KENYA: Correspondence & Memos 1985-1986

BOX 135 FILE 4

ETRAI ETR FILES

#48929

Office Memorandum

Mr. Ouattara
→ Mr. Finch
p. 25, 29, 32, 35, 36
37

TO: The Managing Director
The Deputy Managing Director

October 23, 1986
Nov. 3, 1986

FROM: A.D. Ouattara

SUBJECT: Kenya--Staff Report for the 1986 Article IV Consultation

Attached for your clearance is the staff report for the 1986 Article IV consultation discussions with Kenya.

Sent

It has been cleared by:

Mr. Bhatia	(AFR)
Mr. Kanesa-Thasan	(ETR)
Mr. Mahler	(FAD)
Mr. Gupta	(TRE)
Mr. Ogoola	(LEG)

Attachment

cc: Mr. Brown

cc: Ms Kirmani

1986 OCT 24 AM 9:02
OFFICE OF THE
DEPUTY MANAGING DIRECTOR

tightening credit policy in the near future through more selective instruments aimed at the highly liquid banks. Confidence in the financial system could only be restored by the stricter application of the banking law.

The Kenyan representatives pointed out that a high level committee, chaired by the Minister of Finance, had been formed to study the possible solutions to the problem of insolvent financial institutions and their impact on the economy. As part of the Government's commitment to protect the small depositors, it has already established a deposit insurance scheme. Beginning in September, withdrawals of up to K Sh 50,000 were authorized to be made by small depositors of a financial institution which closed its doors at the end of 1984. Additional amounts are likely to be released in the near future. The Kenyan representatives observed that the return of confidence could be promoted by mergers or other means that would improve the management and liquidity of weak institutions.

In light of our experience in other countries, would we be in a position to provide them some help

The Kenyan representatives pointed out that many of the difficulties being faced by the financial system had been predicted some years ago, and had led to the amendment of the Banking Act in December 1985. Most of the measures approved at that time were directed at improving the liquidity of institutions, strengthening their capital base, and minimizing questionable practices. The measures were being implemented in stages, with the result that the crisis had overtaken this implementation.

So far the Central Bank had followed a cautious policy by minimizing the direct support granted to the ailing institutions.

Table 5. Kenya: Medium-Term Balance of Payments Projections, 1984-1991

	1984	1985	1986 Est.	1987	1988	1989	1990	1991
				Projections				
			(In millions of SDRs)					
Current account	-199	-222	-152	-128	-296	-213	-206	-229
Exports, f.o.b.	1,008	928	1,030	1,019	979	1,059	1,149	1,248
Coffee	276	277	445	406	312	335	359	384
Tea	257	230	175	185	199	215	231	249
Oil products	137	96	53	54	57	61	66	71
Other	340	326	358	374	410	449	494	544
Imports, c.i.f. 1/	-1,514	-1,481	-1,484	-1,465	-1,632	-1,651	-1,778	-1,936
Government	-169	-136	-148	-177	-228	-119	-109	-117
Food	-83	-64	-7	-7	-8	-8	-9	-9
Other	-86	-72	-141	-170	-220	-111	-100	-107
Oil	-450	-452	-251	-258	-278	-299	-322	-347
Other	-895	-893	-1,085	-1,029	-1,126	-1,232	-1,347	-1,472
Trade balance	-506	-553	-454	-446	-653	-591	-629	-688
Services (net)	163	185	168	177	209	224	259	287
Private transfers	4	8	8	9	9	10	11	11
Official transfers	140	139	126	132	138	145	153	160
Capital account	243	129	296	268	252	176	177	188
Long-term (net)	199	97	276	248	232	156	157	168
Official 2/	81	-24	153	122	104	25	24	32
Private	118	121	123	126	128	131	133	136
Short-term (net)	44 3/	32 3/	20	20	20	20	20	20
Overall balance	45	-92	144	139	-44	-37	-29	-41
Financing	-45	92	-144	-139	44	37	29	41
Gross reserves	-37	36	-54	-55	81	-4	-27	-45
IMF credit (net)	-11	55	-90	-84	-67	-98	-76	-19
Other assets (net)	3	1	--	--	--	--	--	--
To be secured	--	--	--	--	30	139	132	105
Memorandum items:								
Gross reserves (end of period)	416	380	434	489	408	412	439	484
Gross reserves (in months of imports) 4/	3.3	3.1	3.5	4.0	3.0	3.0	3.0	3.0
			(In percent of GDP)					
Current account deficit								
Including official grants 5/	3.5	3.9	2.6	2.0	4.2	2.7	2.4	2.4
Excluding official grants 5/	5.8	6.3	4.8	4.1	6.2	4.6	4.2	4.1
Official net capital inflow plus official grants 6/	3.8	2.0	4.9	4.0	3.4	2.2	2.0	2.0

Sources: Data provided by the Kenyan authorities; and staff estimates.
Note: Components may not add up to totals because of rounding.

1/ Includes special imports of SDR 187 million, SDR 89 million, SDR 133 million, and SDR 18 million, respectively, in 1986, 1987, 1988, and 1989, comprising military and civilian aircraft, naval boats and radars, and imports related to the Turkwell hydro-electricity project.

2/ Includes loans to finance special imports (described in footnote 1) and an IDA loan totaling SDR 191 million, SDR 145 million, SDR 133 million, and SDR 36 million, respectively, in 1986, 1987, 1988, and 1989. Excluding these special inflows, long-term official capital inflows are assumed to increase by at least 5 percent per annum during 1987-91 based on the average 1985-86 flows. The projections also assume that official net capital inflows plus official grants will not fall below 2 percent of GDP.

3/ Includes errors and omissions and valuation adjustments.

4/ Excluding the special imports described in footnote 1, reserves would be the equivalent of 4, 4.3, and 3.3 months of 1986, 1987, and 1988 imports, respectively. The medium-term projections are predicated on the maintenance of a minimum reserve level equivalent to 3 months' imports.

5/ Excluding the special imports described in footnote 1, the current account (including official grants) in relation to GDP would be in surplus of 0.6 percent in 1986, and would be in deficit of 0.6 percent in 1987, 2.3 percent in 1988, and 2.5 percent in 1989. Excluding official grants the corresponding amounts would be current account deficits of 1.6 percent, 2.7 percent, and 4.3 percent of GDP in 1986, 1987, and 1988, respectively.

6/ Excluding the loans to finance special imports indicated in footnote 2, the ratios would be 1.5 percent and 1.7 percent in 1986 and 1987, respectively, and 1.5 percent and 1.7 percent in 1988 and 1989, respectively.

Building a medium term scenario on the basis of a minimum reserve level would seem to be risky. See comment on p. 29

Shouldn't the medium term projection be based on a target that would provide Kenya with sufficient reserves to handle some of the contingencies which could be negative?

gap will emerge as a result of large scheduled net repayments to the Fund and the need to accumulate additional foreign assets in these years in order to maintain adequate reserves; the projections are based on a minimum reserve level equivalent to three months of imports. However, it had previously been projected that current account earnings would rise by an average of 7 percent per year and that Kenya would be able to attract, as a minimum, official net capital and grants of about 3 percent of GDP. On the basis of most recent developments, the rate of growth of current account earnings is now estimated at 5 percent per year while foreign assistance (official net capital inflows plus official grants) is projected at about 2.0 percent of GDP. The staff estimate of capital inflows may be considered conservative, and it is probable that amounts greater than those anticipated will be secured through the normal annual or biannual lending programs from main donors. A combination of increase of assistance, the strengthening of the export performance and a lower reserve target would reduce the projected financing gap and enable Kenya to continue to make its repurchases to the Fund on schedule.

but the reserve level is already viewed as a minimum on p.29

The most recent projections, however, are sensitive to the assumptions made with regard to the trend of coffee prices, oil prices, and the level of net official capital inflows and grants. A change in coffee prices of plus or minus 5 percent from the levels presently estimated would affect the current account balance by between SDR 19 million and SDR 29 million a year in the period 1988-91, and affect the debt service ratio by about 0.6 percent of GDP on average (Table 7). Each dollar change per barrel in oil prices from the levels presently assumed would affect the current account by about SDR 15 million and SDR 23 million in the period 1988-91. Similarly, if net official capital inflows plus grants were to be maintained at a level of at least 2.5 percent of GDP, there would be a substantial reduction in the overall balance and in the financing gap, but there would hardly be any change in the debt service ratio. These factors underline the sensitivity nature of the present projections and the need for the Kenyan authorities to maintain a cautious financial policy stance while moving strongly to eliminate the bottlenecks for export growth. The need for a cautious borrowing policy and a strong reserve position is also underscored.

