustration assumes a constant conversion rate of $1 = Ksh 25.)

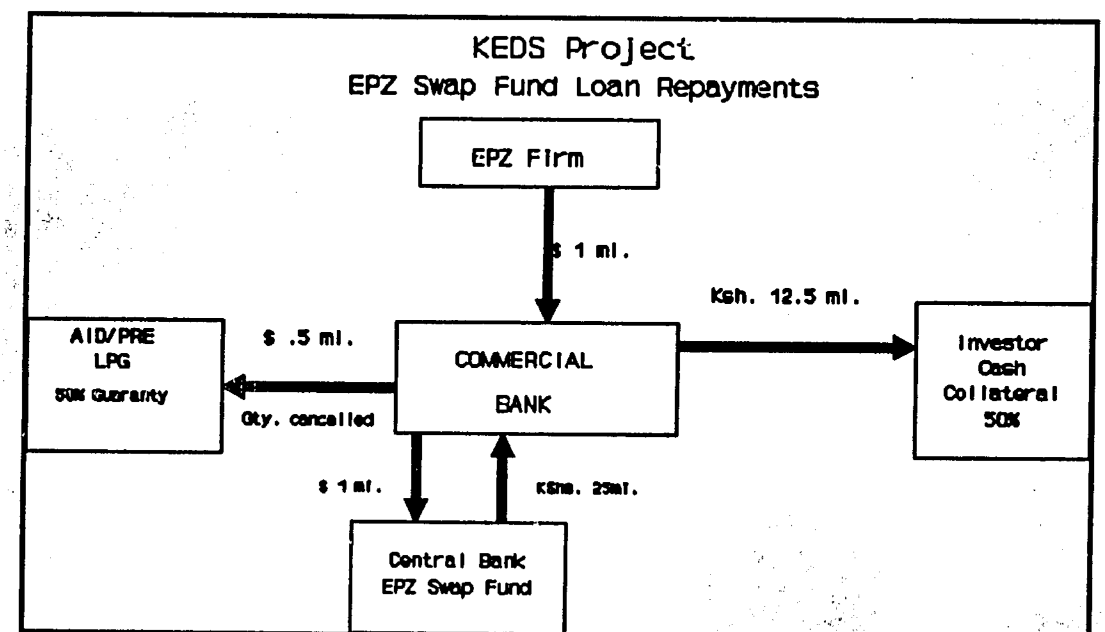

Figure 11:SWAP LOAN REPAYMENTS

Default

An important element to the successful operation of the swap scheme are the provisions set out in the event that an EPZ borrower defaults on the loan repayment. The A/PRE guaranty will be called upon to cover any shortfall up to 50 percent in loan principal due the commercial bank should a borrower default, in part or in full. The steps which will be taken in the event of a default by the EPZ borrower are as follows:

1. The commercial bank seizes all assets of the EPZ enterprise.

2. The commercial bank seizes the cash deposit (if any) placed by the Kenya firm as collateral for the US dollar loan.

3. The commercial bank calls upon the A/PRE guaranty for the balance of the principal loan amount outstanding.

4. The commercial bank accesses the EPZ Swap Fund in the Central Bank and reswaps the US dollar proceeds received from the sale of the assets of the EPZ enterprise (if assets are sold to another firm operating in the EPZ) as well as from the A/PRE guaranty, for Kenya Shillings. This reswap of US dollars for Kenya Shillings is to settle the "obligation" entered into by the commercial bank with the Central Bank at the time of the original swap of Kenya Shillings for US dollars. The Central Bank would exchange the US dollars for Kenyan shillings, at the prevailing market rate.

5. The remaining balance of the reswap "obligation" of the commercial bank would be forgiven by the EPZ fund. The EPZ fund would retain the Kenya Shillings which the commercial bank originally had swapped for US dollars.

6. The effects of this transaction are: EPZ enterprise defaults and loses all assets in the EPZ; firm loses cash deposit with commercial bank; bank seizes the assets of the enterprise, the cash deposit of the Kenyan firm and collects under the A/PRE guaranty; and the EPZ Swap Fund is reduced by half (or less) of the amount of the defaulted loan.

Incentives to Participants in the Swap Fund

A medium-sized Kenyan firm gets an opportunity to establish a company in the EPZ which will legally enable the firm to retain foreign currency outside Kenya. The firm also can obtain a US dollar loan with only 50 percent of the collateral requirement of the commercial banks. The EPZ firm can obtain foreign currency with which to operate in the EPZ. The commercial bank is fully collateralized; loans to the EPZ firms are outside the credit ceiling. The Central Bank of Kenya encourages domestic exporters while not bearing any credit risk.

Role of the Commercial Banks

The commercial banks will provide all the funding and bear all the credit risk of the foreign currency loans. The tenor and grace period appropriate for each loan will be determined by the commercial banks. The commercial banks will charge market interest rates. The loans will be collateralized 50 percent by a Kenyan Shilling cash deposit, or security equivlant, from the Kenyan firm and 50 percent from an A/PRE foreign currency guaranty facility which is to be established in connection with the Swap Fund.

While any of Kenya's commercial banks could engage in the conduit functions of the scheme (swapping Kenya Shillings for US dollars and vice-a-versa), A/PRE will determine which of the commercial banks will be eligible for the EPZ Guaranty Facility. Under A/PRE's current Loan Portfolio Guaranty (LPG) program, eligible commercial banks are those which are privately-owned and operated. The participating banks should be selected on the basis of branch networks (retail banking to medium-sized firms) and demonstrated financial and administrative soundness.

Role of the Central Bank of Kenya

The EPZ Swap Fund will be housed in the Central Bank. The Central Bank will manage the Swap Fund and the commercial bank will, in effect, administer the Fund, disbursing foreign currency against the requirements of the enterprise in the EPZ. KEDS will provide 24 person months of short-term technical assistance over the first four years to facilitate operation of the Swap Fund by working with the Central Bank and the commercial banks.

Technical assistance will be provided to work with the Central Bank to establish mechanisms for the swap and reswap facility; to provide training to the commercial banks in analyzing Kenyan enterprises which apply for foreign currency loans; to work with A/PRE and the commercial banks to establish the guaranty facility for investors applying for foreign currency loans; to obtain additional funding for the EPZ Fund from the GOK and from other donors once the facility has been established and is operational; and to work with commercial banks to try to obtain offshore financing to fund part of the foreign currency requirements of EPZ borrowers.

D. Swap Fund Inputs

USAID will support the EPZ fund in three ways, two directly and one indirectly:

- o A grant of $4.0 million to establish the EPZ Fund will be available to medium-sized firms who wish to establish an enterprise in an export processing zone;
- o 13 person-months of technical assistance will be provided to the Central Bank and commercial banks to establish and implement the swap facility and monitor the EPZ Fund; and,
- o Through APRE, a guaranty mechanism will be established to address the collateral constraint of medium-sized firms to secure foreign currency borrowing.

The short-term technical assistance provided to the Central Bank and commercial banks to establish and implement the Swap Fund will also be used to promote the use of APRE's existing LPGs with commercial banks.

E. Swap Fund Outputs

Outputs under this component will result in:

- o It is expected that between 8-11 export businesses will be established in Kenyan export processing zones by medium-sized locally-owned firms by the end of the Project;

- o EPZ Swap Fund-assisted enterprises are projected to create employment for about 1,600 persons;

- o Generate approximately $30 million in foreign exchange, some of which will flow to domestic firms through these linkages; and,

- o Commercial banks will have learned positive lessons about project finance and project development.

ANNEX B: SOCIAL SOUNDNESS AND GENDER ANALYSIS

Beneficiaries of KEDS will be the Government of Kenya, trade associations, and private sector firms. The Project will provide the GOK with technical assistance training and commodities. The primary recipient agencies will be the Ministry of Finance's Export Promotion Programmes Office and the Export Processing Zones Authority. KEDS will provide the Kenya Association of Manufacturers (KAM), the Fresh Produce Exporter Association of Kenya (FPEAK), and the Horticultural Crops Development Authority (HCDA) with technical assistance, training and commodities.

Private sector large and medium-size firms will receive training for business assistance, and access to US dollars to invest in Kenya's new export processing zones (through the EPZ Swap Facility). Small and medium-size intermediate producers who supply exporters will benefit from the Project through backward and forward linkages with exporting firms. Kenya's labor force will also benefit from KEDS through the generation of additional employment.

The following social analysis concentrates on the individual beneficiaries of KEDS by looking at aspects of employment generation, the business associations, and firms which will be supported throughout the KEDS Project.

I. SOCIAL ANALYSIS

A. Employment Generation

It is anticipated that one million jobs will be created between 1991-2000. This will occur as a result of economic reorientation toward more outward-looking strategies for growth. Of these, 90,000 jobs are projected to be directly and indirectly linked to export processing zones (EPZs), 127,000 in the formal private sector, and 667,000 in smallholder agriculture, mainly through growth of Kenya's horticultural exports.

It is important to look at the structure of employment, unemployment and underemployment in Kenya generally and within each sector and subsector that has been targeted by KEDS. This will determine the impact of the employment KEDS-assisted firms will generate, both in terms of the types of jobs created and income generated.

B. General Structure of Employment

In 1988, 16% of the total urban and rural labor force was employed in the modern sector. Approximately 5% of Kenya's work force was employed in the informal sector, another 5% in the rural nonfarm sector and a further 71% was engaged in the smallholder agriculture. Some 3% of Kenya's labor force was unemployed. Within the modern sector, 50% was engaged in service sector. Of these, over 14% were found in the manufacturing sub-sector, and one fifth were in large scale agriculture. The public sector employed approximately 50% of the work force.

The share of the urban sector in total employment has increased from 11.8% in 1980 to 16.4% in 1988. Of this, the public sector share has increased from 46.9% to 49.4%. Informal urban sector employment has increased from 3% to 5.3%. These figures imply that the private sector's contribution to employment declined from 50.1% to 45.3% during the same period.

Participation of the working population (age 15-64) in urban employment is 70.4% while in rural areas it is 91.8%. Lower participation rates in the urban area can be partially attributed to the number of children over 15 engaged in full time education.

Women make up 43% of the labor force in urban areas, and 55% of the labor force in rural areas. Their representation in the formal urban wage sector has risen from 12.2% in 1964 to 21% in 1986. However, women continue to be in a minority in every sub-sector and are confined mostly to the lowest paid jobs. In urban areas women are most likely to be employed in welfare-oriented activities in the community, personnel and social services sectors. Women engage primarily in agriculture in rural areas. Four times as many men as women work as paid employees in rural areas. Twice as many men as women are involved in non-farm activities.

The rate of open urban unemployment (currently 16%) has changed little since the last urban labor force survey was conducted in 1977/78. However, the composition of the unemployed has altered radically with women now being twice as likely as men to be unemployed. Current unemployment stands at 12% for men and 24% for women. Higher unemployment for women, in addition to a very low participation rate in the formal sector which needs to be understood more completely.

The proportion of Kenya's population living in urban areas and the number of urban centers in the country, has increased steadily since Independence when restrictions on the movement of the indigenous population were lifted. In 1950, 5.6% of the population lived in urban areas. In 1962, the proportion had risen to 7.8%, and in 1987 to 16.7%. This trend is likely to continue, especially given the fact that population pressure on the land has led to the sub-division of family holdings from an average of 1 hectare to 0.3 hectares per capita between 1975 and 1982. There is an increasing number of landless people in proportion to the total population.

It is estimated that by the year 2025 some 45.7% of Kenyans will be living in urban centers. In particular, more women are leaving rural areas to join their husbands or have chosen to migrate permanently because they have lost, or will not inherit, land due to traditional practices which discriminate against them.

Unemployment rates are insignificant in the rural sector where the phenomena of working poor and underemployment is more striking. Underemployment is particularly high in the agricultural sector where hours of work are low, labor productivity is declining and per-capita incomes are low. It is estimated that 9% of the men in rural areas are underemployed whereas total underemployment in urban areas contributes only 1-2% to the overall unemployment figure.

KEDS will help to alleviate the pressure of increased urbanization and rural landlessness on the labor market through employment generation in both urban and rural areas. This will reduce social, political and economic tensions in Kenya.

C. Export Processing Zone Employment

Each EPZ (Nairobi, Athi River and Mombasa) when fully operational will house between 5 to 50 firms, each projected to employ from 1 to 300 workers. In addition, it is expected that as many semi-skilled jobs will be created by EPZ development outside the zones as within them through the generation of backward and forward linkages.[2]

The predominant nature of the work carried out in EPZs throughout the world centers on garment manufacture and electrical component assembly. Thus, export enclaves have tended to employ significant numbers of women in the 18-25 age group, whose assumed attention to detail and good manual dexterity have led to their preferential employment. These women are normally classified as semi-skilled, and most have obtained secondary school education.

Given the historical and cultural constraints to female enrollment in secondary schools in Kenya, the proportion of women in this category is lower than in most other countries which have adopted export enclave strategies. The current level of female enrollment in secondary schools is 222,000, or 41% that of male enrollment.[3] If EPZs hire a labor force which is two-thirds female, they can provide jobs for 27% of these new entrants into

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[2]. International Development Association (IDA, World Bank), "IDA Loan for the Export Development Program" 1990.

[3]. The Services Group (90:56).

the labor force without absorbing any of the currently unemployed women in the market place, 64.6% of whom are young uneducated women or who have attained less than Form 3 secondary level education. (CBS, economic survey 90).

Increased employment for women is consistent with GOK's objective of expanding women's participation in the formal sector. In addition it is expected that such employment will have the secondary impact of reducing fertility among these women as has been the case in Mauritius. To verify this assumption further study in Kenya, where the prevalent attitude is that more children will lead to greater economic returns, is required.

D. Private Sector Employment

In 1989 total formal private sector wage employment accounted for 678,400 jobs. Of these 28.6% were in the agricultural sub-sector and 21.1% were in the manufacturing sub-sector.[4]

The rate of job creation, in contrast to GOK targets and expectations, has declined from 4.2% in 1987 to 3.8% in 1988 and 1.1% in 1989.[5] Reasons for the private sector's poor performance in terms of growth include overvaluation of the exchange rate and subsidization of capital. This has led to a bias towards capital-intensive production, despite the scarcity of capital and the abundance of labor in Kenya. In addition, opportunities for expansion have been constrained by import restriction, monopolistic licensing practices, bureaucratic obstacles, and corruption.

Opening the economy through KEDS and other similar initiatives is expected to lead to a reversal of this trend and a growth in job creation over the 1990-1999 period of 3.5% per annum. Private sector expansion and consequent employment generation is, however, dependent upon the speed and pervasiveness of policy reform allowing for economic reorientation.

Some of the less efficient manufacturing enterprises which are unable to reorient themselves to this new environment will be unable to compete with export oriented businesses and will be forced to close. The loss of jobs which results will decrease the positive impact of employment generated through KEDS in the short run. However, in the long-term improving Kenya's trade climate will lead to more efficient and economically viable industries.

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4. CBS 1990 "Economic Survey"

5. CBS, "Economic Survey", various years.

While no gender disaggregated data exist for the formal private sector, women's participation in both the modern private and public sectors is available. Women make up 24.4% of the wage labor force in agriculture and 9.9% in manufacturing. There is evidence that they are being absorbed into expanding industries at a faster rate than men. However, in 1983 men continued to outnumber women 5 to 1 compared to 6 to 1 in 1976. New policies have enabled women to enter many fields in the formal sector from which they were previously excluded.

However, historical disadvantages with respect to education, cultural and social biases, and restrictive labor laws continue to hamper their advancement. EPZs will provide special allowance for split shift work to enhance women's participation. In addition, night employment of women will be part of a larger KEDS dialogue agenda.

E. Smallholder Agriculture

Smallholder agriculture currently employs 71% of the Kenyan labor force on less than half of the arable land, generating two thirds of the agricultural value. Eighty-seven percent of the total female work force is employed in agriculture and agricultural related activities. Women contribute most of the agricultural labor for food crops and much of the labor used on small and medium holdings in the production of cash crops. However due to patriarchal ideology, available farmland is normally under the control of individual male heads of households even though two-fifths of Kenyan small holdings are de facto managed by women.[6]

Men tend increasingly to opt for cash crop production leaving women with less and less land for growing food crops. Despite their labor input, women do not normally have access to the income derived from men's cash crops.[7]

The horticultural sector within agriculture has been one of the most dynamic in recent years with horticultural and agro-processing exports tripling since 1980 due to the relatively favorable regulatory environment and limited taxation. Continued expansion supported by KEDS initiatives will help to diversify exports and provide an estimated 667,000 new jobs in urban and rural areas. This is expected to increase rural income generation and industrial development and improve nutritional levels. Studies of the impact of commercialization of agriculture on income distribution and nutritional well being are

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6. World Bank, May 1988.