IV. Staff Appraisal

The judicious stabilization effort carried out by Kenya in the period 1981-85 was extremely helpful in allowing the country to weather the massive drought which affected the country in 1984 and part of 1985. Kenya successfully confronted the difficulties brought about by the disastrous climatic conditions without incurring a major financial deterioration. Although the support of the donors was crucial in this regard, a substantial proportion of the relief effort was financed by Kenya's own resources. The improved weather conditions which followed the drought led to a bumper grain harvest in crop years 1985 and 1986, substantially reversing the negative impact of the drought on the agricultural sector, and providing the basis for a recovery in the growth rate of the economy. Kenya's short term outlook was further improved by a major improvement in its terms of trade in 1986, which resulted from a large increase in coffee export prices and a major decline in petroleum import prices. These factors are providing the incentives in the agricultural sector, but this action should only be done in the context of compensatory measures to minimize the expansionary effect of these expenditures on the economy. The Government has indicated that it would attempt to effect larger exports of maize, which, if successful, would reduce the necessary financing for maize. The stocks available at end-1985/86 are clearly above their requirements. The review of the budget should be expedited to determine measures which could supplement the actions on maize and limit the overall budgetary deficit to 4 percent of GDP. Moreover, in view of the reduced level of net foreign financing projected for the fiscal year, such a level will still require a high level of domestic financing. Something is missing Consequently, there is also a need for a tighter credit policy for the private sector, if total domestic credit is to be kept at a level consistent with preserving as external reserves an important proportion of the external windfall, and consolidate the progress made in reducing inflationary pressures. The staff notes that credit to public enterprises was substantially limited in fiscal year 1985/86, and understands that credit to public enterprises is not likely to be a problem in 1986/87.

The restoration of confidence in the financial system should be a high priority of the authorities. The large amount of liquidity being accumulated in certain financial institutions should not be allowed to be turned into additional credit, as it would aggravate the already high growth of credit. Rather the authorities should aim at freezing some of this liquidity, while attempting a consolidation of the financial system aimed at reforming and strengthening the ailing institutions. Given the

what does freeze mean?

excess liquidity with the banking system and simultaneously the large potential credit demand, it would not be prudent to alter the level of interest rates at this time, even though they are positive in real terms by a wide margin, rather a greater degree of market orientation in the determination of interest rates should be encouraged.

Kenya's medium-term balance of payments position remains difficult, requiring increased efforts by the authorities both to expand exports and to attract needed capital inflows. Small changes in many of the assumptions utilized in constructing the medium-term balance of payments outlook can lead to substantial shifts in the overall balance. This dictates continued prudence in financial policies and the need to frequently review external developments in order to ascertain that the policy course is on track.

The potential weaknesses of the external sector in the medium term and the need to improve the growth performance, not withstanding the successful implementation of a stabilization program, are a clear indication that the authorities should redouble their efforts to remove structural bottlenecks in the economy, especially in the export sector, where over the last few years diversification has not materialized. The difficulties in expanding export volume has been an important constraint on the economy, and, unless this constraint is removed, the growth prospects would not improve significantly.

Increased care must be taken to limit Kenya's external borrowing. On the presently projected increase in current account earnings, the debt service ratio will decline only after several years.

Also need to maintain a strong reserve target -

The Sessional Paper approved by Parliament in 1986 provides a proper medium-term framework on which to launch a renewed development effort. Major donors voiced their support for such a program at the 1986 Consultative Group meeting. However, there is a need to develop specific policies and to establish a time frame for their implementation.

Continued emphasis in raising agricultural productivity, maintaining adequate producer incentives, while allowing for greater market influence should be encouraged. The restructuring of the industrial sector to make it more outward looking should be accelerated. Increased exports earnings are likely to be facilitated by increasing competition in the industrial sector. In this regard, the staff finds it unfortunate that further progress in reducing the number of items subject to import control was not made in 1986, and encourages the authorities to redouble their effort to continue with the liberalization of the import regime.

The Government has rightly embarked on a program of budget rationalization, which aims at limiting the size of the civil service, increasing maintenance outlays, and emphasizing ongoing projects, together with a more thorough review of new projects to increase productivity. The implementation of this program should be accelerated. Progress in this area will also require a greater effort at public enterprise reform. Improvements in the monitoring and in the financial control of public enterprises have already been put into place, but there have been lags in restructuring and divestiture.

Isn't this paragraph related to the PP on bottom of p.34 and top of page 35

The modifications in the Banking Act recently enacted to strengthen the liquidity and capital base of institutions, unfortunately, were put in effect at a time when the weakening of the financial position of some institutions was already emerging, and were not in place soon enough to avert the difficulties now being faced in Kenya's financial system. The current situation underlines the need to implement these reforms more rapidly. The encouragement of the capital market should be promoted, as this would help fund new industrial investments and facilitate divestiture of public enterprises.

The authorities have maintained a flexible exchange rate policy, and, in 1986, have improved the timeliness of the adjustments. The staff would encourage the authorities to continue to maintain this policy and to keep the exchange rate under review in light of the steps undertaken to further liberalize imports in the future. and the need to strengthen export performance over the medium term?

move to end

The decreasing level of foreign assistance being received by Kenya is of major concern. It is clear that without continued support from major donors the progress being made by the Government in the implementation of its policies could be compromised.

In recent years Kenya has made progress in liberalizing its exchange system. Profit remittances are being made freely, advance import deposits were removed, and the Central Bank now automatically provides foreign exchange for import licenses issued by the Ministry of Commerce, which are now being issued in a more liberal manner. The foreign exchange budget on the basis of which licenses are issued is subject to Fund approval under Article VIII. Kenya also maintains a restriction on the availability of foreign exchange for rental

IMF OFFICIAL MESSAGE
WASHINGTON, D. C. 20431

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TARAWA ATOLL
KIRIBATI

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MR.R.BROWN

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EXECUTIVE BOARD TOOK FOLLOWING DECISION SEPTEMBER 16:
QUOTE THE FUND NOTES WITH SATISFACTION THAT WITH
EFFECT FROM AUGUST 22, 1986, KIRIBATI HAS ACCEPTED THE
OBLIGATIONS OF ARTICLE VIII, SECTIONS 2, 3, AND 4
OF THE ARTICLES OF AGREEMENT. UNQUOTE
VAN HOUTVEN
SECRETARY
INTERFUND

IF REQUIRED INITIAL BELOW

SPECIAL INSTRUCTIONS — TEXT MUST END HERE

A

B PLEASE TRANSMIT TODAY, SEPTEMBER 16, AFTER 12:00 NOON.

C TELEX NO.:

D DRAFTED BY NAME (TYPE): KFRIEDMAN:BJOWEN:PR EXT.: 6701 DEPT.: SEC DATE: 16SEPT1986

E AUTHORIZED BY NAME (TYPE): LEO VAN HOUTVEN AUTHORIZED BY NAME (TYPE):

(**)

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G B. J. Owen

SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

Mr. Beveridge

Office Memorandum

TO: Mr. Jimenez

August 14, 1986

FROM: W. A. Beveridge

SUBJECT: Kenya: Draft PFP

The Board's discussion of the Article IV consultation would be important in providing guidance on the macroeconomic and structural policies which Executive Directors would expect to see in a possible PFP, should the authorities request SAF sources. And, of course, World Bank inputs would be essential in the preparation and negotiation of the PFP. In view of the above, our comments at this initial stage on the draft PFP are meant to help in the preliminary discussions to be undertaken by the forthcoming mission.

The draft PFP is well written and informative, but needs to be significantly strengthened in its discussion of external sector policies, including the exchange rate, external debt, foreign borrowing capacity, and reserve management issues. I would suggest 1 or 2 paragraphs devoted to external sector policies be added to Section II, and these should also be incorporated in the policy matrix table.

Section III on external financing requirements would need to be clarified and strengthened by more details on the expected amounts and sources of financing, especially in the first year of the SAF program. You may well be right that a 40% increase in aid disbursements may be optimistic (page 16); this has implications for the extent of the adjustment effort required under more realistic assumptions of financing, and is also tied to the question of balance of payments need. But even if the optimistic scenario on foreign resource availabilities was realized, constraints on a higher level of utilization of foreign resources may well arise from domestic factors, particularly the level of domestic savings. In this regard it is particularly important that implementation of the tax reform begin early in the SAF period. Specific comments are attached.

Attachment
cc: Mr. Artus
Ms. Kirmani

Kenya: Specific Comments on Draft PFP

Page 1. From the title, delete "for a Loan Under the Structural Adjustment Facility," and add the program period "1987-89." Section I has to be identified and titled e.g. "I. Background."

Page 4. Since the PFP is the document of the authorities, the phrasing of the last (incomplete) sentence is odd.

Page 6. The title of Section III could more appropriately refer to "Macraeconomic and Structural Objectives and Policies, 1987-89."

Before the detailed discussion of sectoral priorities and policies, the overall objectives of the 3-year program should be explicitly spelled out. This is done to some extent in paragraph 6 which should expand upon the objectives for inflation and the current account balance of payments deficit during 1987-89. It should also describe the extent of progress toward balance of payments viability, (e.g. the extent of reduction in reliance on exceptional financing) during the 3-year period, defining "viability" in the context of Kenya.

The objective for the fiscal deficit for 1989/90 would be helpful. Paragraph 7 should describe how the improvement in the fiscal deficit is to be brought about.

Page 7. One or two paragraphs on external sector policies need to be added.

Page 11. The tax reform is an important structural measure and its implementation should begin during the SAF period and preferably at an early stage, rather than at its end, given the need to reverse the poor revenue performance of the Central Government in recent years and to raise the savings necessary for a higher rate of absorption of foreign resources.

Similarly, with respect to current expenditures, a policy objective that is being highlighted pertains to outlays on education and health, with implementation of all policy recommendations to reduce such expenditures to take place by mid-1989. However, there is no indication of what is to be achieved in the interim years. Also, the discussion on the need to curtail the unsustainable growth of the civil service does not provide any view on the appropriate stance for wage policy.

Page 12. At least some of the features of the state corporation bill which is to be enacted by end-1986, should be implemented during the SAF program period, rather than at its end.

Pages 13-14. The write-up on the financial sector reforms should be supplemented with some mention of the timing of implementation.

Page 15. The coffee price assumptions are unclear.

Page 16. The statement about Kenya's borrowing capacity and projected debt service is unclear. Whether the decline in this ratio is primarily due to export growth, bunching of amortization payments, or declining interest rates has a bearing on assessments of current and future borrowing capacity. These issues should be discussed in the context of external policies under Section II. The phrasing on the realism of foreign resource commitments, disbursements, scenarios, contingency plans, etc., is confusing and needs clarification.

Office Memorandum

cc: Mr. Brachet
Mrs. Diller
Mr. Hino

To: Mr. Jimenez

August 14, 1986

From: Basil Zavoico

Subject: Kenya - SAF Policy Framework Paper

The only comment we have in connection with Kenya's policy framework paper circulated on August 11, 1986 is that the case for Kenya experiencing a protracted balance of payments problem is not made very convincingly, particularly in the light of the overall external surpluses projected for both 1986 and 1987.

In the Managing Director's Summing-Up (86/61), it was agreed that "in the assessment of a protracted balance of payments problem, the member's situation will be reviewed against a wide range of indicators, including..., the recent and prospective behavior of the current account, reserves, indebtedness, arrears and growth performance." Although most of the elements of such an analysis are touched upon in the paper, they are nowhere brought together in a coherent and convincing fashion.

In this same connection, it would be desirable to use the current WEO central estimate for oil prices for 1987 (US $12 per barrel), rather then the seemingly arbitrary figure of US$18.50 suggested in the paper (page 15).

Attachment

cc. Mr. Habermeier
Mr. Gianviti
Mr. Tanzi
Mr. Beveridge
Mr. Artus

INTERNATIONAL MONETARY FUND

August 13, 1986

Mr. Beveridge:

Kenya--Policy Framework Paper

Attached are comments on the draft PFP for Kenya which was reviewed by Mr. Weerasinghe.

cc: Ms. Dillon
Mr. Hino
Mr. Johnson
Ms. Kirmani

Christian Brachet CB

August 13, 1986

Kenya--Comments on Draft Policy Framework Paper

It is not clear to what extent this draft policy framework paper has benefitted from World Bank inputs since the draft briefing paper circulated previously (for the Article IV consultation dated August 6, 1986) noted that the World Bank would only be equipped to provide an input toward the PFP in the latter part of 1986. As noted below there are some important issues touching on the external financing assumptions and the investment program that can only be resolved with a World Bank contribution.

1. External resource use

The paper notes that, based on the suggested high level of foreign commitments, actual disbursements in 1986-87 could be about 40 percent higher than in 1984-85 (page 16). It is noted further that if the higher commitments are translated into actual disbursements, prospective financing gaps in 1988-89 should be minimal. However, the staff considers this to be an "optimistic scenario" and believes it necessary to develop a contingency plan in the event of a disbursements shortfall.

It appears that the constraints on a higher level of utilization of foreign resources are related to domestic factors. The PFP hence should be clear on whether the proposed policy package and the timetable for its implementation in the next three years is consistent or not with the "optimistic scenario" for foreign resource utilization. Given that some of the policy measures that would remove the impediments to a larger absorption of foreign resources are to be postponed until 1989 (e.g., implementation of revenue measures--see below) one may wonder whether the formulation of this timetable has given adequate attention to these factors.

2. Fiscal policy

It is noted in paragraph 12 that additional revenue measures will be adopted. The PFP, however, does not indicate what type of measures is being envisaged. Furthermore, the proposed timetable for complete implementation of these measures (to be studied by mid-1987) is mid-1989 (Table ---). One would have expected that revenue raising measures should have been implemented in the early stages of the SAF period given the need to reverse the poor revenue performance of the Central Government in recent years and to raise the savings necessary for a higher rate of absorption of foreign resources.

Similarly, with respect to current expenditures a policy objective that is being highlighted pertains to outlays on education and health, with implementation of all policy recommendations to reduce such expenditures to take place by mid-1989. However, there is no indication of what is to be achieved in the interim years. Also, the discussion on the need to curtail the unsustainable growth of the civil service does not provide any view on the appropriate stance for wage policy.

3. <u>Other</u>

As noted previously in our comments on the Article IV brief, it would be useful for the PFP to provide some indication of the sensitivity of debt service projections to the assumed level of concessionality of the new capital flows incorporated in the BOP projections.

INTERNATIONAL MONETARY FUND

August 13, 1986

Mr. Beveridge:

Kenya--Comments on the SAF Policy Framework Paper

Attached are comments on the SAF policy framework paper for Kenya which was reviewed by me.

cc: Mr. Brachet
Mr. Johnson
Mr. Hino
Ms. Kirmani

David Lipton DL

August 13, 1986

Kenya: Comments on the SAF Policy Framework Paper

The treatment of external finance issues (primarily in Section III on External Financing Requirements) is less comprehensive than other sections of the paper and would benefit from a more complete presentation of policies pertaining to management of the balance of payments, with emphasis on debt and gross reserve management. Furthermore, we note that the attached summary table of adjustment policies does not include a subsection on external sector or external finance policies. As for the text, the coffee price assumption (stated on page 15) is left particularly unclear. Second, the statement about Kenya's borrowing capacity and projected debt service (on page 16) is unclear. Whether the decline in this ratio is primarily due to export growth, bunching of amortization payments, or declining interest rates has a bearing on assessments of current and future borrowing capacity. Third, there should be a discussion of the gross reserve management and exchange rate policies to be followed.

Mr Beveridge

cc: Mr. Blackel
Ms. Dillon
Mr. Hino

Office Memorandum

To: Mr. Jimenez

August 11, 1986

From: Klaus Boese and Basil Zavoico

Subject: Kenya - Briefing Paper

We have the following comments on the paper circulated August 6, 1986 and regret any inconvenience caused by the delay in offering our comments.

1. The data in Tables 1 and 2 do not always correspond to the discussion in the text. For example, you may wish to reexamine on page 5 the earlier estimate of the fiscal deficit in relation to GDP for 1985/86 (4.1 percent in the text vs. 4.6 percent in Table 2) and the current account deficit in terms of GDP for 1986 (3.4 percent vs. 1.2 percent in Table 1).

2. You note at the bottom of page 4 that "overall domestic credit increased in terms of broad money ...". This formulation strikes us as somewhat unconventional as it suggests that changes in domestic credit and broad money are identical. Since domestic credit can be financed by liabilities that would not normally be regarded as components of money, no matter how broadly defined (e.g. by borrowing abroad), it would seem preferable to confine the discussion in this section to domestic credit.

3. In discussing medium-term targets, you may wish to elaborate on the per capita growth objective (page 7). We would assume that the target is a sustainable growth in real per capita income.

4. Attached is a copy of the Fund relations page with minor corrections indicated.

Attachment

cc. Mr. Habermeier
Mr. Gianviti
Mr. Tanzi
Mr. Beveridge
Mr. Artus

Kenya: Relations with the Fund

(As of June 30, 1986)

I. Membership Status:

(a)	Date of membership	February 3, 1964
(b)	Status	Article XIV

A. Financial Relations

II. General Department

(a)	Quota	SDR 142.0 million
(b)	Total Fund holdings of Kenya's currency	SDR 530.89 million (373.87 percent of quota) .86
(c)	Fund holdings of Kenya's currency subject to repurchase	SDR 401.08 million (282.45 percent of quota) 44
	Of which: credit tranche	SDR 69.81 million (49.16 percent of quota)
	SFF	SDR 54.38 million (38.29 percent of quota)
	E.A.R.	SDR 208.81 million (147.05 percent of quota) C4
	C.F.F.-C.	SDR 68.09 million (47.95 percent of quota) 94
(d)	Reserve tranche	SDR 12.19 million (8.59 percent of quota)

III. Current or previous stand-by arrangements and special facilities

(a) Current stand-by: None

(b) Previous arrangements:

1 extended arrangement approved in July 1975, and 6 stand-by August 1979, October 1980, January 1982, March 1983, and February 1985. Amounts range from SDR 17.25 million to SDR 241.50 million.

Office Memorandum

cc: Mr. Brachet
Ms. Du...
Mr. Hino

TO: Mr. Gianviti (LEG)
Mr. Tanzi (FAD)
Mr. Beveridge (ETR)
Mr. Gupta (TRE)

August 11, 1986

FROM: J. Artus J. R. A.

SUBJECT: Kenya: Policy Framework Paper for a Loan Under the Structural Adjustment Facility

I attach for your review and comments a paper on the above-mentioned subject.

I would appreciate it if you would give your comments directly to Mr. Jiménez, Extension 6952, by noon, Thursday, August 14, 1986 with a copy of any written comments to me.