7. UNICEF, 1987

inconclusive. Though there is evidence to suggest income controlled by women has a greater tendency to be spent on food and health care than that controlled by men.[8] Further data will need to be collected during the life of the Project to verify these hypotheses.

Currently, 60% of exported produce is grown on small holdings of less than four hectares utilizing 1/4-1 hectare for labor intensive export production. In 1987, there were 250,000 smallholder contracts for horticultural production for export. Earnings from horticultural export crops compare favorably with other cash crops. Also, production is more dispersed than for any other industry or cash crop providing income and employment in many parts of the country to approximately 16% of smallholder families. In addition because production is largely divorced from national fruit and vegetable production and marketing it presents little threat to these industries.[9]

Given the wide variety of crops grown for export, (approximately 50) and the numerous methods for their production, the horticultural industry presents a wide variety of institutions and linkages. Marketing channels fall into seven categories with greater or lesser degrees of backward and forward linkages. These have been defined by Jaffee as being, 1) large scale, vertically integrated inputs/production/marketing operations, 2)contract farming and integrated sales, 3) non contract raw material procurement but integrated sales, 4) growers-as-exporters, 5) cooperatives, 6) mixed contract/non contract procurement and marketing, and 7) loosely integrated procurement and marketing.[10]

Of these various methods of production and marketing, contract growing offers excellent opportunity for employment generation, participation of smallholders, increasing local knowledge and skills, fair distribution of benefits and Kenyan (particularly indigenous Kenyan) participation in production and trade. Vertically integrated operations, however, are the most efficient because of their investments in production and post harvest care, detailed planning, transport and marketing, and their overseas marketing networks.

In the absence of government intervention socially unacceptable development patterns should be expected to develop in the horticultural industry which would include, 1) foreign exchange leakage, 2) limited market development, 3) a decreasing

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8. Kennedy, 1987.

9. Jaffee, 1987.

10. Jaffee, 1986, p. 8.

role for smallholders and 4) increasing foreign company domination. Also contract farming leads to increased socio-economic differentiation.[11]

Minimum land holding and production scale requirements usually exclude the poor and contract growing can adversely affect the position of women who provide the labor while the income generated goes to the male land owner. In addition, small contract growers are not adequately represented or protected by intermediary organizations. Increased attention to export crops is consequently likely to increase inequality within the rural areas and solidify emerging social stratification.[12]

F. Impact of Employment and Additional Income

Employment and employment-related income are assumed to be major linkages between private sector strategies promoted by KEDS and satisfaction of basic human needs of the poor. Other linkages such as change in price and availability of services have not been covered.

While the rate of open urban unemployment has increased slightly in the last decade due to the absorptive capacity of the informal sector, between 1975 and 1985 the real minimum wage fell by 52.9%. The cost of labor has been severely restrained by wage control policies. These policies and the decline in real wages have encountered little resistance since 1982 due to surplus labor supply, particularly in the educated sector. In addition because wage employment in the Kenyan context also has a communal dimension, maintaining the welfare of the (ethnic) group (in the form of less unemployment) is often considered as important as the welfare of the individual.

KEDS contends that through the generation of additional employment, further decline in real wages and therefore standards of living can be averted. To date, the fall in real urban wages has led to a decrease in rural-urban income differentials. The urban sector wage earners position has also deteriorated vis-a-vis non wage earners.

Research in Kenya has shown that as income and education levels rise, the average food budget share declines. However, the expenditure elasticities for food and non-food commodities are not correlated with income. Location, occupation, educational level, and household size are as important as income in determining household consumption patterns.

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11. Jaffee, 1987, p. 142.

12. ILO, 1987, p. 180.

The impact of increased income derived from employment in EPZs and KEDS initiatives in the manufacturing and agricultural sectors on the welfare of employees and their families should be studied during the life of the Project. Data from the Dominican Republic have shown that employees in EPZs are more likely to send their children to school, provide better health care and improve their homes than employees of other sectors. In Kenya, the 1981/82 rural household budget survey has shown that income derived from modern wage employment also contributes 15% on average to household budgets which, coupled with remittances from household members employed in urban areas, demonstrates the importance of urban rural linkages and urban viability for both rural well being and growth.

However, as a result of uneven growth, three strata of farm households are emerging, particularly in contract farming areas: capitalist farmers, middle peasants and poor households. Capitalist farmers tend to rely on hired labor on their farms while deriving relatively high incomes from trade and salaries. This is then reinvested in trade, production inputs and public transport for further income generation. Middle peasants derive income from contracted as well as other crop production using family and hired labor. Their income tends to be invested in school fees, consumer goods and home improvements which raises their standard of living but does not increase their economic base and consequent long term security. Poor households rely solely on family labor on their small holdings with casual labor being their primary source of income. They produce under contract only at the expense of food production thus increasing their vulnerability.

Kenyans, regardless of gender, source and level of income, attempt to manage the returns to their labor independently. Nonetheless, men usually control decisions about cash and sales of commercial crops. There is some evidence that women's autonomy in decision making about disposition of returns to their own labor is being reduced. Women's income is usually treated as income for the household, supplementing or alleviating the need for males to contribute to household expenses. Sometimes the income itself is claimed by men depending upon the socio-cultural context. Therefore women's access to income does not automatically improve their status or bargaining power within the household. This is more likely to occur where household income already covers basic needs and less likely where men have poorly paid marginal occupations.

Given that women's employment does not automatically give them rights to the income generated, their status and bargaining power within the household is not always improved. Some income generating activities particularly in the agricultural sector and low wage private sector can even lead to their increased marginalization.

In order to determine whether the ability of the poor, especially poor women, to meet their basic needs has been enhanced, further data should be collected during the Project on the number of jobs created, who got them and what effect they had on improving the standard of living for the households of those who got them.

G. Firms

Direct firm level assistance will be provided by KEDS on a cost sharing basis to 100-150 current and new exporters. The purpose of this assistance is to increase manufacturing, agro-processing and horticultural exports from the private sector. Given the financial commitment required, it is expected that the firms will be predominantly large and medium scale enterprises. 10-15 locally owned, medium sized firms will also be assisted by the establishment of a foreign exchange swap facility enabling them to operate in EPZs. While small scale and microenterprises are not excluded from direct assistance by KEDS if they can meet the eligibility requirements, they will be assisted indirectly through the anticipated development of backward and forward linkages and general improvement of the economic environment brought about by policy changes. KEDS will also fund a study of micro and small enterprises in its initial stages in order to determine whether there are any areas of opportunity for more formal support.

Data on enterprises of all sizes in Kenya is limited. In 1982 there were 24,000 establishments in the formal sector and 107,000 in the informal sector. Given the target areas for KEDS, the following analysis is confined to manufacturing, agricultural and horticultural firms and EPZs. To measure the impact of KEDS initiatives, additional baseline data will need to be collected at the beginning of the Project on the nature of firms assisted in terms of their ownership, employment record and their ability to establish backward and forward linkages with smaller enterprises and the informal sector.

H. Manufacturing and Agricultural Firms

In 1988 Kenya's manufacturing sector consisted of 2,387 enterprises of which 400 were involved in non-traditional export opportunities. The sector employed 169,753 people, of whom 0.7% were employed in microenterprises employing 1-4 people, 1.1% were employed in small enterprises employing 5-9 people, 10.7% were employed in medium enterprises employing 10-49 people and 87.5% were employed in large scale enterprises employing 50 and over.

Kenyan Asians who owned two thirds of the non-farm assets at Independence have been unofficially discouraged from entering manufacturing. However, strategies to broaden the ownership base through the sale of shares backfired because Kenyan Asians have a greater tendency to invest in business than indigenous Kenyans who continue to focus on the land for investment opportunities. Consequently in the early 1970s Kenyan Asians held 35% of the manufacturing assets and their share has increased through partnerships with prominent politicians during recent years.

In the agricultural sector there were 2,711 establishments in 1988. These were located in former colonial settler farms (scheduled areas) and exclude the very large number of small holdings outside those areas. They employed 241,405 people, of whom 0.5% were employed in microenterprises, 0.7% in small enterprises, 6.5% in medium enterprises and 92.3% in large enterprises.

Of the total number of manufacturing and agricultural establishments, 31.5% of the former are medium scale enterprises employing 10-49 people and 25.7% are large scale employing 50 or more people while 24% of the latter are medium scale and 30% are large scale. These enterprises according to the 1989 MAPS survey are predominantly owned by men with indigenous Kenyan owned businesses tending to be smaller than those owned by foreigners and Kenyans of non-African origin. Ownership by women was only significant in small scale and microenterprises.

The larger firms were found by MAPS to be less likely to employ indigenous Kenyans who made up 87% of the total work force but only 72% of the employees and only 19% of the top management cadre. Women, regardless of origin, made up 11% of the work force and 5% of the top management cadre of large firms.

The private sector has expressed skepticism over competing successfully in international markets. Many firms have preferred to remain protected from international competition by government policy, accepting benefits and subsidies. In addition, an inherent mistrust of government has precluded risk taking through venturing into new markets.

I. Horticultural Subsector Firms

In 1986 there were 100 large fresh fruit and vegetable enterprises and 5-7,000 smallholders who supplemented their income by producing for the export market. In addition there were over 100 firms licensed to export, though only 30-40 were active at any one time. Nine firms accounted for 85-90% of all fresh exports; of these, eight were owned and operated by Kenyan Asians and the other by a Kenyan of European extraction. In the flower subsector, two firms dominated, of which one was Kenyan owned but expatriate managed and the other was a transnational company. Fruit and vegetable processing industries also exhibit high levels of foreign involvement. Of the 5 largest firms involved in export production, all are either foreign owned or expatriate managed.

Constraints to entry into the horticultural sector which need to be overcome to achieve the employment growth objectives of KEDS include 1) lack of access to markets, 2) inability to withstand adverse economic situations (market downturns, exchange rate fluctuations, changes in government policies, buyer rejection, overseas produce rejection, or cargo off-loads), 3) lack of a developed reputation in the trade, 4) lack of economical procurement of produce, 5) lack of access to production inputs, 6) lack of access to air cargo space, 7) lack of information about the reliability and credit worthiness of overseas buyers, 8) the narrowness of product line, clientele and target markets and 9) various institutional constraints.

J. EPZ Firms

It is hoped the EPZ approach will allow import substitution to coexist with the export production sector under a dual structure of incentives. Negotiation with foreign counterparts is encouraged to ease trade barriers between governments and/or attract corporations with the technological know how, management and marketing skills required to bring new production characteristics to Kenya. GOK's current goal of 6.4% growth in the manufacturing sector depends on EPZs and other export incentives which are intended to attract more local investment away from real estate and capital flight. However, it is expected that Kenyans will primarily benefit from employment in EPZs until new technologies spread and access to foreign exchange is eased.

EPZ activities/firms to be encouraged should exhibit the following characteristics: (a) labor intensive industries; (b) stable technological life spans; (c) high export growth potential; and (d) high linkages between EPZ and local firms.

K. Associations

KEDS will initially provide institutional assistance to trade associations which already have the framework to utilize KEDS support to deliver improved export related services to non-traditional exporters. The associations targeted are KAM, HCDA and FPEAK.

KAM is one of the most effective business associations in Kenya with approximately 600 members. Members are primarily involved in manufacturing, processing or other directly productive activities. KAM is supported by member subscriptions. However, many KAM members are currently protected by Government policy and may resist a major liberalization of the GOK's export policies.

HCDA's mandate is to support, monitor and regulate the horticultural industry. It is also directly involved in marketing at the expense of some firms since it has monopoly rights over certain commodities. As such HCDA faces a strong credibility problem. However, it has worked successfully to increase the share of total horticultural exports by small scale exporters.

FPEAK was formed to promote horticultural exports from Kenya and to date has 110 registered members (approximately 60% of Kenya's horticultural exporters). It works closely with HCDA and is supported by member subscriptions.

Both the direct firm level training component and training through association seminars have the potential to assist a large number of beneficiaries. However, special efforts should be made to include women and indigenous Kenyan owned enterprises particularly medium and small scale ones.

Reaching women in business may require special access channels since only 23% of the women owned enterprises surveyed by MAPS belong to an association, primarily to the Kenya Women's Finance Trust or women's cooperatives, which are not targeted by KEDS.

In total, 90% of the large and medium scale enterprises interviewed by MAPS reported belonging to some association. However, only 17% of the owner operated, 22% of the microenterprises and 30% of the small enterprises did. Forty six per cent of those who are not members reported that this was because they had no information about membership and another 22% said this was because the no association provided services they found useful. Manufacturing sector firms were more likely to belong to an association (50%) though this was less for indigenous Kenyan owned enterprises.

The majority of firms belonging to an association were members of KNCCI or KAM which they look to as a vehicle to lobby government and assist in the provision of market information. Smaller firms look to associations to provide credit, technical assistance and feasibility studies.

II. LINKAGES: SPREAD OF BENEFITS

There is very little contact between large and small firms in Kenya. They belong to different associations (if at all) and have different perceptions of how these agencies serve their interests. However, large firms are interested in identifying a greater number of subcontracting opportunities with smaller firms. Therefore, there is a need for KEDS to assist with the creation of more linkages between large and small firms to foster the transfer of technology and management skills, boost small firm market contacts with the informal sector, which tends to buy and sell production from small firms. Associations could help to encourage these linkages by brokering contracts between large firms and potential small business subcontractors. However, since the majority of these firms do not belong to any association it may be difficult to reach and provide needed services for these entrepreneurs efficiently.

III. GROUP RELATIONSHIPS

The ideological environment in Kenya favors economic reform in Kenya and the Government is committed to export promotion. However, there are ambiguities towards the private sector, especially Asian investors. EPZs provide incentives to foreign investors without facilitating access by local investors. In addition the current institutional environment in Kenya constrains reform due to the high political cost of reorientation due to entrenched interests in the public and rural sectors. Public support for export reform and the private sector is mediated by the political difficulties in undertaking policies or activities which are perceived to benefit Asians or Kikuyus who will be the beneficiaries if market forces are allowed to prevail. However, it is recognized that efforts made to date to indigenize industry have largely backfired. This has led to a decrease in investment. Ethnic and political problems which hamper incentives to invest and efficiently allocate skills may partially be overcome by facilities such as the swap fund provided by KEDS. This will allow the participation of any Kenyan with sufficient collateral to meet the banks requirements.

IV. GENDER ISSUES

Women in Kenya are actively involved in agriculture in both the production of traditional and cash crops as well as playing an increasing role in small scale enterprises and the informal sector in both urban and rural areas. In addition, women are custodians of family health and welfare making the entire labor force dependent upon them.

Women's multiple roles have to be recognized and their participation in the economy adequately quantified. In addition, deliberate policy is needed to increase the number and opportunities for women in key positions as well as ensuring that their participation as both clients and beneficiaries of projects like KEDS is enhanced.

Constraints to women's equitable participation in development include their failure to be targeted as beneficiaries; limited or lack of access to means of production, inputs and credit as well as appropriate technology; and disparities in access to education and training opportunities.

In addition there are legal barriers and women are exploited as workers and producers. Women's low representation at decision making levels and a general lack of gender consciousness coupled with adverse social and religious influences exacerbates their position.

Women, especially poor uneducated women, are marginalized in all sectors as owners, managers and e ployees. The increasing number of female headed households, adolescent mothers, urban and rural poor face additional handicaps in the marketplace making them more disadvantaged. Their position raises issues of household viability which ' :e manifestations of the employment and underemployment problem in Kenya. These are not addressed by KEDS.

The issue of concern is how to involve women in all aspects of the KEDS Project, as full participants and beneficiaries, to prevent their increasing marginalization in the lowest paid, lowest profit sectors of the economy. An understanding of the socio-economic environment in which they operate will help to ensure effective communication with women and special efforts will have to be made to improve communication channels. Existing channels for communication include women's groups, churches, chiefs meetings and NGOs. Cooperatives also have large numbers of women members. None of these are currently targeted by KEDS and while the structures exist, the catalyst is often missing. Also there is often a lack of leadership and local political support.

In its initial stages KEDS will undertake a special study concerning small and microenterprises and the informal sector. This study will look at how these enterprises can be directly incorporated into KEDS as well as methods for enhancing backward and forward linkages between enterprises. The information gathered will inform a wider targeting process and, because women have greater representation in these enterprises as owners, managers and employees, it should enhance their access to KEDS.

V. CONCLUSION

KEDS initiatives in export processing zones, and the manufacturing and agricultural sectors will generate additional employment opportunities and stimulate the growth of Kenya's economy. However, KEDS is unlikely to have direct impact on the most disadvantaged groups in Kenyan society because of the probable educational requirements of firms operating in the EPZs, the low level of female participation in the manufacturing sector, and land holding requirements in agriculture.

Given the relatively small share of the modern wage sector in total employment (16%), less than one fifth of the increment in urban employment needed over the next decade, is likely to be provided by modern wage employment. However, considerable indirect benefits of non-traditional export led private sector expansion are expected. These will have to be quantified and the backward and forward linkages created examined in order to determine the true extent and impact of KEDS.

Of the total number of firms operating in the private sector, 700-800 are currently eligible for KEDS support. Of these 35-60 will be directly assisted in the first five years. In addition 1,080 members of KEDS supported associations will receive training in export related topics. Furthermore jobs will be created for one million of the estimated 4.25 million new entrants into the labor force this decade.

KEDS initiatives are primarily focused upon medium-sized enterprises and the horticultural sector. The horticultural sector has the broadest base, both in terms of geographical location and socio-economic groups involved. However as with other assisted sectors, there is a strong possibility that access to KEDS services will be restricted for most smallholders, women and smaller enterprises unless special efforts are made to include them.

There is a need for KEDS to balance social and political equity with economic efficiency. Also, because policy reform has different implications for different groups, there is a need to study the effects of KEDS on all sectors of the economy and society, especially the informal sector, small and microenterprises and the least privileged, to avert any unintended negative consequences.

ANNEX C: ECONOMIC ANALYSIS

I. BACKGROUND

There are two objectives of this economic analysis. The first is to analyze the growth rate necessary in non-traditional export earnings to maintain an overall economic growth rate of over five percent annually in the 1991-2000 period. The second is to determine the role, and attribution, of KEDS in meeting these export growth targets.

The KEDS Project targets specific constraints to export growth, which if not overcome, will substantially limit export growth in the coming decade. These Project activities are necessary though not alone sufficient to meet export growth targets. As such, this analysis assumes that implementation of KEDS is critical to the achievement of the Government's export growth targets but, at the same time, full implementation of the Bank's export program is necessary. The KEDS Project can therefore be associated with overall increases in non-traditional exports in the 1991-2000 period.

A. Economy-wide and Sector Growth Projections

The purpose of KEDS is to increase non-traditional exports over the life of the Project by over 55%. For this analysis, we assume that non-traditional exports increase in nominal dollar terms from a base in 1990 of an estimated $430 million dollars to $770 million by the year 2000. This analysis is based on the assumption that non-traditional export earnings can increase by approximately 6 percent annually in nominal dollar terms, increasing by 50 percent the rate of growth over recent years of approximately 4 percent annually. This target rate of 6 percent for annual export growth is necessary to achieve increases in overall economic growth and employment for the 1991-2000 period as outlined in the World Bank's recent medium-term growth scenario (Country Economic Memorandum, November, 1990).

The World Bank has targeted overall growth in real GDP at 5.1 percent annually at factor cost. Internal and external resource requirements (including export growth) to meet its proposed growth target are based on its Revised Minimum Standard Model (RMSM) for Kenya. The RMSM model generated the following estimates for key macroeconomic indicators over the 1990-95 period:

TABLE VIII.

Average Real Growth Rates

Economic Growth	1985-89	1990-95
GDP (at market costs)	5.8	5.6
Of which:		
Agriculture	4.4	3.8
Manufacturing	4.4	7.4
Services	5.4	5.5

The medium-term growth projections for the 1991-2000 period assume growth in the non-traditional export sector of 6 percent is necessary to meet overall growth targets (instead of better than average rains experienced in the 1985-89 period), and lower growth in coffee and tea exports in the 1990-95 period. As such, the manufacturing sector is assumed to be the sector which grows rapidly to keep the overall economy growing at 5.6 percent. For manufacturing to grow at 5.6 percent in real terms annually, manufacturing exports must grow more rapidly as manufacturing for the domestic market is limited by overall domestic demand.

The World Bank medium-term economic growth model, which is consistent with USAID/Kenya estimates, assumes the following growth in exports by sector:

TABLE IX.

	Average Real Shilling Growth Rate a/ 1985-89	1990-95
Total Merchandise Exports	2.8	6.1
Of Which:		
Traditional		
Coffee	-4.5	3.6
Tea	6.9	4.7
Non-Traditional		
Horticulture	6.4	9.3
Manufacturing	6.0	9.0

a/ USAID growth rates quoted earlier are in nominal dollar terms and differ slightly from World Bank estimates of growth in real shilling terms.

USAID has determined that the estimated growth rate of at least 6 percent for exports can not be achieved without specific project-level interventions as proposed in KEDS and agreed to by the World Bank and GOK.

B. Role and Impact of KEDS Assistance

KEDS is different from most project assistance activities in that it proposes to contribute to a substantial structural adjustment in the economy, from an inward-looking, capital intensive economy to an outward-looking, labor-intensive economy. KEDS has been designed to support the Government's export strategy and complement the World Bank's export sector adjustment program. KEDS activities support the critical weak link in the GOK/World Bank program, i.e. assistance for the actual implementation of policy reforms. As such, USAID/Kenya's interventions are necessary to the achievement of the overall GOK/World Bank/USAID program objectives, but are not alone sufficient. Implementation of KEDS second tier reforms and technical assistance will ensure a successful transition to an open economy. Given the above approach, with a focus on the enabling environment and implementation of announced reforms and a program that is inter-linked with the GOK and World Bank, the economic and financial analysis is more of a macroeconomic analysis than is typical in a project activity.

The direct effect of the proposed $15 million KEDS Project on increasing non-traditional exports is described below as well as the indirect effects on increasing GDP and employment growth.

II. KEDS IMPACT ON EXPORT GROWTH

The purpose of KEDS is to increase non-traditional exports, both in value and volume terms. The rate of growth in non-traditional exports (nominal dollars) is assumed to increase 6 percent annually in the 1991 to 2000 period based on successful implementation of KEDS and the World Bank program. A ten year time horizon for this benefit-cost analysis has been selected because the full impact of policy changes and infrastructure support will likely take ten years to achieve.

Other key assumptions in our analysis are that baseline export growth (without implementation of KEDS/World Bank program) in the 1991-2000 period is 4 percent and that 1990 non-traditional export earnings were $430 million.

Under these assumptions, and more general sector and macro assumptions outlined in Section I above, total non-traditional export earnings for the period 1991-2000 are estimated to be $6,007 million. Total non-traditional export earnings are estimated to be only $5,369 million in the baseline (4 percent) scenario.

Recent problems with horticultural exports due to government policies and infrastructure constraints suggest the remote possibility that without positive policy change growth in Kenya's non-traditional exports could stagnate, showing no real growth in these exports over the 1991-2000 period. This alternative, admittedly low case, scenario would achieve total exports of $4,300 million. As shown in the table below, achieving the KEDS/World Bank target growth in exports of 9 percent annually would realize an additional $770 million in export earnings over the 1991-2000 period (against the 4 percent growth baseline) or realize a much larger $2.9 billion increase if the low case scenario is used.

TABLE X.

Non-Traditional Export Earnings

(Estimated in Nominal Dollars Mil.)

	Base	2000	Period Total 1991-2000
I. Export Scenario:			
6 percent growth	430	770	6,007
4 percent growth	430	637	5,369
0 percent growth	430	430	4,300
II. Additional Export Earnings:			
Scenario 1: 6 percent growth vs. 4 percent baseline	---	+133	+ 638
Scenario 2: 6 percent growth vs. 0 percent baseline	---	+340	+1,707

III. KEDS IMPACT ON EMPLOYMENT

KEDS will have both direct and indirect impacts on employment through increased employment in the export sector and through employment increases associated with increasing overall domestic demand as well as through backward linkages into the informal sector. This employment analysis focuses specifically on the direct effect of export expansion on employment.

The analysis below is based on the following recent studies: World Bank Report on Employment and Growth in Kenya (1988), GOK Employment Policy Overview (Discussion Paper, Ministry of Planning and National Development (MPND) May 1990), Draft report on the Definition, Nature and Extent of the Employment Problems (Presidential Commission on Employment, 1990), and A Survey of

Results from the Recent Labor Force Surveys in Kenya (Working Paper, MPND May 1990).

TABLE XI.

EMPLOYMENT ASSUMPTIONS AND PROJECTIONS

	Actual Employment 1985 '000	Trend Growth Rate 1978-85	Elast. Growth WRT GDP 1978-85	Est. Growth Rate 91-00	Est. Elast WRT GDP 91-00
Modern Wage Sector	1,175	3.3	.94	2.5	.5
Private	588	1.7	.49	3.5	.7
Public	346	5.1	1.48	0.0	0
Large Agriculture	241	-1	n.a.	0.0	n.a.
Smallholder Agriculture	5,542	3.0	.3	2.5	.6
Urban Informal	504	10.1	n.a.	9.5	n.a.
Rural Nonfarm	213	6.7	n.a.	6.7	n.a.
Unemployed	236	n.a.	n.a.	n.a.	n.a.
Total Labor Force	7,620	n.a.	n.a.	3.7	n.a.
Urban		n.a.	n.a.	6.5	n.a.
Rural		n.a.	n.a.	2.2	n.a.

This analysis suggests that the impact of opening the economy to greater export promotion and decreased domestic protection will lead to increased labor productivity as well as increased sector economic growth rates. Both of these factor will lead to increased employment for the Kenyan economy over the 1991-2000 period. Results of this analysis show that increasing agricultural and private sector productivity as well as increasing the overall growth rate will lead to the creation of 1 million additional jobs in the economy over the 1991-2000 period. The employment analysis below focus on agriculture, manufacturing and the EPZs.

<u>Agriculture</u>

If we assume that the labor intensity of smallholder agriculture increases (in terms of employment per unit of value added in agriculture) from .3 to .6 and that the growth rate for smallholder farmers stays the same (4 percent annually) then the rural-based smallholder agriculture sector will generate an additional 667,000 jobs over the 1991-2000 period. These results are consistent with a recent USAID analysis of farm labor requirements for horticulture which confirm that horticulture crops utilize in many cases at least ten times the labor per hectare per crop year.

TABLE XII.

Labor Required per Hectare

	Person Days per Hectare
French Beans	675-850
Strawberries	1,280
Fresh Cut Carnations	1,530

Manufacturing

If we assume that: 1) the labor intensity of private sector manufacturing increases slightly to the level attained in recent years (1.22); 2) manufacturing growth occurs in the private sector and not the public sector; 3) manufacturing exports increase by 9 percent; and 4) manufacturing as a whole increases by 7.4 percent, then approximately 127,000 additional jobs will be created in the private manufacturing sector.

Export Processing Zones

Using World Bank estimates, we assume that the Export Processing Zones (EPZs) will create approximately 90,000 jobs over the 1991-2000 period. These assumptions are consistent with recent data which show that the elasticity of employment with respect to sector value added for private manufacturing is more than double that of the public sector parastatals and that manufacturing exports will tend to be much more labor intensive than manufacturing for the domestic market. Parastatals in Kenya working under massive protection from imports, and having priority access to foreign exchange, have chosen capital intensive techniques while private companies have chosen to take advantage of Kenya's cheap labor pool.

ANNEX D: ADMINISTRATIVE ANALYSIS

I. EXPORT PROMOTION PROGRAMMES OFFICE (EPPO)

The Export Promotion Programmes Office (EPPO) was established in late 1990 under the Legal Notice No. 435 of the Kenya Gazette Supplement No. 71 (Customs and Excise (Amendment) Regulations, 1990). The regulations governing the EPPO were introduced to provide for the "remission of duty on goods imported for use in the production of goods for export". The EPPO, which is under the Ministry of Finance, is responsible for the implementation of export incentive schemes such as Duty Exemption, Duty Drawback, Export Compensation and Manufacturing-under-Bond in order to enhance export production.

The EPPO is structured to manage five functional units: Economic Technical Support and Policy Unit; Duty Exemption Applications Approvals Unit; Duty Exemption Verification and Duty Drawback Administration Unit; Export Compensation Payments and Verification Unit; and Statistical and Computer Support Unit.

The current Head of the EPPO reports directly to the Deputy Secretary, Fiscal and Monetary Affairs Division of the Ministry of Finance. The Ministry intends to elevate the EPPO Head to a level of Deputy Secretary in order to give the office adequate authority to influence GOK trade policies and implement export development programs effectively. The KEDS Project component will be implemented by the Deputy Secretary/Head of EPPO, an Under-Secretary, and a Senior Assistant Secretary in the EPPO.

II. THE EXPORT PROCESSING ZONES AUTHORITY (EPZA)

The Export Processing Zones Act 1990, provides for the establishment of export processing zones and the Export Processing Zones Authority (EPZA). According to the Act, the principal objectives of the EPZA shall be: (a) the development of all aspects of the export processing zones with particular emphasis on provision of advice on the removal of impediments to, and the creation of incentives for, export-oriented production in areas designated as export processing zones; (b) the regulation and administration of approved activities within the export processing zones through implementation of an administrative system in which the export processing zone enterprises are self regulatory to the maximum extent; and (c) the protection of Government revenues and foreign currency earnings.

In carrying out the above objectives, the EPZA may exercise, perform and discharge all or any of the following powers, duties and functions:

- to advise the Minister of Finance on all aspects of development of the export processing zones;
- to implement the policies and programs of the Government with regard to the development of the export processing zones;
- to identify and map the areas to be designated as export processing zones;
- to plan the development and maintenance and to finance the basic infrastructure up to the perimeter of the export processing zones;
- to examine and process applications for designation of export processing zones and issue relevant approvals;
- to examine and process applications for licenses by the export processing zone developers, export processing zone operators, and export processing zone enterprises and issue the relevant licenses;
- to promote and market export processing zones among investors;
- to issue certificates of origin to export processing zone enterprises for the purpose of a generalized system of preferences and other trade preferences given under bilateral or multilateral trade agreements;
- to act as a "one-stop" center through which the export processing zone enterprises can channel all their applications for permits and facilities not handled directly by the EPZA;
- to process building plans and issue relevant approvals in consultation with the Ministry responsible for physical planning and other relevant authorities;
- to perform all such administrative functions in relation to the designated export processing zones as would normally be performed by local authorities;
- to maintain current data on the performance of the program in each individual export processing zone and export processing zone enterprise;
- to enforce within the export processing zone compliance with customs procedures and other requirements for preventing the unauthorized use of designated export processing zones and export processing zone enterprises;

- to enforce compliance with exchange control procedures and other requirements for preventing the unauthorized use of designated export zones and enterprises;

- to suspend or cancel the license of an export processing zone operator or an export processing zone enterprise which is in the violation of the Customs and Excise Act, the Exchange Control Act and the Value Added Tax Act, 1989; and,

- to do all such other acts as may be incidental or conducive to the attainment of the objectives of the Authority or the exercise of its powers under this Act.

The EPZA will consist of a chairman, a Chief Executive, the Permanent Secretaries to the Treasury and the Ministry of Industry, the Governor of the Central Bank of Kenya, the Commissioner of Customs and Excise, the Commissioner of Lands, the Managing Director of the Investment Promotion Centre, a representative of the Kenya Association of Manufacturers, a representative of the Kenya National Chamber of Commerce and Industry and four additional members from the private sector. To date the GOK has only appointed the Chief Executive of the EPZA. The Chief Executive and the Chief Economist to the EPZA will be responsible for implementing this KEDS Project component.

III. KENYA ASSOCIATION OF MANUFACTURES (KAM)

KAM was formed in 1958. The Association is a representative organization of industrialists and was established in order to encourage private investments and to develop the industrial potential of Kenya. It is a non-political and non-profit making organization. The association's main objectives are:

- to promote and protect the interests of industrialists and manufacturers in Kenya;

- to initiate and encourage discussion among its members on all problems concerning industries in Kenya;

- to advise the Kenyan Government on policy measures considered by the Association to be necessary from time to time for the establishment and support of industries in Kenya;

- to promote the sales, both inside and outside Kenya, of the products of industries in Kenya and the attainment and maintenance of proper standards of quality in relation to price; and,

- to collaborate with any other organization having objectives altogether or in part similar to those of the Association.

Its ordinary membership is restricted to persons, firms, companies, or other bodies directly engaged in manufacturing, processing, or other productive methods within Kenya. It also has an Associate Membership available to others by invitation who, by the very nature of their business, have a direct interest in the expansion of the industrial potential. Since the Association's inception in 1958 its membership has grown from 60 member companies to over 600 members covering a cross-section of all industrial sub-sectors and other enterprises with direct interest in development of industry in general. Its main source of funds is annual subscriptions from its members.

The Executive Committee of the Association consists of 17 leading industrialists who also are the chief executives of their firms. This group meets every month to deliberate and review the industrial trend and the expansion of the industry. The Association has divided its membership into 20 sectors where a group of companies manufacturing, processing or assembling the same type of products can come together to discuss the general and specific problems affecting their sector. The problems are then analyzed and disseminated to the relevant Government Departments for record and implementation.