Attachment

cc: Mr. Bhatia

KENYA

Policy Framework Paper for a Loan Under the Structural Adjustment Facility

1. Kenya's economic performance in the decade following its independence in 1963 was characterized by structural transformation and an impressive annual average growth rate. During the period, real per capita income rose substantially and the average rate of inflation was kept below 4 percent. The agricultural sector was stimulated by the conversion of land use to small holder cultivation, the adoption of high-yielding maize varieties, and the introduction of high-value production activities. Simultaneously, the rising agricultural income and consequent expansion in domestic demand induced growth in the manufacturing sector, which also benefited from an import substitution policy based on tariffs and quantitative restrictions, liberal foreign investment policy, active Government promotion and participation in manufacturing ventures, and the attraction created by the East African Community. After 1973, however, the situation changed. Economic growth decelerated and strong balance of payments pressures emerged reflecting both exogenous factors, such as unfavorable weather conditions and fluctuations in external terms of trade, and inadequate policies to deal with growing structural problems. The oil price increases in 1973 and 1974 and 1979 and 1980 adversely affected the growth rate. The temporary sharp rise in coffee and tea prices and the subsequent large

balance of payments surpluses in 1976 and 1977 and record growth rate were short-lived and subsequently had unfavorable effects on the economy due to inappropriate demand management policies. Underlying structural problems, such as high population growth, weak export sector, a restrictive import system, and an inoperative development plan, further contributed to the deteriorating economic and financial situation.

2. During the first half of 1980's the Kenyan authorities undertook a major stabilization effort, which aimed at correcting the critical financial situation and improving the growth potential of the economy. Despite the weak foreign demand resulting from the world recession, an attempted coup in 1982 and an extremely severe drought in 1984, considerable progress was made in reducing the economy's internal and external imbalances. The adjustment effort, supported by a series of Fund arrangements, included a flexible exchange rate policy, import liberalization, adjustments in producer prices, financial analysis of public enterprises, significant tightening of fiscal and monetary policies, and adjustments in the interest rate structure. Between end-1980 and end-1985 the Kenyan shilling, which is pegged to the SDR, depreciated by about 46 percent in terms of the SDR and by 21 percent in real effective terms. Beginning in 1982 an attempt was made to maintain constant the real effective exchange rate through the use of a flexible exchange rate policy. In 1983, advance import deposit requirements were removed and a new import system was put in place, which has since

undergone two phases of liberalization to more than recover the position as of 1980. Incentives in the agricultural sector were maintained in the context of yearly reviews of producer prices. The overall budgetary deficit (including grants) which had reached the equivalent of 9.5 percent of GDP in fiscal year 1980/81 (July-June) was reduced to 4.2 percent in 1983/84, and rose in 1984/85, due to the drought, to 5.0 percent. The fiscal adjustment was made primarily through expenditure control since the ratio of revenues to GDP declined during this period, despite new revenue measures, due to less buoyant economic conditions and substantial reduction in imports. Concomitant with the improvement in the budget, domestic credit expansion was reduced from 20 percent of the initial broad money stock in 1980/81 to about 9 percent in 1983/84 before rising to about 12 percent in fiscal 1984/85. Interest rate adjustments during this period ensured all rates becoming positive in real terms. The Central Bank increased its surveillance of financial institutions, especially nonbanks, with a view to securing closer compliance with monetary policy initiatives.

3. During 1980-85 the average real GDP growth was under 3 percent, below the population growth rate of close to 4 percent. Growth was affected by the stabilization effort, the recessionary conditions of the world economy, the impact of the political crisis in 1982, which brought economic activity to a near stand-still, and the severe drought of 1984 which caused real GDP to fall below 1 percent. The growth rate also

reflected the fiscal adjustment which resulted in development expenditures declining from about 10 percent of GDP in 1980/81 to about 7 percent in 1984/85. During the period, however, the inflation rate was almost halved, from 20.2 percent in 1981 to 10.5 percent in 1985. In the external sector, the current account deficit, which had reached the equivalent of over 11 percent of GDP in 1981 was reduced to 3.2 percent in 1984 before rising to 4.7 percent in 1985. There was a sharp turnaround in the overall balance of payments which moved from annual deficits averaging SDR 164 million in 1980-82 into surpluses in 1983 and 1984. As a result, gross official reserves rose from an annual average equivalent to about 1.8 months of imports at end-1980-82 to 3.4 months at end-1983 and end-1984. Gross official reserves were maintained at this level at end-1985 even though due to the drought an overall balance of payments deficit of SDR 92 million was recorded. During 1980-85 Kenya's debt service ratio rose from 13 percent in 1980 to 30 percent in 1985, but Kenya remained current in its international payments and did not seek a debt rescheduling.

4. Considerable progress has been made in financial management; however, less success has been achieved in terms of economic growth. In part, this reflects the exogenous factors previously mentioned and the impact of the stabilization effort, which initially resulted in a decline in real development expenditures and involved the adjustment of the economy to a lower level of imports. There was also hesitation on

the part of the authorities to embark on a quicker structural adjustment path. However, given the progress attained so far in stabilizing the economy and the favorable weather conditions, at the beginning of 1986, the Government turned its attention to policies, geared not only toward demand restrain, but also overcoming the structural problems facing the economy. The significant improvement in Kenya's terms of trade in late 1985 and early 1986 provided the opportunity and challenge to utilize the inflow of resources into the economy for structural reform and strengthening the balance of payments for the time when the favorable temporary factors no longer existed. The financial program for 1986 aimed at promoting higher growth rate, reducing inflationary pressures, and capturing in reserves the projected overall balance of payments surplus. To achieve these objectives, tight demand management policies were to be continued.

5. The Sessional Paper on Economic Management for Renewed Growth was approved by the Parliament earlier this year. It outlines in general terms the economic and financial policies through the year 2000 to accommodate Kenya's rising population. The paper contains a broad strategy to deal with Kenya's structural issues and emphasizes increased productivity in agriculture, widespread rural nonfarm activity, dynamic informal sector, and restructured industry with the aim of increasing growth and employment. At the World Bank-organized Consultative Group Meeting for Kenya on April 29-30, 1986, Kenya's donors agreed that the

Sessional Paper provided an appropriate policy framework for medium-term policy action.

II. Structural Policy Framework, 1987-89

6. In the medium term the broad objectives of the Government's economic program are to attain an average growth rate of about 5.6 percent to accommodate in order to attain a positive real per capita growth rate, reduce inflationary pressures further, and reach a sustainable balance of payments position. The achievement of these objectives require continuation of cautious demand management policies, improvements in the allocation of domestic resources, and foreign support for Kenya's development objectives.

7. Demand management and economic stabilization will continue in the next three years to be important elements of the Government's economic program. Although considerable progress has been made in stabilizing the economy, additional actions, particularly in the fiscal field, are required to remove remaining inflationary tendencies and in the immediate future to help the economy benefit from the favorable external terms of trade. The overall budgetary deficit will be reduced to a level which does not lead to excessive bank financing which can crowd out the private sector. This would require the reduction of the overall deficit from 4.6 percent of GDP in 1985/86 to 3.1 percent in 1986/87 and

to less than 3 percent by 1988/89. Monetary policy will be geared to reinforce this stabilization effort.

8. To realize the medium-term growth target for the economy and thus to attain a sustained per capita growth, the Government will address structural problems, inefficiencies, and bottlenecks. In the next three years, improvements will be effected in both the real and financial sectors with a view to increasing incentives to the private sector. The main areas of Government activity will be in improving resource allocation in the agricultural and industrial sectors, development planning, public enterprises, and fiscal and monetary management. Concomitant to this effort, the Government will continue to emphasize family planning since without such an effort all the long-term objectives for the Kenyan economy would be jeopardized.

9. The agricultural sector will continue to be the leading sector in Kenya's economic growth and will thus have to provide for the food security of the population, generate growing income and employment, expand export output, and stimulate the growth of productive off-farm activity in the rural areas. To realize these objectives, the Government will try to induce the adoption of more productive practices within existing crop patterns, reorganize and accelerate research, and improve yields by providing ready access to inputs, including credit, and extension services. Improvements in incentive system and support services will be emphasized. Kenya has a good record in setting

appropriate producer prices and will continue with the yearly review of administered producer prices. The Government will also continue to improve the timing and amount of parastatal payments to farmers. Payments to farmers and/or cooperatives for milk, cotton, grain, and pyrethrum, will be effected within one month of commodity delivery by end-1987. Further improvements in marketing arrangements for commodities and farm inputs will be introduced. Maize marketing controls will be gradually removed and by end-1987 a restructuring of the National Cereals and Produce Board will be effected. The restructuring will include redefinition of objectives and operational policies, financial revamping, and training and redeployment of its staff. The Cotton Lint and Seed Marketing Board will divest all its cotton and ginning activities by beginning of 1987. An attempt will also be made to improve agricultural input supply and use through liberalizing the fertilizer import system, improving distribution incentives, assuring the supply of maize seeds, phasing out subsidies for livestock services and improving their quality, and promoting the development of input distribution channels.