The Association believes that the private sector is essential to economic progress and prosperity and that national welfare and industrial growth are synonymous. The Association also believes that industry can play its proper role in economic development of Kenya only through a strong organization such as KAM.

KAM currently has four professionals composed of the Chief Executive, a Senior Executive Officer, a Chief Economist and an Executive Officer. The Chief Executive, the Chief Economist, and the Executive Officer will be responsible for implementing this KEDS Project component.

IV. KENYA AGRI-BUSINESS ASSOCIATION

This Kenyan organization was established in May 1990. The objectives of the association are:

- to promote dialogue on agricultural and energy development issues between the private sector, public sector and the donor community;
- to promote the role of the private sector in the development of agriculture and related sectors in Kenya;

- to encourage dialogue and cooperation on matters related to agribusiness development between Kenya and other nations; and,

- to provide members with specific information and contacts on trends and technologies affecting agro-industrial development.

The organization is now in the process of selecting a final name for itself and recruiting its members. Its membership will be composed of policy makers in the Kenyan Government, agri-business and donor community. The association also intends to form sub-committees on important areas, such as farming, agro-chemicals, energy, agricultural education, finance, science and technology, trade and investments, research and other special projects. The association's sole source of funding will be membership subscriptions and fees for services.

The Association has a full Board of Directors with both private and public sector representatives. The Chairman of the Management Committee serves as the Association Chairman. The National Program Officer will serve as the Chief Executive of the Association who will be assisted by a Promotion Specialist and a Research Specialist. Since the Association is still in its formative stage, a secretariat with professionals has not been established to date. This Project component will be implemented by the Chairman of the Management Committee and the National Program Officer.

V. THE FRESH PRODUCE EXPORTERS ASSOCIATION OF KENYA

The Fresh Produce Exporters Association of Kenya (FPEAK) was formed in 1979 but became active in 1984. The chief objectives of the Association are:

- to promote the export of horticultural products from Kenya and to do all things that may be incidental and conducive thereto with particular regard to the interests of its members;

- to establish standards for the trade in order to enhance the reputation of those engaged in the trade and the reputation of Kenyan products in general;

- to consider and, if necessary, to advise on all questions connected with the export of horticultural products;

- to propose or oppose Bills in Parliament and to negotiate with the Kenyan Government or any Ministry on matters relating to export of horticultural products;

- to collect and circulate commercial and other useful information regarding the horticultural export trade; and,

- to assist members in obtaining all permits, licenses and sanctions that may be required for the export of horticultural products.

The Association was established with 66 members and to date it has registered 110 members. Its main source of funding are annual subscriptions and fees for services from its members. The Association is currently managed by a Board of Directors which is composed of a Chairman, a Deputy Chairman, a Secretary, a Treasurer, a representative of the Horticultural Crops Development Authority (HCDA) and three additional members from the private sector. This Project component will be implemented by the Chairman of the Board, the Vice-Chairman and the Chief Executive of the Association.

VI. THE HORTICULTURAL CROPS DEVELOPMENT AUTHORITY (HCDA)

HCDA was established in 1967 by the GOK as a parastatal authority to facilitate and regulate the development of Kenya's horticultural industry. It operates under the aegis of the Ministry of Agriculture's (MOA) Horticultural Division. The HCDA's key responsibilities are to:

- provide specialized extension services to farmers and advisory services to the government;

- provide market information to farmers and exporters;

- organize the provision of vital inputs to small farmers and assist in grading, storage, collection, transportation, and warehousing of produce;

- assist smallholders with marketing their crops by providing contacts with traders, processors and exporters;

- monitor export prices and foreign exchange remittances to Kenya;

- regulate the industry through licensing and application of rules;

- regulate and control cultivation, picking, transportation and marketing of horticultural crops; and,

- establish, acquire and operate processing factories and to impose levies, fix prices and fix loans.

HCDA has worked successfully to increase the share of total horticultural exports by small scale exporters from 45 percent in 1985 to 60 percent in 1989. HCDA provides small farmer groups with extension services and information on international market prices. Between January and March 1991 HCDA issued Export Certificates, which certify produce quality and the reasonableness of export (invoice) prices on a fee basis, to 177 exporters of fruits, vegetable and cut flower products.

The organization is financially autonomous of GOK subsidies. Its activities are funded through a direct export levy of Ksh.0.11/kg. on produce. HCDA uses its Export Certificates to maintain records of all horticultural exports from Kenya but does not maintain gender specific information. HCDA, like KAM, is well respected for its professional approach to institutional support to the export sector. USAID believes that it is the most effective mechanism for channelling export assistance to the small farmers who have emerged as a major export resource in Kenya.

On institutional capacity, HCDA is well staffed with well qualified professionals in the horticulture sector. Additional training and technical assistance to the organization would greatly enhance its capacity to disseminate market information and other services to more existing and potential exporters of horticultural produce.

HCDA is currently managed by a Board of Directors comprised of a Board Chairman, a Managing Director, a Marketing Manager and a Production Manager. This KEDS Project component will be implemented by the Managing Director, the Marketing Manager and the Production Manager.

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

APRE/I FAX

FAX: (1) (202) 647-1605
TELE: (1) (202) 647-9842

TO: Holly Wise, Private Sector Office
USAID Kenya

FAX NO. 254-2-337304

TELEPHONE NO.

FROM: Sandra Goshgarian

SUBJECT: Guarantee Facility for EPZs

NO. OF PAGES 1 DATE: 4/10/91

MESSAGE:

See attached.

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

April 10, 1991

MEMORANDUM

TO: Holly Wise, Private Sector Office
USAID Kenya

FROM: Sandra Goshgarian, APRE/I

SUBJECT: Guarantee Facility for EPZs

Attached is a copy of the Concept Paper that Ken Angell prepared concerning the proposed guarantee facility for the EPZs. This paper was reviewed by the APRE/I Credit Committee today.

Based on the Committee's favorable reaction to this proposal, I am pleased to confirm APRE/I's interest, in principle, in establishing a guarantee facility for one or more privately-owned local banks which plan to provide financing for the EPZs. When in Kenya, I plan to call on the banks suggested by Ken Angell as possible candidates to further explore their interest in participating in a program of this nature.

Formal approval of the individual guarantee limits (not to exceed US$ 3.0 million per institution) will be subject to a satisfactory review of the financial statements presented to us by the candidate banks.

Thanks very much for bringing this interesting project to APRE/I's attention. We look forward to working with USAID Kenya and providing support for the KEDS Project.

Look forward to seeing you soon.

cc: Jim Dry, Private Sector Office
USAID Kenya

Clearance:
SEastham SLE Date ____

CONCEPT PAPER

SUBJECT:

This concept paper presents a proposal submitted by the USAID Mission in Kenya concerning the establishment of a loan guarantee facility to support the investment by small and medium-sized Kenyan firms in export processing zones (EPZs) in Kenya.

Under consideration is the creation of a $5 million guarantee facility (EPZ Guarantee) to address the constraint of lack of collateral by these firms in securing a foreign currency loan, which is a prerequisite for operating in EPZs.

BACKGROUND:

Over the past two months, USAID/Kenya has been designing the Kenya Export Development Support (KEDS) Project, an export promotion project. The project, an integral part of the Mission's private sector program, involves grants and technical assistance to the Government of Kenya (GOK) and to the private sector. One of the components involves assisting Kenyan companies to establish operations in newly created export processing zones. This latter component presents an interesting opportunity for APRE/I to diversify the use of the guarantee authority by assisting in mobilizing financing for companies operating in EPZs.

Under Kenyan law, investments in EPZs must be financed in foreign exchange. The prevailing exchange control regime constitutes an obstacle to the Kenyan firm wishing to establish operations in EPZs as Kenyan residents and firms operating in Kenya are prohibited from holding foreign exchange. To address this constraint, the EPZ Swap Fund, an essential component of the KEDS Project, is being created in the Central Bank of Kenya whereby commercial banks will exchange or swap Kenyan Shillings for US dollars. The EPZ Swap Fund will initially consist of $10 million; a USAID grant of $5 million matched by an equal contribution from the GOK.

The commercial banks will provide all the funding and bear all credit risks of the foreign currency loans. The EPZ Guarantee will enable the commercial banks to make foreign currency loans to small and medium-sized domestic firms to establish export operations in EPZs. Please refer to the attached diagram for further information.

It is anticipated that Kenyan firms in the EPZ, particularly small and medium-sized firms, will face a significant constraint in mobilizing sufficient collateral for a foreign currency loan. An A.I.D. guarantee facility will help address the collateral constraint of Kenyan firms by encouraging commercial banks to allocate funding for these firms.

The EPZ Swap Fund and the EPZ Guarantee facility will be directed at medium-sized firms which would otherwise find it difficult to acquire the necessary amount of foreign exchange to enable them to operate in the EPZ. Access to the EPZ Guarantee and the EPZ Swap Fund will be available to any privately-owned business operating in Kenya with total assets not to exceed US$ 1,000,000 (Ksh. equivalent), excluding property and buildings.

Due to the foreign exchange regulations, the loans by the commercial banks will be for the entire amount of the investment and will be determined by the type of investment and the size of the investment. Each loan under the EPZ Guarantee to an EPZ company will encompass not only fixed investments in capital equipment, but also all working capital requirements. It is expected that the loans will range in size between $750,000 and $1,000,000.

DISCUSSION:

Development Impact

The benefits to opening the EPZs to domestic firms include generating employment and foreign exchange through backward and forward linkages to domestic firms operating outside the EPZs, liberalizing the foreign exchange regime and enticing foreign investment into the EPZs.

Business Rationale

The EPZ Guarantee will generate local private sector financing for Mission private sector activities. The facility will supplement the private sector activities of the Mission which in turn complements World Bank credit assistance to establish operational EPZs. The Mission will help overcome barriers to entry into the EPZs by Kenyan firms and provide an opportunity for Kenyan firms to participate in the benefits of the EPZ regime. The swap mechanism has been discussed with the GOK and commercial banks who have both welcomed and supported the concept.

In addition, the EPZ Guarantee offers a way for APRE/I to expand the use of the guarantee authority as well as to expand APRE/I's programs in Kenya.

U.S. Interests

Firms establishing operations in the EPZ may well look to US for capital equipment and for supplying raw materials.

Opening the EPZs to domestic firms is expected to assist in liberalizing the foreign exchange regime of the GOK. A liberal foreign exchange administration will assist US companies currently operating in Kenya which face long delays in repatriating dividends, royalties, and licensing fees.

Firms operating in the EPZs will send a signal to foreign investors that the EPZs are functioning and serve to attract foreign investment in the EPZs. As the EPZ develops, there is a possibility that a successful EPZ will attract US investment.

Political Consideration

USAID Kenya maintains an excellent relationship with the GOK. Policy changes recommended by the Mission have been adopted by the Government, demonstrating its continuing commitment to economic reform. The establishment of the export processing zones was due, in part, to work USAID/Kenya funded through the Investment Promotion Center, a GOK agency.

The EPZ Guarantee is an essential element of the EPZ Swap Fund. To support the EPZ Swap Fund, the Mission will provide a grant of $5.0 million to the GOK to create the Fund. In addition, the Mission will provide 24 person months of technical assistance to the Central Bank of Kenya to establish and implement the swap facility and monitor the EPZ Swap Fund.

ISSUES FOR CONSIDERATION:

1. Is there an issue of cross border risk ?

There is no cross border risk in the transaction. The guarantee to the commercial banks will be used to cover short and medium term US dollar loans to small and medium-sized Kenyan companies operating in the export processing zones. All companies operating in the EPZs will be permitted to retain foreign exchange earnings. The loans will be repaid in hard currency from export earnings generated by these companies.

2. Which financial intermediaries will be used for the EPZ guarantee facility ?

Financial institutions involved as intermediaries could include Barclays Bank of Kenya and Standard Chartered Bank of Kenya, which currently are involved in the LPG program, First American Bank of Kenya, Commercial Bank of Kenya, and Citibank. A thorough financial analysis of each bank used in the EPZ Guarantee will be undertaken using the CAMEL model.

3. Is there adequate liquidity in the commercial banking system to support the EPZ Swap Fund ?

Although the Central Bank of Kenya has instituted tight monetary policies, the large commercial banks have access to funds through mobilization of savings to generate sufficient levels of liquidity to utilize the EPZ Swap Fund.

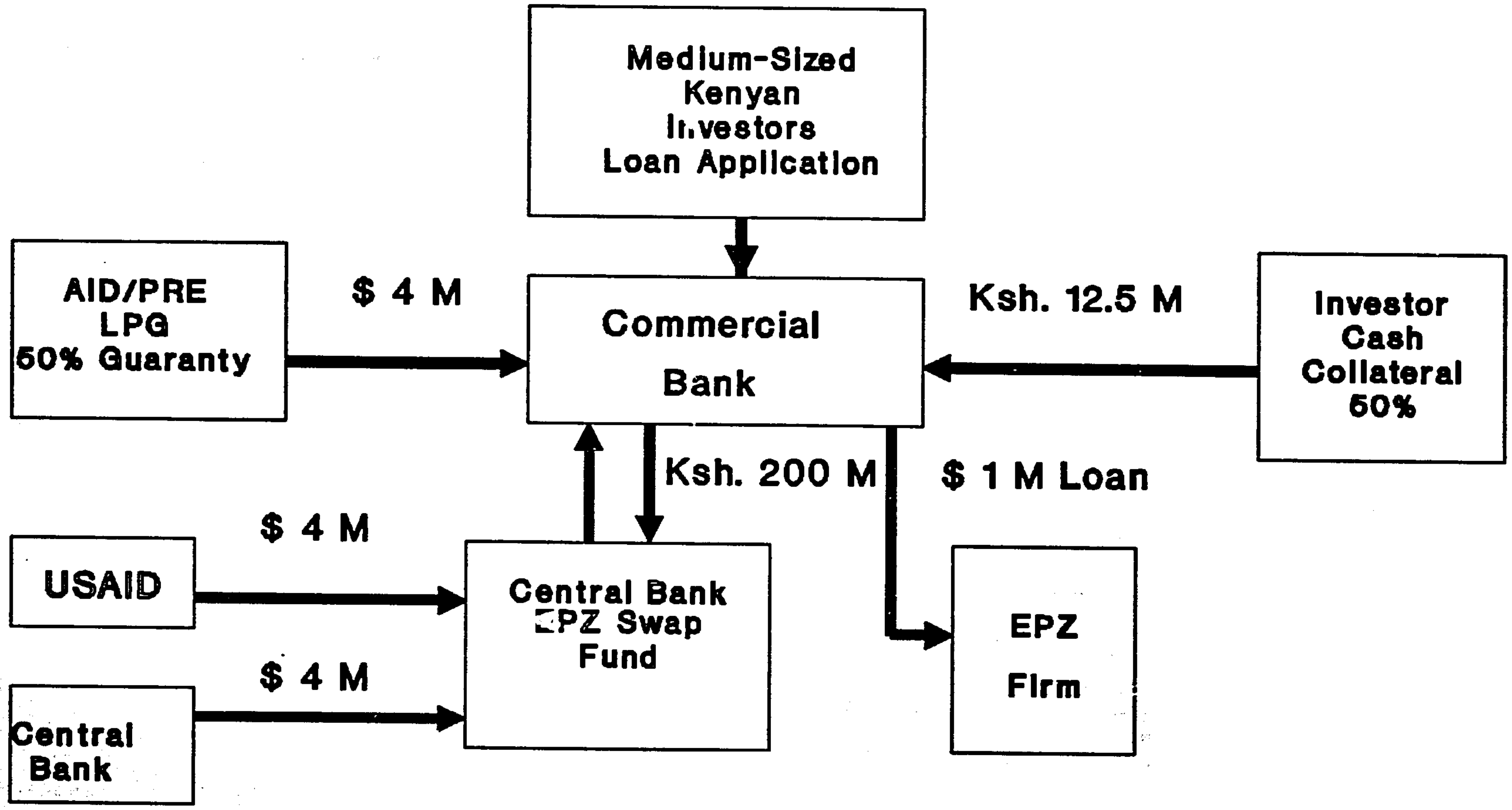
4. Given the legislative guidelines of APRE/I authority, can the EPZ Guarantee be designed based on the projected loan size and the size of the company expected to be the beneficiary ?

The legislation states that the guarantee authority must be used predominantly for small businesses. APRE/I has addressed this mandate primarily through the LPG Program. The Mission is targeting the EPZ Swap Fund to medium-sized firms as they are the companies most likely to be constrained by lack of foreign exchange required to operate in the EPZs as well as the lack of collateral needed to obtain foreign exchange. The projected loan size was determined following discussions with financial institutions, the Mission, and private businesses, and is based on the amount of investment expected to be required by companies establishing operations in the EPZs. The amount of the investment will cover both the purchase of capital equipment and working capital requirements.

RECOMMENDATION:

That APRE/I endorse the concept as described above, and hire a consultant to undertake the necessary financial analysis and the preparation of an IOP.

KEDS Project
EPZ Swap Fund Loan made to EPZ Firm



INITIAL ENVIRONMENTAL REVIEW

Country: Kenya

Project: Kenya Export Development Support (KEDS, 615-0249)

Funding: $ 25.0 million DFA

Environmental Action Recommended: Categorical Exclusion

The purpose of the KEDS program is to increase Kenya's non-traditional exports. The program will:

1. Provide technical assistance and training to ensure that the key policy and regulatory changes are efficiently and effectively implemented.
2. Develop export financing schemes that facilitate new investments in non-traditional export capacity.
3. Provide firm level technical assistance and training to enhance the private sector's ability to rapidly respond to the improved policy and regulatory environment.
4. Develop a trade policy research capability for the GOK.

The KEDS program meets the criteria for a Categorical Exclusion in accordance with the Environmental Regulations set forth in 22 CFR Part 216.2 (c) (2) (i) - technical assistance and training programs, (iii) - analyses and studies, (x) - support for intermediate credit institutions, and (xiv) - projects intended to develop the capability to engage in development planning.

Categorical Exclusion Recommended By: John Westley
John Westley
USAID/Kenya Director

Bureau Environmental Officer Determination: [signature]

Approved: X
Disapproved:

Date: 3/7/91

GC/AFR Clearance: M A Kleinjan

cleared by: REDSO/ESA/RLA/CBrown CB

I. PROJECT DESCRIPTION

The Kenya Export Development Support (KEDS) Project (615-0249) is a seven year project whose goal is to increase employment and foreign exchange earnings in Kenya on a sustainable basis. The purpose of the project is to increase non-traditional exports through increased investment in the export sector and development of a more favorable trade environment.

The Project will consist of four major components. A Public Sector Component will provide support to the newly-established Export Promotion Programmes Office (EPPO) and the Export Processing Zones Authority (EPZA) to assist the Government of Kenya in its efforts to improve the export environment. The Firm Level Assistance Component will provide direct assistance to Kenyan firms and to several export support organizations to expand non-traditional exports. The EPZ Swap Facility will provide US dollars for local firms to invest in Kenya's new export processing zones. The KEDS Studies Component will help develop a strong analytical base for ongoing improvement of Kenya's export climate.

Under the Public Sector Component, long-term and short-term technical assistance will be provided. Training in export-related policy areas will be provided as well. The intent of the technical assistance and training is to establish a functioning policy and institutional framework for the GOK in the export sector.

Under the Firm Level Assistance Component, direct technical assistance will be provided to firms to increase their capabilities in the export sector. In addition, technical assistance will be provided to key private sector support organizations which have an enabling role to play in stimulating non-traditional export development.

Under the Swap Facility, USAID will provide matched funding to establish an account whereby existing or emerging export firms can obtain the foreign exchange necessary to participate in the EPZs. No new financial institutions are envisaged, and the funding will be provided through established commercial banking operations.

Under the Studies Component, studies, seminars and workshops are to be financed along with limited amounts of technical assistance. The intent of this component is to strengthen GOK and private sector capabilities to identify and address constraints to the non-traditional export sector.

II. IDENTIFICATION AND EVALUATION OF ENVIRONMENTAL IMPACT

The impact of this Project on the environment is likely to be slight in overall magnitude and essentially indirect. Working with existing GOK and private sector institutions, this technical assistance based project feeds into and supports the broader World Bank's Export Development Project (EDP). The only activity with a potential impact on the physical environment is the Swap Facility which will facilitate foreign exchange availability for firms establishing in export processing zones. These zones, being developed under the World Bank's project, have had environmental analyses undertaken and documented.

USAID has reviewed the substance of Kenya's environmental guidelines as well as the World Bank project and finds them to be appropriate. Their effectiveness will depend on how they are applied in the future. As for monitoring, indirect monitoring through quarterly Project reviews and off-year evaluations of Project activities will be undertaken. These reviews and evaluations will provide USAID the ongoing abilities to determine future physical environmental issues as they may arise.

III. RECOMMENDED ENVIRONMENTAL ACTION

On the basis of the planned Project Activities and review of the Kenyan and World Bank environmental activities related to the Project, a categorical exclusion, in accordance with CFR Part 216.2 (c) (2) (i) and (iii) is requested. Since the contributions of the Swap Facility represent contributions by the U.S. Government to intermediate credit institutions which are not for the purpose of carrying out specifically identifiable activities, neither an Environmental Assessment nor Environmental Impact Statement is deemed necessary.

ANNEX G: PID APPROVAL CABLE AND USAID RESPONSE

I. SUMMARY

The Project Committee reviewed the KEDS PID in Washington on December 4, 1990. The Committee commended USAID/Kenya for the high quality of the PID. The KEDS Project PID Approval Cable was transmitted by AID/W on March 8, 1991. The KEDS Project fits entirely within USAID/Kenya's "Private Enterprise Strategy" (PES), as set out in 1990. The Design Committee has ensured that the KEDS Project Paper is a logical outgrowth of the Mission's Country Program Strategic Plan (CPSP) of March 1990.

USAID/Kenya has taken into account the guidance given by AID/W through the PID Approval Cable (attached) for this KEDS Project Paper. Since the PID was written, several of the components have been changed due to actions by the GOK and other donors as well as revised assessments of KEDS priorities by USAID.

II. CUSTOMS AND EXCISE DEPARTMENT (CED)

The PID Approval Cable transmitted by AID/W raised issues regarding proposed KEDS Project support to the Customs and Excise Department of the Ministry of Finance (MOF), the Export Promotion Programmes Office (EPPO/MOF), and legislation which might be required to implement the Project.

KEDS Project assistance to the Customs and Excise Department (CED) is no longer necessary. The African Development Bank (AfDB) will fund long and short term technical assistance, training and commodities to the CED for export promotion as part of the MOF/UNDP (USAID-supported) Tax Modernization Program. The AfDB's Project will address all components set out by USAID in the KEDS PID.

III. EXPORT PROMOTION PROGRAMMES OFFICE (EPPO)

With regard to the EPPO, the Regional Legal Advisor (RLA) has given a legal opinion that the work of the USAID sponsored advisor to EPPO (via the US Customs Service), falls outside of the Foreign Assistance Act, Section 660. Thus, KEDS Project assistance to the EPPO does not constitute a problem.

IV. LEGISLATIVE CHANGES

The Guidance Cable pointed out that if the achievement of the Project requires host country legislative action, there must be a reasonable basis to believe that such action could be taken to permit the achievement of the Project purpose. The only legislative action anticipated for the KEDS Project involves the

EPZ Swap Facility. The Mission believes that such action can be taken in a timely manner by the GOK to ensure the success of the EPZ Swap.

Discussions with relevant GOK officials indicate that such changes are matters of further defining the Export Processing Zones Authority Act of 1990 and will be accomplished in such a fashion to permit orderly accomplishment of the KEDS Project purpose.

The proposed EPZ Swap Fund is conditional upon receiving clarification from the Ministry of Finance on whether Kenyan firms can use local currency to establish companies in the EPZs (i.e., to pay Kenya Shillings for legal fees and other establishment costs). The Central Bank, under Exchange Control Notice Number 37, article 10, should permit local commercial banks to on-lend foreign exchange to firms for EPZ investments and working capital. The article states that "institutions and other persons resident in Kenya require the permission of Exchange Control before they may extend any credit facilities to an EPZ enterprise."

Currently, the Exchange Control approves each transaction on a case-by-case basis. This process would be facilitated by granting domestic commercial banks permission to extend credit facilities to an EPZ firm. An alternative would be to exempt bank branches which operate in the EPZ from the article since banks in the EPZ would be considered offshore banks.

Additionally, the GOK must also agree to match A.I.D.'s grant to the EPZ fund of US$5 million. The GOK presently makes foreign exchange available for domestic importers. A portion of the foreign exchange allocated for importers could be set aside for the Swap Fund.

It is important that local currency swapped for foreign exchange to invest in the export processing zones should be exempt from commercial bank credit ceilings. The Central Bank, at the behest of the International Monetary Fund, has imposed a credit ceiling on commercial banks, restricting credit growth to about 1 percent per month. It should be noted that local currency swapped for foreign exchange has a similar effect of taking Kenya Shillings out of circulation. Extending the credit ceiling to include loans by domestic commercial banks to companies in the EPZ (which the GOK treats as being offshore) will be a severe lending constraint.

Finally, the Central Bank should permit commercial banks to place liens on assets in the export processing zones. While an EPZ firm is allowed to pledge assets against borrowing from non-residents, no guidance has been provided for domestic commercial banks lending to EPZ firms. This issue might be addressed if the

Central Bank permitted domestic banks to establish branches in the EPZ and those branches were considered as offshore banks.

V. GRAY AMENDMENT

This Project will comply with the Gray Amendment Provisions which state that 10 percent of any contract over $500,000 will be subcontracted to Gray Amendment entities.

VI. IMPLEMENTATION ARRANGEMENTS

The KEDS Project will be managed by USAID's Private Enterprise Office. A PSC and two FSNs will be primarily responsible for managing the Project.

VII. URBANIZATION AND EXPORT PROCESSING ZONES

RHUDO has agred to provide technical advice to the Mission on this issue.

VIII. DISINCENTIVES TO DOMESTIC INVESTMENT

The EPZ Swap Facility Component addresses concerns regarding disincentive to domestic investment by providing US dollars for local currency. This will encourage local investors in the export processing zones.

IX. LAUTENBERG, BUMPERS AND POLICY DETERMINATION

At the present time USAID/Kenya does not foresee any activities contrary to the above legislation; however, in order to ensure compliance, the Mission will require the contractor to submit requests for assistance to potential leather, textile, sugar, palm oil, citrus or agricultural commodity exporters to USAID/Kenya for approval.

ACTION AID-3 INFO ECON POL/RLO

OFFICIAL FILE

Project 615-0249

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ANNEX G

AIDAC

E.O. 12356: N/A
TAGS:
SUBJECT: KENYA EXPORT DEVELOPMENT SUPPORT (KEDS) PROJECT PID APPROVAL CABLE

1. A PROJECT COMMITTEE MEETING WAS HELD ON DECEMBER 4, 1990 IN AID/W TO REVIEW THE KENYA EXPORT DEVELOPMENT SUPPORT (KEDS) PROJECT IDENTIFICATION DOCUMENT (PID). THE REVIEW MEETING WAS ATTENDED BY REPRESENTATIVES OF AFR/PD, AFR/EA, AFR/DP, AFR/TR, GC/AFR, AFR/MDI, REDSO/ESA AND USAID/NAIROBI DEPUTY DIRECTOR ERIC ZALLMAN AND PRIVATE ENTERPRISE OFFICER HOLLY WISE. THE MISSION WAS COMMENDED FOR THE HIGH QUALITY OF THE PID SUBMITTED FOR AID/W REVIEW. THE PROJECT COMMITTEE RECOMMENDED THAT THE PID BE APPROVED AND THAT THE MISSION BE DELEGATED AUTHORITY TO APPROVE AND AUTHORIZE THE PROJECT IN THE FIELD SUBJECT TO THE FOLLOWING GUIDANCE. INASMUCH AS ISSUES WERE RESOLVED AT THE PC MEETING, IT WAS FURTHER RECOMMENDED THAT AN ECPR NOT BE CONVENED FOR FURTHER ACTION.

2. SECTION 660 AND ASSISTANCE TO CED. FAA SECTION 660 PROHIBITS ASSISTANCE TO LAW ENFORCEMENT FORCES. A CRITICAL ((ALTHOUGH SMALL DOLLARWISE) ELEMENT OF THE PROJECT PROPOSED IN THE PID IS ASSISTANCE (LONG-TERM TECHNICAL ASSISTANCE AND COMMODITIES - COMPUTERS AND SOFTWARE) FOR THE ESTABLISHMENT AND OPERATION OF A NEW UNIT WITHIN THE GOK CUSTOMS AND EXCISE DEPARTMENT (CED) TO IMPLEMENT THE EXPORT PROCESSING ZONES, THE DUTY/VAT EXEMPTION PROGRAMS AND THE MANUFACTURING UNDER BOND SCHEME. GC/AFR CONCURRED WITH THE PID STATEMENT THAT ON FACE OF THE FACTS CONTAINED IN THE PID (SUCH AS THE STATUTORY GRANT OF POLICE, SEARCH AND ARREST POWERS TO ALL CED OFFICERS) IT APPEARS LIKELY THAT CED AND UNITS WITHIN IT WOULD BE CONSIDERED TO BE A LAW ENFORCEMENT FORCE TO WHICH ASSISTANCE COULD NOT BE PROVIDED UNDER SECTION 660, AS CURRENTLY INTERPRETED. GC/AFR SUGGESTED THAT THE MISSION AND RLA CAREFULLY AND CLOSELY EXAMINE THE FULL FACTS IN DETAIL REGARDING THE ORGANIZATIONAL STRUCTURE OF THE PROPOSED UNIT TO DETERMINE WHETHER IT IS SEVERABLE FROM LAW ENFORCEMENT FORCES UNDER EXISTING SECTION 660 STANDARDS. (EXISTING SECTION 660 STANDARDS LOOK TO THE NATURE OF THE ENTITY ASSISTED, RATHER THAN THE NATURE OF THE ASSISTANCE.) IF THE RLA CANNOT CONCLUDE, IN A WRITTEN

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LEGAL OPINION, THAT THE PROPOSED ASSISTANCE TO THE PROPOSED EXPORT UNIT DOES NOT VIOLATE SECTION 660 UNDER EXISTING STANDARDS, RLA AND MISSION COULD SUBMIT AN ARGUMENT FOR REVISION OF EXISTING STANDARDS FOR INTERPRETING SECTION 660 TO GC, WHICH WILL CONSIDER THE MATTER. IT IS ESSENTIAL THAT ANY SUBMISSION INCLUDE A FINAL, FULL DESCRIPTION OF THE FACTS AND THE LEGAL ARGUMENT FULLY SPELLED OUT. ANY ARGUMENT FOR A CHANGE IN THE LEGAL STANDARD SHOULD BE DRAWN AS NARROWLY AS POSSIBLE. HOWEVER, MISSION SHOULD NOT COUNT ON ANY CHANGE IN THE CURRENT LEGAL STANDARD OR ON A RAPID RESOLUTION OF THE ISSUE. GIVEN THAT THIS COMPONENT IS CRITICAL TO SUCCESS OF THE ENTIRE PROJECT, THE MISSION AGREED (1) TO SIMULTANEOUSLY SEEK OTHER DONOR FINANCING FOR IT AND (2) NOT TO AUTHORIZE THE PROJECT WITHOUT FIRM ASSURANCES THAT THIS COMPONENT WILL BE FUNDED FROM SOME SOURCE.

THE PID ALSO PROPOSED ASSISTANCE TO THE EXPORT PROMOTION PROGRAMMES OFFICE (EPPO), A NEW UNIT UNDER THE MINISTRY OF FINANCE BUT OUTSIDE CED, TO DEVELOP POLICY AND OPERATIONAL PROCEDURES FOR THE DUTY EXEMPTION SCHEME AND TO ESTABLISH A MONITORING AND EVALUATION SYSTEM. RLAS RECENTLY INDICATED THAT THEY THOUGHT IT LIKELY THAT THEY COULD CONCLUDE THAT EPPO WAS NOT A LAW ENFORCEMENT FORCE UNDER THE EXISTING SECTION 660 STANDARD. IF RLAS DID SO CONCLUDE AFTER CAREFULLY EXAMINING THE FACTS, THE ECPR ASSUMES THAT THE SAME CONCLUSION WOULD APPLY TO THE ASSISTANCE TO EPPO PROPOSED UNDER THIS PROJECT.

3. SECTION 611(A)(2). FAA SECTION 611((A)(2) PROVIDES THAT, IF ACHIEVEMENT OF THE PROJECT PURPOSE REQUIRES HOST COUNTRY LEGISLATIVE ACTION, NO FUNDS MAY BE OBLIGATED UNLESS THERE IS A REASONABLE BASIS FOR BELIEVING THAT THE LEGISLATIVE ACTION WILL BE ACCOMPLISHED IN TIME TO PERMIT ORDERLY ACCOMPLISHMENT OF THE PROJECT PURPOSE. THE MISSION REPRESENTATIVE AND AFR/MDI STATED THAT THE MISSION HAD COMPLETED STUDIES OF LEGISLATIVE AND REGULATORY CHANGES IN OTHER AFRICAN COUNTRIES NECESSARY FOR ESTABLISHMENT AND EFFECTIVE IMPLEMENTATION OF EXPORT PROCESSING ZONES, AND OF KENYAN LAWS AND REGULATIONS THAT NEEDED REVISION. GC/AFR ADVISED THAT THE PROJECT PAPER SHOULD REFLECT THIS WITH REGARD TO 611(A)(2).