10. The Government recognizes the need for industrial restructuring to expand and diversify the export base, create jobs for the ever growing labor force, and to support and promote the development of agriculture and rural areas. In recent years, the efficiency of the industrial sector has been improved by increasing import competition and

encouraging an export orientation. Import duties on a wide range of goods have been reduced and the import system has been increasingly liberalized by moving import items from more restrictive schedules to less restrictive schedules. In the years ahead, the pace of import liberalization will be sharply accelerated. By June 1987, the proportion of total import items in the category IIB, which covers items for which licenses are approved restrictively, will be reduced to 20 percent and the proportion in category IA, which contains items that may be imported without restrictions, will be increased to 60 percent. This approach will be followed until by 1989 restrictive import licensing to protect local industry would be completely replaced by the tariff system. Moreover, duty rates that provide excessive protection to industry will be gradually reduced. Adjustments in the real effective exchange rate will be implemented to compensate for the removal of quantitative import restrictions and reductions in tariffs to maintain Kenya's external competitive position. Manufacturing in bond will be promoted. Green channel system to simplify and hasten administrative approvals for exporters will be introduced. To induce additional investment, the Government will undertake a general review of the Foreign Investment Protection Act and will also establish an interministerial committee to recommend simplified procedures for investment approvals. Restrictive trade practices will be prohibited. Prices of items not produced by monopolies and/or are not essential for low income families, will be gradually decontrolled. The administration of price controls for these limited items will be improved and applications for price increases will be handled more quickly.

11. The sectoral priorities of the Government, along with the emphasis on achieving over the medium term rural-urban balance, will be reflected in the Government's development efforts. In the period ahead, the Government will proceed with the implementation of the 1984-88 Development Plan whose implementation has been delayed due to the required outlays for drought relief in 1984/85. The Development Plan stresses the need to base development increasingly on domestic resources, and has been recast and incorporated into the forward budget for 1986/87-1988/89. In line with the Government's budget rationalization program to improve the productivity of scarce budgetary resources and lower the capital output ratio, development expenditures will be confined to fewer projects to bring new capacity into service sooner, to projects with high efficiency that contribute to growth, and projects which take into account district priorities. Highest priority will be given to improving the utilization of existing capacity and for improving the operations of completed projects. The Government, moreover, is determined to use external aid for new projects more selectively and primarily for productive purposes. Emphasis will be on grants and soft loans and commercial borrowing abroad will be restricted. All externally aided projects will be reviewed and projects

which do not correspond with sectoral priorities or rationalization plan objectives will be redesigned, rephased, or cancelled.

12. In order for the rationalization program to be successful and to reduce the gap between budgetary resources and requirements, additional revenue measures will be adopted. The Government will undertake a comprehensive study of the tax system to increase the level of taxation relative to the GDP. The aim of the study will be a revised tax structure which will not only increase revenue and make it more responsive to changes in GDP, but will also induce saving and investment, promote rural-urban balance, and accommodate other structural adjustments. The Government will also as part of the budget rationalization program increase user fees. Those using government services will be required to contribute more to the financing of the recurrent costs of those services. Special working parties will study and recommend methods and timetables for reducing budgetary expenditures in education and health. All the agreed recommendations will be implemented by the end of 1989. To curtail the unsustainable growth of the civil service, guaranteed employment in the Government for those graduating from universities without private sector jobs, which is already restricted, will be discontinued. In addition, government training programs will be scaled downward so that the number of graduates more closely matches the real needs of the Government. Employment in the Government will be based on merit and achievement.

Staff requirements and job descriptions will be reviewed to reduce overstaffing and increase productivity.

13. Public enterprise reform will continue to be an important element of the Government's program. During the past few years, progress has been made in improving the monitoring and control of the financial operations of public enterprises, especially the financial flows between these enterprises and the Government. A computerized external and internal debt reporting system has been established, transfers to public enterprises have been reduced sharply, and the office of the Auditor General for parastatals has been created. The Parastatal Advisory Committee has drafted the State Corporation Bill, which provides the Government with the necessary legal apparatus to extend its supervision of public enterprises, to collect money from them, and to sell the Government's share in them. The Bill will be enacted by the Parliament by the end of 1986 and all of its provisions will be implemented by end-1989. The Task Force on Divestitures has completed its reports, and its recommendations for the sale, divestiture, and liquidation of public enterprises will be fully implemented. Already, some progress along these lines has been made. In the period ahead, public enterprises will be classified into those to remain in the public sector, those to remain in the public sector but which need some restructuring, and those to be sold, divested, or liquidated. The classification will also specify procedures for divestiture. By the end of 1988 the classification will

be completely implemented. A system of preparing forward budget for recurrent and development expenditures for public enterprises has been introduced. The Treasury will not process the requests of public enterprises for budgetary support or for loan guarantees except on the basis of an approved public enterprise forward budget.

14. In monetary management, the Government will continue to move towards greater reliance on market forces in allocating financial resources to their most productive uses. Noninflationary sources of government financing will be emphasized and an attempt will be made to introduce more generalized monetary policy instruments. Kenya's financial system, although well developed for a country of Kenya's per capita income level, suffers from some major inefficiencies. These include an inappropriate dichotomy in regulations and supervision between banks and nonbanks and the lack of involvement by the commercial deposit-taking institutions in the provision of longer-term finance for fixed investment and development. The recent amendment to the Banking Law attempts to reduce the dichotomy between banks and nonbanks by incorporating measures to strengthen the capital base, to improve the quality of portfolio, and to increase the regulations by the monetary authority. The Government will complete implementing these measures as soon as possible. The regulation of interest rates has been an important factor in the development of the Kenyan financial system. The Government is determined to allow increased market determination of

investors in such securities. A Capital Markets Development Authority will be established to develop and regulate the capital market. The establishment of full service brokers will be encouraged.

III. External Financing Requirements, 1987-89

17. Due to the improved coffee prices and the reduction in petroleum prices, Kenya will record large overall balance of payments surpluses in 1986 and 1987. In 1988 and 1989, however, with the end of these favorable developments in coffee prices and despite the adjustment efforts of the government in 1986 and 1987, Kenya will be faced with balance of payments financing gaps. However, a viable and sustainable balance of payments position is possible by 1990, if the current account deficit is reduced to about 2-3 percent of GDP. The magnitude of the surpluses in 1986 and 1987 are very sensitive to the assumptions underlying the projections, particularly those for coffee and oil prices. Assuming, however, that after increasing by over 50 percent in SDR terms in 1986 coffee prices will realign in subsequent years with the underlying rate of inflation from 1985 onwards and that oil prices rise to about US$18.50 per barrel in 1987, Kenya will have an overall surplus of about SDR 159 million in 1986 and SDR 64 million in 1987. The current account deficit will be about 3.4 percent of GDP in 1986 and will rise to an average of 3.6 percent during 1987-89. At the recent Consultative Group Meeting for Kenya, the World Bank suggested that the

donors aim to commit grants and loans totaling US$515 million per year during 1986-87, with about one fourth in fast disbursement terms. This suggested level is almost 40 percent more than actual disbursements in 1984-85. If this high level of foreign commitments is in fact translated into equally large disbursements, external financing gaps (including any SAF program) should be minimal in 1988-89. However, the staff regards this as an optimistic scenario and a contingency plan needs to be developed. In the period ahead, Kenya's borrowing capacity will be enhanced since the debt service ratio which peaked to 30 percent in 1985 is projected to decline to about 27 percent in 1988 and to under 20 percent in 1991.

Table . Kenya: Summary and Time Frame for Implementation of Structural Adjustment Policies, 1987-89

Issues	Objectives and Policies	Strategies and Measures	Phasing of Implementation
A. Sectoral Policies 1. Agriculture	Maintain production incentives	Yearly review of producer prices	Continuing
		Improve timing of payment to farmers	Continuing, by end-1987 payments for milk, cotton, grain, and pyrethrum will be made within one month of delivery
	Improve marketing arrangements	Gradually remove controls on maize marketing	Restructure NCPB by end-1987
	Improve agricultural input supply	Liberalize fertilizer import system	Beginning in 1987
		Promote distribution through better pricing of inputs	Beginning in 1987
2. Industry	Further import liberalization	Reduce coverage of items in the restricted Category IIB	A 20 percent limit on all items by June 1987
			A 12 percent limit of all items by June 1988
			A 5 percent limit of all items by June 1989

Table . Kenya: Summary and Time Frame for Implementation of Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing of Implementation
		Review tariffs	From time to time
	Export incentives	Review exchange rate in conjunction with changes in trade system	From time to time
		Expand manufacturing in bond	Yearly reviews
	Improve credit availability	Supply low cost loans to commercial banks for on-lending to agro-based industries	1987
	Promote informal sector growth	Have Kenya Commercial Bank provide credit, without collateral, to informal sector firms	1987
		Establish new tendering procedures that favor informal sector firms in bidding for all Government contracts	1987
	Promote investment	Review Foreign Investment Law	1987
		Simplify and streamline procedures for implementing projects	1987
		Allow foreign investors greater access to domestic credit	1987

Table . Kenya: Summary and Time Frame for Implementation of Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing of Implementation
B. Fiscal policy	Budget rationalization	Confine development expenditures to fewer projects to bring new capacity into service sooner, to projects with high efficiency that contribute to growth, and projects which take into account district priorities. Give highest priority to improving the utilization of existing capacity and for improving the operations of completed projects.	Continuing
		Redesign, rephase, or cancel all externally aided projects which do not correspond to sectoral priorities or rationalization plan objectives. Confine use of external aid (mainly grants and soft loans) primarily to projects for productive purposes.	Continuing