4. GRAY AMENDMENT. IN ITS DISCUSSION OF THE GRAY AMENDMENT, THE PP SHOULD REFLECT THE STATUTORY REQUIREMENT THAT ALL DIRECT CONTRACTS ABOVE $500,000 MUST REQUIRE THAT AT LEAST 10 PERCENT OF THE CONTRACT AMOUNT BE SUBCONTRACTED TO A GRAY AMENDMENT ENTITY, UNLESS THE

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CONTRACTING OFFICER CERTIFIES THAT THERE ARE NOT U.S. SUBCONTRACTING OPPORTUNITIES OR UNLESS THE PRIME CONTRACTOR ITSELF IS A GRAY AMENDMENT ENTITY.

5. IMPLEMENTATION ARRANGEMENTS. IN THE COURSE OF PROJECT DEVELOPMENT, THE MISSION WILL SEEK WAYS TO REDUCE THE MANAGEMENT BURDEN IMPLICIT IN PROPOSED IMPLEMENTATION ARRANGEMENTS FOR THE PROJECT WITH REGARD TO REDUCING THE NUMBER OF SEPARATE CONTRACTING/GRANT ACTIONS AND THUS THE NUMBER OF IMPLEMENTING AGENTS REPORTING TO MISSION OR GOK STAFF.

6. URBANIZATION AND EXPORT PROCESSING ZONES (EPZS). DISCUSSION CENTERED ON THE IMPACT OF EPZS IN TERMS OF INCREASING URBANIZATION AND ITS ATTENDANT PROBLEMS. IT WAS AGREED THAT THE MISSION WILL VET THIS ISSUE FULLY WITH RHUDO WITH A VIEW TOWARD USING EXISTING RHUDO RESOURCES TO ADDRESS URBANIZATION ISSUES ARISING FROM THE CREATION AND DEVELOPMENT OF EPZS.

7. DISINCENTIVES TO DOMESTIC INVESTMENT. THE PP SHOULD INCLUDE A FULL DISCUSSION OF WHY ALL INVESTMENTS IN THE KENYA EPZS MUST BE IN FOREIGN EXCHANGE AS WELL AS DISCUSSION OF THE POTENTIAL DISINCENTIVES TO LOCAL INVESTMENT ASSOCIATED WITH SUCH REQUIREMENTS IN JUSTIFYING THE EPZ FOREIGN EXCHANGE SWAP FACILITY.

8. LAUTENBERG, BUMPERS AND POLICY DETERMINATION (PD) 71. THE PROJECT PAPER (PP) NEEDS TO EXAMINE WHETHER ANY OF THE PROJECT ACTIVITIES, AS THEY ARE FURTHER DEVELOPED, WILL RUN AFOUL OF THE LAUTENBERG, BUMPERS, AND PD 71 RESTRICTIONS, OR WHETHER THE PP NEEDS TO BUILD IN A

MECHANISM FOR ANALYSIS OF SUBACTIVITIES IN LIGHT OF THESE RESTRICTIONS DURING PROJECT IMPLEMENTATION.

- LAUTENBERG, CURRENTLY SECTION 521(C) OF THE FY 91 FOREIGN ASSISTANCE APPROPRIATIONS ACT, PROHIBITS THE USE OF PROJECT FUNDS TO PROCURE DIRECTLY FEASIBILITY STUDIES OR PREFEASIBILITY STUDIES FOR, OR PROJECT PROFILES OF POTENTIAL INVESTMENT IN, THE MANUFACTURE, FOR EXPORT TO THE U.S. OR TO THIRD-COUNTRY MARKETS IN DIRECT COMPETITION WITH U.S. EXPORTS, OF CERTAIN IMPORT-SENSITIVE ARTICLES, AND PROHIBITS ASSISTING DIRECTLY IN THE ESTABLISHMENT OF FACILITIES SPECIFICALLY DESIGNED FOR THE MANUFACTURE OF SUCH ARTICLES. MANY TYPES OF LEATHER GOODS AND TEXTILES ARE LAUTENBERGSENSITIVE ARTICLES.

BUMPERS, CURRENTLY SECTION 521(B), PROHIBITS THE USE OF PROJECT FUNDS FOR ANY TESTING OR BREEDING FEASIBILITY STUDY, VARIETY IMPROVEMENT OR INTRODUCTION, CONSULTANCY, PUBLICATION, CONFERENCE OR TRAINING IN CONNECTION WITH THE GROWTH OR PRODUCTION IN A FOREIGN COUNTRY OF AN AGRICULTURAL COMMODITY FOR EXPORT WHICH WOULD COMPETE WITH A SIMILAR COMMODITY GROWN OR PRODUCED IN THE U.S.

" PD 71 REQUIRES SPECIFIC AID/W APPROVAL FOR ACTIVITIES

INVOLVING THE PRODUCTION, PROCESSING OR MARKETING OF SUGAR, PALM OIL, OR CITRUS FOR EXPORT.

WHILE, BASED ON THE PID-LEVEL DESCRIPTION, THE ECPR DID NOT IDENTIFY ANY ELEMENT OF THE PROJECT THAT WAS CLEARLY A PROBLEM UNDER THESE RESTRICTIONS, IT IS IMPORTANT THAT THE MISSION REVIEW PROPOSED PROJECT ACTIVITIES WITH THE RLA AT AN EARLY POINT TO IDENTIFY ANY ISSUES AS THE PROJECT DETAILS ARE DEVELOPED.

9. FUNDING/MISSION OYB. IN A SEPARATE MEETING HELD ON DECEMBER 6, 1992 AND ATTENDED BY AFR/EA, AFR/PD AND DEPUTY DIRECTOR ZALLMAN, MISSION OYB AND PROJECTED MORTGAGE FIGURES WERE REVIEWED TO DETERMINE WHETHER THE KEDS OBLIGATION WOULD RESULT IN A SIGNIFICANT INCREASE IN THE MISSION'S MORTGAGE AND THE NEED TO INCREASE THE MISSION'S OYB. IT WAS AGREED THAT FUNDING WAS AVAILABLE FOR KEDS WITHIN THE CURRENT US DOLLARS 26 MILLION OYB FOR FY91 AND THE SAME LEVEL CURRENTLY PROJECTED FOR FY 92 AND THAT THE MORTGAGE WILL NOT INCREASE SIGNIFICANTLY AS A RESULT OF AN OBLIGATION OF US DOLLARS 25 MILLION FOR THE KEDS PROJECT.

10. THE ACTING, AA/AFR HEREBY DELEGATES AUTHORITY TO THE MISSION DIRECTOR, USAID/NAIROBI, OR TO THE PERSON ACTING IN THAT CAPACITY, TO APPROVE AND AUTHORIZE THE KENYA

EXPORT DEVELOPMENT SUPPORT (KEDS) PROJECT IN AN AMOUNT NOT TO EXCEED $25 MILLION. THIS AD HOC DELEGATION OF AUTHORITY SHALL BE EXERCISED ON ALL THE OTHER TERMS AND CONDITIONS OF DOA 551, EXCEPT FOR THE DOLLAR AMOUNT LIMITATION, AND IN ACCORDANCE WITH THE GUIDANCE PROVIDED HEREIN.

11. IEE. AID/W IS CURRENTLY REVIEWING THE IEE AND WILL ADVISE SEPTEL. EAGLEBURGER
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ANNEX I LOGICAL FRAMEWORK

KENYA EXPORT DEVELOPMENT SUPPORT PROJECT (615-0249)

NARRATIVE SUMMARY GOAL:	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
To expand employment opportunities and to increase foreign exchange earnings on a sustainable basis.	1. One million additional jobs between 1991-2000. (127,000 private sector, Manufacturing, 90,000 EPZ, 667,000 Agriculture)	Economic Survey; Statistical Abstract Central Bank Digest; EPZ Authority Records, IPC Reports, Employment Elasticity Analysis, KEDS Baseline studies.	GOK maintains commitment to broad-based export strategy and continues to implement structural adjustment based on the 90-92 PFP, IBRD sustains export, financial and industrial sector loans.
	2. Additional foreign exchange earnings (from KEDS and IBRD program) $340 million by 1999.	Economic Survey; Statistical Abstract Central Bank records; KEDS Baseline surveys.	Foreign exchange inflows from non-traditional exports do not decline.
PURPOSE:	**EOPS:**		
To increase non-traditional exports.	1. Manufactured, horticultural and other non-traditional export earnings increased by 55% in nominal dollar terms by 1998 (1990 base year). 2. Increase in percentage of non-traditional exports relative to traditional from 42-48% (1989 base). 3. Geographical diversification of export markets. Exports to EEC reduced from 44% to 41% (1989 base year).	Economic Survery; Statistical Annex; CBK Kigest; KAM Statistics; HCDA & EPZ Authority KEDS Baseline data. Ports Authority and ACHL Reports.	Other donors play contributory role in export-oriented growth program. GOK continues hands-off policy towards horticulture. Cargo space increased and handling improves. Ports rehabilitation improves turn-around, and container air handling capabilities expand with increase in exports.

OUTPUTS:	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
1. Reduction of GOK controls including licensing simplification, and import export liberalization.	GOK officials trained; Reduction in delays for issuing export and import licenses.	Kenya Gazette; Budget Speech, Base line data review; Actual	Sufficient foreign exchange to guarantee continued trade liberalization.
2. Trade policy analysis capability at EPPO established and strengthened.	Eight to twelve studies completed.	EPPO, Central Bank and trade association reports.	Availability of MOF staff and public sector counterparts.
3. Firm-level assistance and institutional support delivered to exporters.	Three trade associations assisted. FPEAK and AER-K have functioning secretariats and provide export services to members.	KNNC&I, KAM, FPEAK and AER-K reports, HCDA Reports. Registrar of societies.	Demand for commercial export services will increase as non-traditional exports increase.
4. Export incentives provided by GOK.	Duty/VAT exemption schemes in place.	Kenya Gazette. Budget Speech. EPPO Reports.	Sufficient foreign exchange to guarantee continued trade liberalization.
5. Foreign Exchange available to Kenyan investors through Swap facility with CBK.	$8 million swapped. 8-11 EPZ companies established.	EPZA Reports. Central Bank and Commercial Bank records.	GOK contributes $5 M. Credit ceiling exclu sion. APRE guaranty established. Legislative changes by GOK.
6. Functioning EPPO and EPZA Authority and export processing zones.	EPZA (MOF) operational. Access to EPZs by domestic investors; 2 EPZs established.	EPPO, EPZA and Central Bank reports.	Industrial labor productivity increases. Investment/political climate is stable or improves.

INPUTS:	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
1. Technical assistance, training and commodities to the GOK.	TA - 85 person-months; Training - Short-term, Seminars, Study Tours, Workshops; Commodities- Computers, hardware and software.	Work Plans, Progress Reports, Audited Accounts and Bank	Availability of GOK counterparts.
2. TA, training and commodities for business assistance to institutions and firms.	TA - 288 person-months; Training - export Seminars; Commodities - Computers, hardware and software.	Work Plans, Progress Reports, Audited Accounts and Bank Statements.	Core Contractor delivers delivers TA to firms. Institutions disseminate export info; improve private sector advocacy.
3. TA and training to commercial banks and Central Bank.	13 person-months	Work Plans, Progress Reports and contractor Reports.	CBK and banks participate in guaranty promotion.
4. US $4 million for Swap fund.	Swap facility established.	Central Bank records.	GOK contributes US $5 million.
5. Policy and export promotion studies to GOK and private enterprises.	TA - 15 person-months.	Studies completed.	Availability of GOK and private sector counterparts.

B. CRITERIA APPLICABLE TO DEVELOPMENT ASSISTANCE ONLY

1. **Agricultural Exports (Bumpers Amendment)** (FY 1991 Appropriations Act Sec. 521(b), as interpreted by conference report for original enactment): If assistance is for agricultural development activities (specifically, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training), are such activities: (1) specifically and principally designed to increase agricultural exports by the host country to a country other than the United States, where the export would lead to direct competition in that third country with exports of a similar commodity grown or produced in the United States, and can the activities reasonably be expected to cause substantial injury to U.S. exporters of a similar agricultural commodity; or (2) in support of research that is intended primarily to benefit U.S. producers?	No direct competition is planned. Non-traditional exports are the focus of project activities N/A
2. **Tied Aid Credits** (FY 1991 Appropriations Act, Title II, under heading "Economic Support Fund"): Will DA funds be used for tied aid credits?	No
3. **Appropriate Technology** (FAA Sec. 107): Is special emphasis placed on use of appropriate technology (defined as relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?	N/A
4. **Indigenous Needs and Resources** (FAA Sec. 281(b): Describe extent to which the activity recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective	The Project is fully responsive to the needs of the local population. Institutional development, employment, and public-

participation in governmental and political processes essential to self-government.	private sector dialogue promotion are key project elements.
5. **Economic Development** (FAA Sec. 101(a)): Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?	Yes
6. **Special Development Emphases** (FAA Secs. 102(b), 113, 281(a)): Describe extent to which activity will: (a) effectively involve the poor in development by extending access to economy local level, increasing labor-intensive production and the use of appropriate technology, dispersing investment from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using appropriate U.S. institutions (b) 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.	(a) Increased labor employment (skilled and unskilled) is planned. Technologies are those suited for Export Processing Zones (b) N/A (c) Directly responsible (d) Women share equally in all project activities (e) N/A
7. **Recipient Country Contribution** (FAA Secs. 110, 124(d)): Will the recipient country provide at least 25 percent of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?	Country will provide 25% of program costs
8. **Benefit to Poor Majority** (FAA Sec. 128(b)): If the activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological	Yes. Existing private and public institutions

research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority? | are to be supported with techncial assistance which will increase productivity and employment.

9. **Abortions** (FAA Sec. 104(f); FY 1991 Appropriations Act, Title II, under heading "Population, DA," and Sec. 535):

a. Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions? No

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

c. Are any of the funds to be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization? No

d. Will funds be made available only to voluntary family planning projects which offer, either directly or through referral to, or information about access to, a broad range of family planning methods and services? N/A

e. In awarding grants for natural family planning, will any applicant be discriminated against because of such applicant's religious or conscientious commitment to offer only natural family planning? N/A

f. Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, No

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abortions or involuntary sterilization as a means of family planning?

g. Are any of the funds to be made available to any organization if the President certifies that the use of these funds by such organization would violate any of the above provisions related to abortions and involuntary sterilization?	No
10. **Contract Awards** (FAA Sec. 601(e)): Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?	Yes
11. **Disadvantaged Enterprises** (FY 1991 Appropriations Act Sec. 567): What portion of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities, colleges and universities having a student body in which more than 40 percent of the students are Hispanic Americans, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)?	10% Gray Amendment Requirement
12. **Biological Diversity** (FAA Sec. 119(g): Will the assistance: (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity; (b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other wildlife habitats; (c) support efforts to identify and survey ecosystems in recipient countries worthy of protection; or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas?	N/A

13. **Tropical Forests** (FAA Sec. 118; FY 1991 Appropriations Act Sec. 533(c)-(e)

& (g):

a. **A.I.D. Regulation 16:** Does the assistance comply with the environmental procedures set forth in A.I.D. Regulation 16? — Yes

b. **Conservation:** Does the assistance place a high priority on conservation and sustainable management of tropical forests? Specifically, does the assistance, to the fullest extent feasible: (1) stress the importance of conserving and sustainably managing forest resources; (2) support activities which offer employment and income alternatives to those who otherwise would cause destruction and loss of forests, and help countries identify and implement alternatives to colonizing forested areas; (3) support training programs, educational efforts, and the establishment or strengthening of institutions to improve forest management; (4) help end destructive slash-and-burn agriculture by supporting stable and productive farming practices; (5) help conserve forests which have not yet been degraded by helping to increase production on lands already cleared or degraded; (6) conserve forested watersheds and rehabilitate those which have been deforested; (7) support training, research, and other actions which lead to sustainable and more environmentally sound practices for timber harvesting, removal, and processing; (8) support research to expand knowledge of tropical forests and identify alternatives which will prevent forest destruction, loss, or degradation; (9) conserve biological diversity in forest areas by supporting efforts to identify, establish, and maintain a representative network of protected tropical forest ecosystems on a worldwide basis, by making the establishment of protected areas a condition of support for activities involving forest clearance or degradation, and by helping to identify tropical forest ecosystems and species in need of protection and establish and maintain appropriate protected areas; (10) seek to increase the awareness of U.S. Government

(1) N/A
(2) Yes
(3) N/A
(4) N/A
(5) N/A
(6) N/A
(7) N/A
(8) N/A
(9) N/A
(10) N/A

agencies and other donors of the immediate and long-term value of tropical forests; (11) utilize the resources and abilities of all relevant U.S. government agencies; (12) be based upon careful analysis of the alternatives available to achieve the best sustainable use of the land; and (13) take full account of the environmental impacts of the proposed activities on biological diversity?

(11) N/A

(12) N/A

(13) N/A

c. **Forest degradation:** Will assistance be used for: (1) the procurement or use of logging equipment, unless an environmental assessment indicates that all timber harvesting operations involved will be conducted in an environmentally sound manner and that the proposed activity will produce positive economic benefits and sustainable forest management systems; (2) actions which will significantly degrade national parks or similar protected areas which contain tropical forests, or introduce exotic plants or animals into such areas; (3) activities which would result in the conversion of forest lands to the rearing of livestock; (4) the construction, upgrading, or maintenance of roads (including temporary haul roads for logging or other extractive industries) which pass through relatively undergraded forest lands; (5) the colonization of forest lands; or (6) the construction of dams or other water control structures which flood relatively undergraded forest lands, unless with respect to each such activity an environmental assessment indicates that the activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development?

(1) N/A

(2) N/A

(3) No

(4) No

(5) No

(6) No

d. **Sustainable forestry:** If assistance relates to tropical forests, will project assist countries in developing a systematic analysis of the appropriate use of their total tropical forest resources, with the goal of developing a national program for

N/A

sustainable forestry?

e. **Environmental impact statements:** Will funds be made available in accordance with provisions of FAA Section 117(c) and applicable A.I.D. regulations requiring an environmental impact statement for activities significantly affecting the environment?

Yes

14. **Energy** (FY 1991 Appropriations Act Sec. 533(c)): If assistance relates to energy, will such assistance focus on: (a) end-use energy efficiency, least-cost energy planning, and renewable energy resources, and (b) the key countries where assistance would have the greatest impact on reducing emissions from greenhouse gases?

N/A

15. **Sub-Saharan Africa Assistance** (FY 1991 Appropriations Act Sec. 562, adding a new FAA chapter 10 (FAA Sec. 496)): If assistance will come from the Sub-Saharan Africa DA account, is it: (a) to be used to help the poor majority in sub-Saharan Africa through a process of long-term development and economic growth that is equitable, participatory, environmentally sustainable, and self-reliant; (b) to be used to promote sustained economic growth, encourage private sector development, promote individual initiatives, and help to reduce the role of central governments in areas more appropriate for the private sector;

(a) Assistance will help to establish employment in the Kenyan economy.
(b) Yes

(c) being provided in accordance with the policies contained in FAA section 102;

(c) Yes

(d) being provided in close consultation with African, United States and other PVOs that have demonstrated effectiveness in the promotion of local grassroots activities on behalf of long-term development in Sub-Saharan Africa;

(d) No, not applicable to. this project.

(e) being used to promote reform of sectoral economic policies, to support the critical sector priorities of agricultural production and natural resources, health, voluntary family planning services, education, and income generating opportunities, to bring about appropriate sectoral restructuring of the Sub-Saharan

(e) Reforms in export regulations and policies will be encouraged by this project.

African economies, to support reform in public administration and finances and to establish a favorable environment for individual enterprise and self-sustaining development, and to take into account, in assisted policy reforms, the need to protect vulnerable groups; (f) being used to increase agricultural production in ways that protect and restore the natural resource base, especially food production to maintain and improve basic transportation and communication networks, to maintain and restore the renewable natural resources base in ways that increase agricultural production, to improve health conditions with special emphasis on meeting the health needs of mothers and children, including the establishment of self-sustaining primary health care systems that give priority to preventive care, to provide increased access to voluntary family planning services, to improve basic literacy and mathematics especially to those outside the formal educational system and to improve primary education, and to develop income-generating opportunities for the unemployed and underemployed in urban and rural areas?

(f) N/A

16. **Debt-for-Nature Exchange** (FAA Sec. 463): If project will finance a debt-for-nature exchange, describe how the exchange will support protection of: (a) the world's oceans and atmosphere, (b) animal and plant species, and (c) parks and reserves; or describe how the exchange will promote: (d) natural resource management, (e) local conservation programs, (f) conservation training programs, (g) public commitment to conservation, (h) land and ecosystem management, and (i) regenerative approaches in farming, forestry, fishing, and watershed management.

N/A

17. **Deobligation/Reobligation** (FY 1991 Appropriations Act Sec. 515): If deob/reob authority is sought to be exercised in the provision of DA assistance, are the funds being obligated for the same general purpose, and for

N/A

countries within the same region as originally obligated, and have the House and Senate Appropriations Committees been properly notified?

18. **Loans**

a. **Repayment capacity** (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. **Long-range plans** (FAA Sec. 122(b)): Does the activity give reasonable promise of assisting long-range plans and programs designed to develop economic resources and increase productive capacities?

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

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

19. **Development Objectives** (FAA Secs. 102(a), 111,113, 281(a)): Extent to which activity will: (1) effectively involve the poor in development, by expanding access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (2) help develop cooperatives, especially by technical

(1) Increased labor employment (skilled and unskilled) is planned. Technologies as those suited for Export Processing Zones
(2) N/A

assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (3) support the self-help efforts of developing countries; (4) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (5) utilize and encourage regional cooperation by developing countries?

(3) Directly

(3) Directly responsible
(4) Women to share equally in all project activities
(5) N/A

20. **Agriculture, Rural Development and Nutrition, and Agricultural Research** (FAA Secs. 103 and 103A):

a. **Rural poor and small farmers:** If assistance is being made available for agriculture, rural development or nutrition, describe extent to which activity is specifically designed to increase productivity and income of rural poor; or if assistance is being made available for agricultural research, has account been taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made.

N/A

b. **Nutrition:** Describe extent to which assistance is used in coordination with efforts carried out under FAA Section 104 (Population and Health) to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value; improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration programs explicitly addressing the problem of malnutrition of poor and vulnerable people.

N/A

c. **Food security:** Describe extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the

N/A

poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

21. **Population and Health** (FAA Secs. 104(b) and (c)): If assistance is being made available for population or health activities, describe extent to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems, and other modes of community outreach. — N/A

22. **Education and Human Resources Development** (FAA Sec. 105): If assistance is being made available for education, public administration, or human resource development, describe (a) extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, and strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education and training of people of developing countries in such disciplines as are required for planning and implementation of public and private development activities. — N/A

23. **Energy, Private Voluntary Organizations, and Selected Development Activities** (FAA Sec. 106): If assistance is being made available for energy, private voluntary organizations, and selected development problems, describe extent to which activity is: — N/A

a. concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and facilitative of

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research on and development and use of small-scale, decentralized, renewable energy sources for rural areas, emphasizing development of energy resources which are environmentally acceptable and require minimum capital investment;

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

c. research into, and evaluation of, economic development processes and techniques;

d. reconstruction after natural or manmade disaster and programs of disaster preparedness;

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

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

24. **Sahel Development** (FAA Secs. 120-21). If assistance is being made available for the Sahelian region, describe: (a) extent to which there is international coordination in planning and implementation; participation and support by African countries and organizations in determining development priorities; and a long-term, multidonor development plan which calls for equitable burden-sharing with other donors; (b) whether a determination has been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of projects funds (dollars or local currency generated therefrom). **N/A**

ANNEX J: Detailed Cost Estimates Supporting Component Budgets

I. Public Sector Component

Estimates & Assumptions

Positions (Annualized Pay)

Export Promotion Advisor	($88,152)
Trade Policy Consultant	($80,138)
EPPO Systems Analyst	($70,000)
EPZ (Promotion) Advisor	($80,138)

Calculations

88,152 = FS-01 Pay Cap (80,138) + 10% Post Differential
80,138 = Pay Cap (No Diff.)
70,000 = 70,000 (No. Diff.)

Direct Costs	YEAR 1
Transportation (1 RT/LT Advisor (U.S.) + 1 RT/3 mos of ST Advisor (U.S.) = (1+4) x $3000/RT)	= $15,000
Housing (LT Advisors @ 15,000/yr/person)= 1 x $15,000	= 15,000
Education ($7000/yr x 1 LT Advisors x 1.5 children/LT Advisor	= 10,500
Per Diem ($100 day x 12 mos x 30 days)	= 36,000
Transport (HHE/POV/UAB - 1LT Advisor x 10,000)	= 10,000
Other (Health/Life/Shots/etc) 1LT x $2500	= 2,500
	$89,000

EPPO Seminars/Workshops (Kenya)

1-Day Seminar

. 15 attendees x $10 (lunch/tea)	= $ 150
. Room Rental	= 150
. Speaker	= 150
. Materials	= 225
	$ 675
	x 10
	$ 6,750

EPPO Short-Term Training (USA)

60-Day (Average) Training

. RT Ticket	= $ 3,000
. USA Travel	= 500
. Per Diem (60 days x 100)	= 6,000
. Tuition	= 2,000
. Direct Costs	500
	$12,000
	x 10
	$120,000

EPZ Seminars/Workshops (Kenya)

1-Day Seminars (Same as EPPO seminars)	= $ 675
	x 10
	$ 6,750

Inflation

Inflation Adjustment (5%/compounded yearly)

Yr 1	Yr 2	Yr 3	Yr 4	Yr 5	Yr 6	Yr 7
0	.05	.1025	.1576	.2155	.2763	.3401

II. Firm Level Assistance Component

Position (Annualized Pay)

Export Dev. Advisor (Mgr)	($88,152)
Export Dev. Advisor (Dpty)	($88,152)
Kenyan PEMU Office Manager	($25,000)
Kenyan PEMU Office Assistant	($15,000)
ST Technical Assistance (USA)	($80,138)

Calculations	YEAR 1
Transportation (1 RT/LT Advisor (U.S) + 1 RT/3 mos ST Advisor (U.S.) (2 + 2) x $3,000/RT	= $12,000
Housing (LT Advisors @ 15,000/yr)= 2 x $15,000	= 30,000
Education ($7000/yr x 2 LT Advisors x 1.5 children/LT Advisors	= 21,000
Per Diem ($100/day x 6 mos x 30 days)	= 18,000
Transport (HHE/POV/UAB - 2LT Advisors x $10,000)	= 20,000
Other (Ins/shots/etc.) 2LT x 2,500/yr	= 5,000
	$106,000

PEMU Office Costs

Office Rent (2000/mo x 12)	= $20,000
Office Supplies (300/mo x 12)	= 3,600
Photocopying (200/mo x 12)	= 2,400
Telecommunications (417/mo x 12)	= 5,000
Database Rental (5000/yr)	= 5,000
Subscriptions (2000/yr)	= 2,000
Office Help (1667/mo x 12)	= 20,000
	$58,000

INSTITUTIONAL GRANTS	TOTAL COST
Commodities for KAM, HCDA & FPEAK	
a) Three 386/25MH/100MG computers with modems, internal cards and laser printer (@ $12,250 each)	= $36,750
b) Computer Software Programs (@ $3,000 each)	= 9,000
c) Fax machines and other equipment	= 7,250
	$53,000
Information and Foreign Data Base Access	
a) On-line access to foreign data base libraries @ $7,000 per year	= $49,000
b) Subscriptions to Export Publications at $3,000 per year	= 21,000
	$70,000
Export Seminars	
a) Per Diem costs for 5 years with 3 courses per year x 20 participants x $50/ participant x 2 day seminar	= $30,000
b) Rental of Course Facilities with 15 courses x 2 days/course x $100/day	= 3,000
c) Course material for 15 courses @ $100 per participant x 20 participants	= 30,000
d) Other training costs for 15 courses x $800/course	= 12,000
	$75,000
Trade Fairs	
a) Air fares @ $2,500 per person per RT x 3 persons x 3 trips x 5 years	=$112,500
b) Per Diem and allowances @ $150 per day x 7 days x 3 trips x 3 persons x 5 years	= 47,250
c) Excess Baggage and sample transport @ $2,000 per trip x 3 trips x 5 years	= 30,000
d) Equipment Rental, Promotional Material Trade Fair registration and communication costs $683 per fair x 3 fairs x 5 years	= 10,250
	$200,000
Institutional Development Support Costs	
a) Export Development Admin Asst with each organization @ $12,000 per year	= $36,000
b) Corporate Promotional material for each organization @ $3,000/set	= 9,000
	$45,000

III. Swap Facility

Position (Annualized Pay)

Swap Facility Advisor	($80,138)

Direct Costs

		YEAR 1
Transportation (2 RT @ 3000)	=	$6,000
Per Diem ($100/day x 6 mos x 30 days)	=	18,000
Other (miscellaneous)	=	1,000
		$25,000

IV. Studies Component

Position (Annualized Pay)

TA for Studies	($70,000)

Direct Costs

		YEAR 1
Transportation (1 RT every 2-3 mos ST Advisor)= 2 mos/2 x $3,000 RT	=	3,000
Per Diem (100/day x 11 mos x 30 days)	=	6,000
Other Direct Costs	=	1,000
		$10,000

2.5 day Seminar (Kenya)

Per Diem (100/day x 20 attendees x 2.5)	=	$5,000
Room Rental	=	375
Total		5,375
		x 10
		$53,750

Materials/Publication/Dissemination

• 10 Studies @$1000/ea	=	10,000
• Dissemination (250 copies x $10)	=	2,500
• Summary Publication (250 x $5)	=	1,250
Total	=	13,750

V. Evaluation/Audits

POSITION (ANNUALIZED PAY)

TA for Evaluation/Audits	($80,138)
Evaluations	**TOTAL COST**
YR 3(4 people x 3 wks)= ($80,138/12 x 3 mos)	= 20,035
YR 6(4 people x 3 wks)= "	= 20,035
Audit	
YR 4 (2 people x 4 wks) = ($80,138/12) X 2 mos	= $13,356
YR 6 (3 people x 4 wks) = " x 3 mos	= 20,035
	$33,391
Evaluation/Audits	
Transportation (13 people RT @3000)	= $39,000
Per Diem ($100/day x 11 mos x 30 days)	= 33,000
Other Direct Costs	= 24,104
Report Costs	= 5,500
	$101,604

VI. Mission Support

US PSC	**YEAR 1**
Salary & Differencial	= $80,000
Housing	= 14,000
Furniture	= 10,000
Transportation (one-way) $1750 x 4 people	= 7,000
R&R (RT $2000 x 4 people)	= 8,000
HHE,UAB, POV	= 11,000
Education (2 children x $7,000/yr)	= 11,500
Other Direct Costs	= 2,000
	$143,500
FSN PSC	
Salary	= $15,000
Benefits	= 20,000
	$35,000
PASA (Program Administration Advisor)	**YEAR 1**
Salary	= $53,578
Other PASA Costs	= 69,893

PUBLIC SECTOR COMPONENT:

ANNEX K: DETAILED BUDGETS

POSITION	Year 1		Year 2		Year 3		Year 4		Year 5		Year 6		Year 7		TOTAL	
	PM	$	PM	$	PM	$	PM	$	PM	$	PM	$	PM	$	PM	$
Export Promotion Advisor	12	88,152	12	88,152	12	88,152	12	88,152	6	44,076					54	396,684
Trade Policy Consultant	6	40,069	3	20,035	3	20,035	3	20,035	3	20,035					18	120,209
EPPO System Analyst	3	17,500	1	5,833											4	23,333
EPZ Promotion Advisor	3	20,035	3	20,035	3	20,035									9	60,105
Subtotal	24	165,756	19	134,055	18	128,222	15	108,187	9	64,111					65	600,331
O/H (100% Direct Labor)		165,756		134,055		128,222		108,187		64,111						600,331
DIRECT COSTS																
Transportation		15,000		12,000		9,000		6,000		6,000						48,000
Housing		15,000		15,000		15,000		15,000		15,000						75,000
Education		10,500		10,500		10,500		10,500		10,500						52,500
Per Diem		36,000		21,000		18,000		9,000		9,000						93,000
Transport		10,000		10,000		10,000		10,000		10,000						50,000
Other		2,500		2,500		2,500		2,500		2,500						12,500
Subtotal		89,000		71,000		65,000		53,000		53,000						331,000
G&A (20%)		84,102		67,822		64,289		53,875		36,244						306,332
OTHER DIRECT COSTS																
EPPO 1 Day Seminars (Kenya)		2,700		2,700		675		675								6,750
EPPO 60 Day ST Training (US)		24,000		48,000		24,000		24,000								120,000
EPZ 1 Day Seminars (Kenya)		2,700		2,700		675		675								6,750
EPPO Commodities:																
- 3 Computers/2 Printers		15,000		25,000												40,000
- Software		2,500		5,000												7,500
- 1 Fax, 1 Photocopier, 1 Binding Machine		10,000														10,000
- On-line Database Access				2,000		2,000		2,000		2,000		2,000		2,000		12,000
- Subscriptions		500		1,000		1,000		1,000		1,000		1,000		1,000		6,500
EPZA Commodities:																
- 1 Computer/Printer		10,000														10,000
- Software		3,000														3,000
- 1 Fax, 1 Photocopier, 1 Binding Machine				10,000												10,000
- On-line Database Access				2,000		2,000		2,000		2,000		2,000		2,000		12,000
- Subscriptions		500		500		500		500		500		500		500		3,500
Subtotal		70,900		98,900		30,850		30,850		5,500		5,500		5,500		248,000
SUBTOTAL		575,514		505,832		416,583		354,099		222,966		5,500		5,500		2,085,944
Inflation (5%/year)				25,292		42,700		55,806		48,049		1,520		1,871		175,237
Contingency (7.5%)		43,164		39,834		34,446		30,743		20,326		526		553		169,592
SUBTOTAL		618,678		570,958		493,729		440,648		291,342		7,546		7,923		2,430,824
Fee (5%)		30,934		28,548		24,686		22,032		14,567		377		396		121,541
GRAND TOTAL		649,612		599,506		518,415		462,680		305,909		7,923		8,320		2,552,365

FIRM LEVEL ASSISTANCE:

POSITION	Year 1 PM	Year 1 $	Year 2 PM	Year 2 $	Year 3 PM	Year 3 $	Year 4 PM	Year 4 $	Year 5 PM	Year 5 $	Year 6 PM	Year 6 $	Year 7 PM	Year 7 $	TOTAL PM	TOTAL $
Export Development Advisor	12	88,152	12	88,152	12	88,152	12	88,152	12	88,152	12	88,152			72	528,912
Deputy EDA	12	88,152	12	88,152	12	88,152									36	264,456
Kenyan PEMU Support Manager	6	12,500	12	25,000	12	25,000	12	25,000	12	25,000	12	25,000	6	12,500	72	150,000
Kenyan PEMU Support Asst.	9	11,250	12	15,000	12	15,000	12	15,000	12	15,000	12	15,000	6	7,500	75	93,750
ST Technical Assistance	6	40,069	6	40,069	6	40,069	6	40,069	6	40,069	3	20,035			33	220,380
Subtotal	45	240,123	54	256,373	54	256,373	42	168,221	42	168,221	39	148,187	12	20,000	288	1,257,498
O/H (100% Direct Labor)		240,123		256,373		256,373		168,221		168,221		148,187		20,000		1,257,498
DIRECT COSTS																
Transportation		12,000		12,000		12,000		9,000		9,000		6,000				60,000
Housing		30,000		30,000		30,000										90,000
Education		21,000		21,000		21,000		10,500		10,500		10,500				94,500
Per Diem		18,000		18,000		18,000		18,000		18,000		9,000				99,000
Transport		20,000		20,000		20,000		10,000		10,000		10,000				90,000
Other		5,000		5,000		5,000		5,000		5,000		5,000				30,000
Subtotal		106,000		106,000		106,000		52,500		52,500		40,500				463,500
G&A (20%)		117,249		123,749		123,749		77,788		77,788		67,375		8,000		595,699
OTHER COSTS																
Export Development Fund		100,000		100,000		100,000		100,000		100,000						500,000
IESC Fund		75,000		75,000		50,000		25,000		25,000						250,000
PEMU Office Costs																
- Office Rent		20,000		20,000		20,000		20,000		20,000		20,000		10,000		130,000
- Office Supplies		3,600		3,600		3,600		3,600		3,600		3,600		2,400		24,000
- Photocopying		2,400		2,400		2,400		2,400		2,400		2,400		1,200		15,600
- Telecommunications		5,000		5,000		5,000		5,000		5,000		5,000		5,000		35,000
- Database Rental		5,000		5,000		5,000		5,000		5,000		5 000		5,000		35,000
- Subscriptions		2,000		2,000		2,000		2,000		2,000		2,000		1,000		13,000
- Office Help		20,000		20,000		20,000		20,000		20,000		20,000		10,000		130,000
PEMU Commodities																
- Computer/Printer		12,500														12,500
- Software		3,000														3,000
- 1 Fax, 1 Photocopier, 1 Binding Machine		10,000														10,000
- Office Furnishings		7,500		7,500												15,000
Institutional Grants																
- 3 Computers, software,		53,000														53,000
- Database, Subscriptions		10,000		10,000		10,000		10,000		10,000		10,000		10,000		70,000
- Export Seminars		7,500		15,000		15,000		15,000		15,000		7,500				75,000
- Trade Fairs		20,000		40,000		40,000		40,000		40,000		20,000				200,000
- Development Support		9,000		9,000		9,000		9,000		9,000						45,000
- EDF Reflows		(50,000)		(50,000)		(50,000)		(50,000)		(50,000)						(250,000)
Subtotal (Other Costs)		365,500		264,500		232,000		207,000		207,000		95,500		44,600		1,416,100
SUBTOTAL		1,068,995		1,006,995		974,495		673,730		673,730		499,749		92,600		4,990,295
Inflation (5%/year)				50,350		99,896		106,180		145,189		138,081		31,493		571,178
Contingency (7.5%)		60,175		79,301		80,579		58,493		61,419		47,837		9,307		417,111
SUBTOTAL		1,149,170		1,136,646		1,154,960		838,404		880,338		685,667		133,400		5,978,584
Fee (5%)		57,458		56,832		57,748		41,920		44,017		34,283		6,670		298,929
GRAND TOTAL		1,206,628		1,193,478		1,212,708		880,324		924,355		719,950		140,070		6,277,513

SWAP FACILITY:

POSITION	Year 1 PM	Year 1 $	Year 2 PM	Year 2 $	Year 3 PM	Year 3 $	Year 4 PM	Year 4 $	Year 5 PM	Year 5 $	Year 6 PM	Year 6 $	Year 7 PM	Year 7 $	TOTAL PM	TOTAL $
SWAP Facility Advisor	6	40,069	4	26,713	3	20,035										86,817
O/H (100% Direct Labor)		40,069		26,713		20,035										86,817
DIRECT COSTS																
Transportation		6,000		6,000		3,000		3,000								18,000
Per Diem		18,000		12,000		9,000										39,000
Other		1,000		1,000		1,000		1,000								4,000
Subtotal		25,000		19,000		13,000		4,000								61,000
G&A (20%)		21,028		14,485		10,614		800								46,927
Subtotal		126,166		86,911		63,684		4,800								281,561
Inflation (5%/year)				4,346		6,528		756								11,630
Contingency (7.5%)		9,462		6,844		5,266		417								21,939
SUBTOTAL		135,628		98,101		75,477		5,973								315,180
Fee (5%)		6,781		4,905		3,774		299								15,759
TOTAL		142,409		103,006		79,251		6,272								330,939
SWAP Fund		1,000,000		1,250,000		1,750,000										4,000,000
GRAND TOTAL		1,142,409		1,353,006		1,829,251		6,272								4,330,939

STUDIES:

POSITION	Year 1 PM	Year 1 $	Year 2 PM	Year 2 $	Year 3 PM	Year 3 $	Year 4 PM	Year 4 $	Year 5 PM	Year 5 $	Year 6 PM	Year 6 $	Year 7 PM	Year 7 $	TOTAL PM	TOTAL $
Consultants	2	8,750	5	26,250	3	17,500	3	17,500	2	8,750					15	78,750
O/H (100% Direct Labor)		8,750		26,250		17,500		17,500		8,750						78,750
<u>DIRECT COSTS</u>																
Transportation		3,000		6,000		3,000		3,000		3,000						16,000
Per Diem		6,000		15,000		9,000		9,000		6,000						45,000
Other		1,000		2,000		2,000		1,000		1,000						7,000
2.5 Day Seminars		5,375		10,750		16,125		10,750		5,375		5,375				53,750
Materials/Publication		1,375		4,125		2,750		2,750		1,375		1,375				13,750
Subtotal		16,750		37,875		32,875		26,500		16,750		6,750				137,500
G&A (20%)		6,850		18,075		13,575		12,300		6,850		1,350				59,000
Subtotal		41,100		108,450		81,450		73,800		41,100		8,100				354,000
Inflation (5%/year)				5,423		8,349		11,631		8,857		2,238				36,497
Contingency (7.5%)		3,083		8,540		6,735		6,407		3,747		775				29,287
SUBTOTAL		44,183		122,413		96,534		91,838		53,704		11,113				419,784
Fee (5%)		2,209		6,121		4,827		4,592		2,685		556				20,989
GRAND TOTAL		46,392		128,534		101,360		96,430		56,389		11,669				440,774

EVALUATION AND AUDIT:

POSITION	Year 1 PM	Year 1 $	Year 2 PM	Year 2 $	Year 3 PM	Year 3 $	Year 4 PM	Year 4 $	Year 5 PM	Year 5 $	Year 6 PM	Year 6 $	Year 7 PM	Year 7 $	TOTAL PM	TOTAL $
Evaluation					3	20,035					3	20,035			6	40,070
Audit							2	13,356			3	20,035			5	33,391
Subtotal					3	20,035	2	13,356			6	40,070			11	73,461
O/H (100% Direct Labor)						20,035		13,356				40,070				73,461
DIRECT COSTS																
Transportation						15,000		6,000				18,000				39,000
Per Diem						9,000		6,000				18,000				33,000
Other						5,000		5,000				14,104				24,104
Report Costs						1,500		1,500				2,500				5,500
Subtotal						30,500		18,500				52,604				101,604
G&A (20%)						14,114		9,042				26,549				49,705
Subtotal						84,684		54,254				159,293				298,231
Inflation (5%/year)						8,680		8,550				44,013				61,243
Contingency (7.5%)						7,002		4,710				15,248				26,961
SUBTOTAL						100,366		67,515				218,553				386,435
Fee (5%)						5,018		3,376				10,928				19,322
GRAND TOTAL						105,385		70,891				229,481				405,757

MISSION PROJECT SUPPORT:

POSITION	Year 1 PM	Year 1 $	Year 2 PM	Year 2 $	Year 3 PM	Year 3 $	Year 4 PM	Year 4 $	Year 5 PM	Year 5 $	Year 6 PM	Year 6 $	Year 7 PM	Year 7 $	TOTAL PM	TOTAL $
US PSC																
- Salary & Differential	12	80,000	12	80,000	12	80,000	12	80,000							48	320,000
- Housing		14,000		14,000		14,000		14,000								56,000
- Furniture		10,000				10,000										20,000
- Transportation		7,000				7,000										14,000
- R&R		8,000				8,000										16,000
- Home Leave				8,500				8,500								17,000
- HHE, UAB, POV		11,000				11,000										22,000
- Education		11,500		11,500		11,500		11,500								46,000
- Other Direct Costs		2,000		2,000		2,000		2,000								8,000
Subtotal	12	143,500	12	116,000	12	143,500	12	116,000							48	519,000
Inflation (5%/year)				5,800		14,709		18,282								38,790
Contingency (7.5%)		10,763		9,135		11,866		10,071								41,834
TOTAL (US PSC)	12	154,263	12	130,935	12	170,074	12	144,353							48	599,625
FSN PSC																
- Salary	12	15,000	12	15,000	12	15,000	12	15,000	6	12,500	6	12,500	6	12,500	66	97,500
- Fringe		2,700		2,700		2,700		2,700		1,350		1,350		1,350		14,850
- Education		1,000		1,000		1,000		1,000		500		500		500		5,500
- Transportation		500		500		500		500		250		250		250		2,750
- Meals		400		400		400		400		200		200		200		2,200
- Vacation Travel		100		100		100		100		50		50		50		550
- Housing		4,500		4,500		4,500		4,500		2,500		2,500		2,500		25,500
- MSSF		50		50		50		50		25		25		25		275
- Overtime		1,500		1,500		1,500		1,500		750		750		750		8,250
- Life/Disability		300		300		300		300		150		150		150		1,650
- Medical		250		250		250		250		125		125		125		1,375
- Pension		1,600		1,600		1,600		1,600		800		800		800		8,800
- Office Space		1,300		1,300		1,300		1,300		650		650		650		7,150
- International Travel		5,800		5,800		5,800		5,800		2,900		2,900		2,900		31,900
Subtotal	12	35,000	12	35,000	12	35,000	12	35,000	6	22,750	6	22,750	6	22,750	66	208,250
Inflation (5%/year)				1,750		3,588		5,516		4,903		6,286		7,737		29,779
Contingency (7.5%)		2,625		2,756		2,894		3,039		2,074		2,178		2,287		17,852
TOTAL (FSN PSC)	12	37,625	12	39,506	12	41,482	12	43,555	6	29,727	6	31,214	6	32,774	66	255,881
PASA ADVISOR																
- Salary			12	55,578											12	55,578
- Benefits				8,767												8,767
- Travel				8,742												8,742
- Per Diem				4,645												4,645
- Transportation				5,500												5,500
- Other				5,525												5,525
- O/H				22,314												22,314
- AID Support				14,400												14,400
TOTAL (PASA)			12	123,471											12	123,471
GRAND TOTAL	24	191,888	36	293,912	24	211,556	24	187,907	6	29,727	6	31,214	6	32,774	126	978,977

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OFFICIAL FILE

Project 615-0238 0249

REPUBLIC OF KENYA

OFFICE OF THE VICE-PRESIDENT AND MINISTRY OF FINANCE

Telegraphic Address: 22921
FINANCE-NAIROBI
FAX No. 330426
Telephone: Nairobi 338111
When replying please quote

14 JUN 1991

THE TREASURY
P.O. Box 30007
NAIROBI
KENYA

Ref. No. and date EA/FA 9/03

6th June 19 91

Mr. John R. Westley
Director
USAID/Kenya
P.O. Box 30261
NAIROBI.

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

DATE REC'D 6-14
REPLY DUE 6-24
ACTION OFFICE PEO

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91/6148

Dear John,

RE. REQUEST FOR ASSISTANCE TO KENYA'S EXPORT PROMOTION ACTIVITIES

You are aware the Government of Kenya is fully committed to export promotion policies and incentives as announced in the 1990 Budget speech whose theme was, "Economic Growth through Export Promotion". Following the Speech, the Government has implemented several policies including the establishment of the Export Promotion Programmes Office (EPPO) in the Treasury and the enactment of the Export processing Zones (EPZ) Bill through which the Export Processing Zones Authority (EPZA) has been established and its Chief Executive named.

The Government has realized that the import-substitution policies, which have been implemented since Independence, have outlived their usefulness and have resulted in an anti-export bias over the years. As the Kenyan manufacturing sector has expanded, job creation in the sector has been minimal and the sector has become a net user of scarce foreign exchange earned by traditional exports of coffee, tea, petroleum products and tourism. The Government has therefore decided to diversify the export sector in order to increase job opportunities in the private sector and to earn more foreign exchange from non-traditional exports. The Government hopes to achieve these goals through a fully liberalized enclave approach, Export Processing Zones (EPZs), and through gradual liberalization of the general economy. The Government considers assistance to both the public and private sectors as critical to the success of the export-led growth strategy.

For the public sector, assistance to the EPZA and to the EPPO is required to ensure effective implementation of the programmes. Assistance to the Central Bank of Kenya and to local commercial banks will be required to implement an EPZ Swap Fund to assist domestic investors to operate in the EPZs. Also assistance to the Horticultural Crops Development Authority (HCDA) will be necessary in order to make the Authority more effective in delivering services to horticultural exporters. Finally, special studies will be required to address trade policies, export incentives, implementation constraints and other export related issues which will facilitate dialogue between the public and private sectors.

As regards the private sector, assistance to Kenyan Private sector firms and associations will be required in order to assist these firms in responding to the Government's export promotion policies. The Government believes the Kenyan manufacturing sector must respond to the liberalized environment in order to compete effectively in world markets.

Given USAID's long involvement in the Kenyan public and private sectors, we hereby request technical and financial assistance for the implementation of the above policies. We trust your assistance for the Kenyan export sector will meet your Mission's sub-goal of increasing production, employment, incomes and foreign exchange earning.

We look forward to continuing our longstanding co-operation in our economic development task.

Yours Sincerely

C. S. MBINDYO
PERMANENT SECRETARY/TREASURY