Table . Kenya: Summary and Time Frame for Implementation of Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing of Implementation
	Improve revenue performance	Undertake a comprehensive study of the tax system.	Complete the study by mid-1987
		Implement its agreed recommendations	By end-1989
		Increase user fees	By mid-1987
	Reduce budgetary expenditures in education and health	Have working parties study and recommend methods and timing of changes.	Complete studies by mid-1987
		Implement all agreed recommendations	By mid-1989
	Rural-urban balance	Move larger share of government resources towards the rural economy	Continuing
	Civil service reform	Discontinue guaranteed employment	By mid-1987
		Reduce overstaffing and increase productivity	By mid-1987
		Base employment on merit and achievement	By mid-1987
C. Public enterprises	Extend government control over public enterprises	Implement the State Corporation Bill	By end-1989

Table . Kenya: Summary and Time Frame for Implementation of Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing of Implementation
	Improve performance of public enterprises	Implement the recommendations of the Task Force on Divestitures	By end-1988
		Have all investments of public enterprises financed by the government or by borrowing under government guarantee be approved within the context of the annual and forward budgets.	By end-1989.
		Classify public enterprises into those to remain in public sector, to be restructured within the public sector, and to be sold, divested, or liquidated. Define procedures for divestiture.	By mid-1987
		Implement the agreed classification	By end-1989
D. Monetary and Financial policy	Move toward greater reliance on market forces in allocating financial resources	Move toward market determination of interest rates by allowing the issuance of bearer negotiable certificates of deposit and other private sector instruments	1987

Table . Kenya: Summary and Time Frame for Implementation of Structural Adjustment Policies, 1987-89 (continued)

Issues	Objectives and Policies	Strategies and Measures	Phasing of Implementation
	Introduce noninflationary sources of government finance	Develop system to competitively market Treasury bills and a secondary market for Treasury bills. Issue a wider variety of maturities of Treasury bills	1987
	Introduce more generalized monetary policy instruments	Utilize cash ratios, rediscount policy, and open market operations	1989
	Remove inefficiencies in the financial system	Implement the amendment to the Banking Law.	1988
		Help the Agricultural Finance Corporation and the Cooperative Bank of Kenya in their efforts to collect arrears.	1987
		Change the loan terms of development finance institutions to comply with the Government's development objectives	1987
	Develop the capital market	Revise the tax system to encourage capital market activity.	By end-1987

Table . Kenya: Summary and Time Frame for Implementation of Structural Adjustment Policies, 1987-89 (Concluded)

Issues	Objectives and Policies	Strategies and Measures	Phasing of Implementation
		Establish a Capital Market Development Authority	1987
E. Pricing policy	Remove price controls	Decontrol prices of items not produced by monopolies and/or are not essential for low income families	Continuing to be completed by 1989
		Establish Monopolies and Price Commission to administer price controls and monitor practices that restrain competitive forces.	Early 1987

INTERNATIONAL MONETARY FUND

August 8, 1986

Mr. Beveridge:

Kenya--Staff Report

Attached are comments on the staff report for Kenya which was reviewed by Mr. Weerasinghe.

cc: Ms. Dillon
Mr. Hino
Mr. Johnson
Mr. Haque

cu.

Christian Brachet

August 8, 1986

Kenya--Comments on Briefing Paper for Article IV Consultation and Use of Structural Adjustment Facility

The brief notes that the mission is to conduct only very preliminary discussions on an SAF program, with further discussions to take place at a later date following the World Bank's review of certain sectoral issues. Therefore, the brief is understandably rather general.

The following areas could, however, benefit from some elaboration:

1. Medium-term scenario

a. The brief should indicate whether or not the better prospects for official capital inflows now anticipated (page 15) for 1986-87 are already included in the capital account figures shown in Table 3. In EBS/85/217 the official capital flows in 1986-87 were projected at about the same levels as Table 3, with the increase in 1986-87 reflecting commercial borrowing for special imports.

b. The medium-term BOP scenario (Table 3) could usefully include the ratio of the current account to GDP, terms of trade, gross reserves (in months of imports), and key external debt indicators.

c. Gross reserves are projected to decline during 1987-89 and more than offset the strengthening of reserves that is anticipated for 1986 owing to the improvement in the terms of trade. With the possible drawings under the SAF, the reserves objective should be strengthened, while maintaining the target for the current account deficit.

d. The brief should indicate the debt management/borrowing strategy appropriate in the circumstances of Kenya during the period to be covered by the SAF. In this regard, it would also be useful to provide some indication of the sensitivity of the debt service projections to the assumed level of concessionality of the new capital flows included in the BOP projections.

2. Other issues

a. It appears that in the second half of 1985/86 there has been a significant increase in domestic credit and in central government current expenditures compared with earlier projections. The mission would need to evaluate these developments closely. The brief could usefully include information on price developments so far in 1986 (add to the discussion on page 5).

b. As already noted, the brief suggests that official capital inflows are likely to increase markedly in the years 1986-87 compared with 1984-85. Since such flows are usually linked to domestic resource mobilization, the mission would need to stress the urgency for increasing domestic savings. In particular, the poor revenue performance (relative to GDP) of the Central Government in recent years would need to be reversed.

c. On a presentational point, the sentence on page 1 that "Kenya does not have a great urgency for the SAF resources at the present time, given the projected surplus in the balance of payments" justifies a lack of urgency for an SAF on financial grounds only. However, recent economic developments suggest some urgency on the policy front to consolidate the gains from recent terms of trade developments and address the structural adjustment problems facing the economy. Therefore, it might be preferable to drop this sentence.

INTERNATIONAL MONETARY FUND

August 7, 1986

Mr. Beveridge:

Kenya--Briefing Paper

Attached are comments on the briefing paper for Kenya which I reviewed myself.

Attachment

cc: Mr. Brachet
Mr. Hino
Mr. Johnson
Ms. Kirmani

David Lipton DL

August 7, 1986

Kenya: Comments on the Briefing Paper

1. In the external area, we are concerned about the projection of a large increase in official capital inflows in 1986 and 1987. Although the pipeline may be increasing, there is a history of disappointment in this regard. This assumption has strong implications for international reserves, the budget and the allocation of domestic credit.

2. More generally, we see reason for more alarm than is sounded in the brief with regard to recent trends in money and credit. The money and credit increases in fiscal 1985/86 would seem to endanger price stability and the balance of payments. That these slippages have not yet manifested themselves is little cause for comfort. This subject deserves greater attention. We also suggest that the objective mentioned (on page 6) of "further" reducing imbalances might be reworded to make mention of reversing serious slippages.

3. We are puzzled by the targetted decline in gross reserves over the next four calendar years (in Table 3).

4. The current account deficit of 1.2 percent projected for 1986 (in Table 1) does not concur with the deficit of 3.4 percent mentioned in the text (on page 15). We presume that the latter is correct.

499034

Governor

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June 19, 1986

Mr. Jacques de Larosiere
Managing Director
International Monetary Fund
Washington D.C. 20431
U.S.A.

Dear Mr. de Larosiere,

SYMPOSIUM TO COMMEMORATE THE 20TH ANNIVERSARY OF THE CENTRAL BANK OF KENYA

The Central Bank of Kenya is preparing to commemorate its Twentieth Anniversary during the second week of December 1986. A number of events are planned to take place during the occasion. The highlight of the celebrations will, however, be a symposium organized by the Bank in which all Governors of African central banks, who have been invited to attend the celebrations, will participate. The symposium is scheduled to be held on Tuesday, 9th December 1986.

I am formally inviting you to participate in the symposium and deliver the keynote speech. The general theme of the symposium will be the current economic and financial situation in Africa and future prospects.

I very much hope you will accept our invitation.

With best wishes.

Yours sincerely,

PHILIP NDEGWA
GOVERNOR

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February 10, 1986

Kenya--Comments on Briefing Paper

I. General Comments

It is obviously difficult at this point to ascertain with any degree of confidence what the budgetary and balance of payments impact will be of developments in the international coffee market. Nonetheless, as the brief points out, it is of some importance that the foreign exchange gains emanating from the buoyant state of the coffee market be used not only to further the import liberalization process but to reduce recourse to commercial borrowing and allow a build up of foreign reserves. As the brief stands at present, however, it is difficult to see how the limited adjustments proposed in fiscal and credit policies can be sufficient to ensure that the balance of payments improvement will be sustained. In this connection, our concerns are as follows.

First, while the balance of payments data have incorporated the increased ~~the increase~~ in coffee prices, no attempt has been made ~~at~~ to quantify this impact on the budget; the estimates for the overall deficit and bank borrowing in 1985/86 are exactly the same as those contained in the last brief which was prepared before the impact of the Brazilian drought became evident. We would, therefore, suggest that the budgetary impact of the incrase in coffee prices be quantified and explicitly incorporated into the brief. Any necessary revisions to the projections could then be made in the field should any ~~revised~~ updated information become available. A stonger budgetary performance in 1985/86 and 1986/87 than that contained in the brief would provide some reassurance that the improvement in the external position that has already taken place is not eroded away through capital outflows and increased current account expenditures.

A second and related point is that it is difficult to understand why, when the external sector is now expected to provide a substantial infusion of liquidity into the economy, credit to the nongovernment sector in 1986 is to be allowed to grow at a faster pace than previously proposed. Again, some reduction (which should not be interpreted as a tightening) in domestic credit growth will surely be necessary if the balance of payments gains are to be consolidated.

II. Specific Issues

1. The description of exchange rate policy (page 14) is cryptic and needs further elaboration. It should indicate explicitly that the real effective exchange rate will be adjusted downward to compensate for the import liberalization and tariff reductions ~~is~~ undertaken in 1985-86. A mention of the timing, and the magnitude~~s~~, of these adjustments would also appear necessary.

2. The brief contains no mention of the impact of the decline in oil prices ~~or~~ on the key macroeconomic targets.

3. With the abolition of ICO coffee quotas, it is important that the brief indicate the size of existing coffee stocks that are available for export. It should also indicate whether or not any capital gain that is

realized from the sale of these stocks accrues to budget, the marketing agency, or the producers. The program should, in any event, build in a corresponding reduction in domestic credit.

4. In keeping with the medium-term perspective of the structural reform strategy, a timetable should be specified for the actions contemplated in the proposed program. In particular, the brief should indicate when the process of import liberalization will be completed. If the transfer of items from the restrictive category is to continue at the same rate as in 1986 (10 percent of the total per year), can one conclude that no items will be left in this category by mid-1988?

5. In view of the improved external position and the reduced reliance on commercial borrowing, we find the proposed debt ceiling of SDR 150 million difficult to justify. The objective of these ceilings should be to restrict, not accomodate, borrowing on commerical terms. In view of the magnitude of the substantial debts incurred recently to finance airplane purchases (see EBS/85/217), some prudence in external debt management is warranted if Kenya is indeed to achieve balance of payments viability in the medium term.

III. Presentational Points

1. The section on monetary policy (page 9, second paragraph) would be more appropriately placed in the section dealing with the financial

sector on page 11.

2. The program is to limit borrowing from the nonbanks "under the control of the Central Bank" (page 9, first paragraph). What does this mean and how are they to be distinguished? Also, on the same page (second paragraph), we have no idea what is meant by "the progress that has been made in programming monetary policy on the basis of the full financial system." An explanation would be useful.

3. There is a reference on page 16 to an increase in "borrowing capacity." What does this mean?

4. Table 3 on the balance of payments shows no increase in exports despite the fact that it apparently incorporates the impact of the increase in coffee prices. Similarly, the increase in imports referred to in the text is not apparent in the table. An explanation would be helpful.

5. The brief should indicate what ~~the~~ prior actions ~~that~~ are contemplated.

6. Attachments II and III are missing.

7. The comparator table is being prepared.

INTERNATIONAL MONETARY FUND

February 10, 1986

Mr. Beveridge:

Kenya--Briefing Paper

Attached are comments on the briefing paper for Kenya which was reviewed by Mr. Nowak.

cc: Ms. Dillon
Mr. Johnson
Mr. Nowak
Mr. Badrul Haque

PN

Paulo Neuhaus

February 10, 1986

Kenya--Comments on Briefing Paper

I. General Comments

It is obviously difficult at this point to ascertain with any degree of confidence the budgetary and balance of payments impact of developments in the international coffee market. Nonetheless, as the brief points out, it is of some importance that the foreign exchange gains emanating from the buoyant coffee market be used not only to further the import liberalization process but to reduce recourse to commercial borrowing and allow a build up of foreign reserves. As the brief stands at present, however, it is difficult to see how the limited adjustments proposed in fiscal and credit policies can ensure that the balance of payments improvement will be sustained. In this connection, our concerns are as follows.

First, while balance of payments data have incorporated the increase in coffee prices, no attempt has been made to quantify this impact on the budget; the estimates for the overall deficit and bank borrowing in 1985/86 are exactly the same as those contained in the last brief which was prepared before the impact of the Brazilian drought became evident. We would, therefore, suggest that the budgetary impact of the increase in coffee prices be quantified and explicitly incorporated into the brief. Revisions to the projections could then be made in the field should any updated information become available. A stonger budgetary performance in 1985/86 and 1986/87 than that contained in the brief would provide some reassurance that the external improvement that has already taken place is not eroded through capital outflows and increased current account expenditures.

As a second and related point, it is difficult to understand why, when the external sector is now expected to provide a substantial infusion of liquidity into the economy, credit to the nongovernment sector in 1986 is to be allowed to grow at a faster pace than previously proposed. Again, some reduction (which should not be interpreted as a tightening) in domestic credit growth will surely be necessary if the balance of payments gains are to be consolidated.

II. Specific Issues

1. The description of exchange rate policy (page 14) is cryptic and needs further elaboration. It should indicate explicitly that the real effective exchange rate will be adjusted downward to compensate for the import liberalization and tariff reductions undertaken in 1985-86. A mention of the timing and magnitude of these adjustments would also appear necessary.

2. The brief contains no mention of the impact of the decline in oil prices on the key macroeconomic targets.

3. With the abolition of ICO coffee quotas, it is important that the brief indicate the size of existing stocks that are available for export. It should also indicate whether or not any capital gain that is realized from the sale of these stocks accrues to the budget, the marketing agency, or the producers. The program should, in any event, build in a corresponding reduction in domestic credit.

4. In keeping with the medium-term perspective of the structural reform strategy, a timetable should be specified for the actions contemplated in the program. In particular, the brief should indicate when the process of import liberalization will be completed. If the transfer of items from the restrictive category is to continue at the same rate as in 1986 (10 percent of the total per year), can one conclude that no items will be left in this category by mid-1988?

5. In view of the improved external position and the reduced reliance on commercial borrowing, the proposed debt ceiling of SDR 150 million seems difficult to justify, since the objective of the ceiling should be to restrict, not accomodate, borrowing on commercial terms. In view of the substantial recent borrowing to finance airplane purchases (see EBS/85/217), some prudence in external debt management is warranted if Kenya is indeed to achieve balance of payments viability in the medium term.

III. Presentational Points

1. The section on monetary policy (page 9, second paragraph) would be more appropriately placed in the section dealing with the financial sector on page 11.

2. The program is to limit borrowing from the nonbanks "under the control of the Central Bank" (page 9, first paragraph). What does this mean and how are they to be identified? Also, on the same page (second paragraph), it is not clear what is meant by "the progress that has been made in programming monetary policy on the basis of the full financial system"; an explanation would be useful.

3. The reference on page 16 to an increase in "borrowing capacity" should be clarified.

4. Table 3 on the balance of payments shows no increase in exports despite the fact that it apparently incorporates the impact of the increase in coffee prices. Similarly, the increase in imports referred to in the text is not apparent in the table. An explanation would be helpful.

5. The brief should indicate what prior actions are contemplated.

6. Attachments II and III are missing.

7. The comparator table is attached.

INTERNATIONAL MONETARY FUND

February 11, 1986

Mr. Beveridge:

Kenya--Comments on the Briefing Paper

Attached are comments on the draft briefing paper for Kenya which was reviewed by Ms. Xafa.

cc: Mr. Brachet
Mr. Johnson
Mr. Nowak

K. Burke Dillon KBD

February 11, 1986

Kenya--Comments on the Briefing Paper

The balance of payments and external debt section is very thin. A number of points will need elaboration and some apparent conflicts between the information presented in tables 1 and 3 will have to be resolved.

Balance of payments and debt projections

It is surprising that the ratio of debt to GDP is projected to remain at its 1985 level in 1986 and decline in 1987 while the current account is projected to show continued deficits over this period and reserves are projected to increase (Table 1). Will the net capital inflows shown on the medium-term table (Table 3) not add to debt? The following additional information could usefully be shown on that table:

a. Rather than showing total net capital inflows, a distinction should be made between debt and nondebt creating inflows, as well as between gross inflows and amortization/dividend payments;

b. The table should include a projection of the debt service ratio, including the cost of servicing the financing gaps that are projected beyond 1986. In this connection, it is not clear whether the debt service ratio shown on Table 1 for 1987 includes the service on borrowing to finance the SDR 33 million gap for that year;

c. The main assumptions underlying the medium-term projections should be made explicit, including the prices and volumes of the main exports; and

d. The overall balance of payments deficit in 1985 is quoted as being SDR -100 million (initial estimate) and SDR -92 million (revised) on Table 3, and as SDR -202 million (initial) and SDR -192 million (revised) on Table 1.

Debt ceilings

1. The brief mentions that a zero ceiling on short-term borrowing will be a performance criterion under the program, except when trade-related. In this respect:

a. If difficult to monitor, import-related financing could be excluded from the short-term ceiling. However, export prefinancing--which could conceal financing of nonexport related expenditure--could and should be monitored, and

b. A very small positive ceiling might be preferable to a zero ceiling insofar as it would promote the establishment of short-term debt monitoring procedures.

2. The proposed program maintains the ceiling of SDR 150 million on nonconcessional borrowing in the 1-12 year maturity range about unchanged from the current program, but disposes of the subceiling in the 1-5 year maturity range. This subceiling would need to be maintained, even if the maturity structure of the debt has improved (which the paper does not provide enough information to assess), to avoid a possible bunching of maturities down the road.

3. The program does not envisage a particularly strong fiscal adjustment. The fiscal deficit is projected to decline by 0.3 percentage points to 3.8 percent of GDP in fiscal 1986/87 and further adjustments would depend on the level of concessionary development assistance, which, according to the brief, is likely to increase (page 9). In view of this, the program could include a provision for reducing the ceiling on nonconcessional borrowing as concessionary assistance exceeds an explicitly stated target.

Mr. Finch, ETR

Office Memorandum

cc: Mr. Kanesa-Thasan

December 4, 1985

To: The Managing Director
The Deputy Managing Director

From: V. Sundararajan

Subject: CBD Technical Assistance: Inspection Visits to Seychelles, Kenya, and Mauritius

I visited Victoria (November 11-13), Nairobi (November 14-16), and Port Louis (November 18-20) to evaluate the effectiveness of the CBD technical assistance program and to discuss with the authorities their efforts to localize the assignments and their future technical assistance needs.

There are presently two experts in the Central Bank of Seychelles, one serving as the Director of Bank Supervision, and another as Director of Research. Both of them are performing well and are actively involved in training local counterparts. Governor Morel stressed that the process of localizing these posts was necessarily slow because of the low level of local educational facilities, and the need to send promising local staff abroad even for a basic undergraduate degree. Nevertheless, he plans to localize the bank supervision post by mid-1987, following a one-year extension of the present CBD expert. The Joint Director for Bank Supervision, who functions as the understudy, is expected to take over as Director. In the area of research, CBD technical assistance would have to continue for some more time until the Assistant Director of Research obtains additional on-the-job training, and, if necessary, also completes graduate level education abroad.

The Seychelles authorities are facing some difficulties in implementing the new Financial Institutions Act, which was drafted earlier with Fund technical assistance, and which is to come into effect on January 1, 1986. One of the foreign banks has raised objections to the licensing requirement that the bank provide an unconditional undertaking to meet all its obligations arising from banking business in Seychelles. The bank wished to provide only a conditional undertaking and the authorities are in the process of reaching a compromise on the conditions proposed by the bank. Also, some loss-making banks have protested the legal requirement to publish and exhibit their income statements. The authorities requested information on whether similar legal provisions exist in neighboring countries and on the experience of these countries in implementing such legal provisions.

There is presently one expert who serves as an Advisor to the Research Department of the Central Bank of Kenya. The expert is performing well. In addition to advising the Governor and the Director of Research on policy matters, he is also guiding the junior staff in the routine operations of the department. The authorities requested a replacement for the expert who will return to his parent central bank at the expiry of his term. As regards localization of this position, the authorities noted that under the new organizational structure for the Research Department, approved by the Governor, two Deputy Directors of Research will soon be appointed, one of whom will work closely with the expert so that by mid-1988 the present technical assistance can be dispensed with. Governor Ndegwa requested a new form of technical assistance in the area of training. He said that the previous effort to develop The College of Banking and Finance had not succeeded, with the College ceasing operations in 1983. He attributed this failure to a lack of information on the training needs of the banking industry, and the consequent duplication of training facilities, and the resulting lack of support from banks. Therefore, he needed an expert who could first conduct a survey of manpower and training needs in the banking industry, then identify gaps in banking skills and work out new training programs, if needed, to complement existing facilities.

Based on the recommendations of the Fund advisory report on the Kenyan banking system (a joint Fund-Central Bank of Kenya study completed in August 1984), the authorities have worked out detailed amendments to the Banking Act which are now being debated in Parliament. The amendments have been designed to strengthen the supervisory capabilities of the Central Bank, improve prudential controls on financial institutions, and bring about greater uniformity in the regulations governing banks and non-banks. In this context, the authorities reconfirmed their request for a follow-up advisory mission to analyze certain financial reform issues that were not fully addressed in the previous study due to limitations of time.

In Mauritius, two experts are serving under the CBD technical assistance program, one as Advisor to the Governor of the Bank of Mauritius and the other as Foreign Exchange Advisor to the Ministry of Finance. Both experts are performing well. The authorities were informed that technical assistance in the form of Advisor to the Governor would be terminated at the expiry of the term of the present incumbent, because such assistance had been given for a sufficiently long time to permit ready localization of the post. While the Governor was not pleased with this decision, he was reassured that CBD would be happy to assist him in other specific areas of central banking and in more specific policy issues in financial sector development. The Governor said that there was an urgent need to strengthen further the bank supervision system in Mauritius, particularly because of an increase in problem loans in some economic sectors, and that he planned to request technical assistance in this area soon. He currently obtains bank supervision assistance under a temporary arrangement with the Reserve Bank of India.

The Minister of Finance, the Honorable Seetanah Lutchmeenaraidoo, stated that he planned to liberalize foreign exchange regulations, and that the main function of the Foreign Exchange Advisor was to assist him in formulating liberalization measures and in developing and strengthening the expertise in the Ministry of Finance in monitoring policies in this area. At the initiative of the Minister of Finance, the expert has completed several studies on foreign exchange regulations in Mauritius, and has assisted in setting up a new Foreign Exchange Division in the Ministry of Finance. The Bank of Mauritius which administers exchange control regulations has been apprehensive of these developments which are seen as steps to undermine its authority. Against this background the future effectiveness of the Foreign Exchange Advisor is far from assured, since active support and collaboration from the Bank of Mauritius is essential to develop measures to liberalize exchange controls. The Minister and senior officials in the Ministry of Finance provided assurance that they would seek the cooperation and support of the Bank of Mauritius in order to ensure the effectiveness of the expert. The Ministry officials stressed that the Bank's apprehensions were misplaced since the intention in setting up a new Foreign Exchange Division in the Ministry was simply to develop parallel expertise in foreign exchange matters to enable them to monitor developments in this area, and to institutionalize the new external debt management system. In implementing the system, the authorities will be assisted by a Consultant on External Debt provided under the CBD technical assistance program, who will visit Mauritius in January 1986. At the request of the Minister of Finance, I conveyed to the Governor the Minister's views on the need to liberalize foreign exchange regulations and streamline exchange control procedures, and explained the role of the Foreign Exchange Advisor in developing expertise in these areas in the Ministry of Finance.

cc: Directors of Departments, Bureaus
and Offices
Mr. Brown

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

November 6, 1985

FROM: Wm. C. Hood Wm. C. H.

SUBJECT: Kenya--CF Request (Cereal)

In my covering memorandum of October 28 on the above paper, which you have approved for circulation to the Board, I had referred to the possibility of shortly being in a position to finalize the shortfall calculations on the basis of actual rather than partly estimated data for the shortfall year (attached). Actual data for the entire shortfall year were received a few days ago and it is this data on which the Board must base its decision. We have accordingly revised the paper and attach it for your approval.

The earlier paper proposed a purchase under the early drawing procedure of SDR 31.7 million in respect of a net shortfall of the same amount estimated for the 12 months ended June 1985. The net shortfall represented the sum of an excess in cereal imports (SDR 63.1 million) and an excess in merchandise exports (-31.4 million) with the latter excess calculated by use of estimated data for the month of June 1985.

Actual exports for the shortfall year, at SDR 964.7 million, were 2 percent less than the estimate in the earlier paper. Incorporating the actual data for the shortfall year, together with minor revisions of the projected earnings, which maintained the growth rates contained in the earlier paper, has the effect of reducing the excess in export earnings from SDR 31.4 million to SDR 25.2 million. With the excess in cereal imports (SDR 63.1 million) unchanged from the figure contained in the earlier draft, the net shortfall is now calculated at SDR 37.9 million, which is the purchase proposed in the attached paper.

Attachment

cc: Mr. Habermeier
Mr. Finch
Mr. Nicoletopoulos
Mr. Ouattara
Mr. Brown

Office Memorandum

→ MD

CK

PDE 10/31/85

OCT 31 1985

TO: The Managing Director (o/r)
The Acting Managing Director

October 28, 1985

OK Nov-1-85

FROM: Wm. C. Hood Wm. C. H.

SUBJECT: Kenya--CF Request (Cereal)

Attached for your approval is a draft paper on Kenya's request for a CF purchase of SDR 31.7 million (22.3 percent of quota) under the cereal decision. The purchase is equal to the net shortfall estimated for the year ended June 1985, which results from an excess in the cost of cereal imports that is partly offset by an excess in merchandise exports. The purchase would raise Kenya's outstanding CF purchases from 37.2 percent to 59.5 percent of quota.

The calculations are based on the early drawing procedure by which exports for the last month (June 1985) of the shortfall year have been estimated--for cereal imports, actual data are available for the whole year. Consequently, this case involves a risk of overcompensation, and, in that event, Kenya would be subject to a prompt repurchase expectation. In order to avoid this eventuality, we are hoping to be able to confirm export data for June 1985 before Board consideration of the request.

The case satisfies all the criteria for a CF purchase. Balance of payments need is evident and the Kenyan authorities' adjustment efforts, supported by a stand-by arrangement, meet the test of cooperation for the proposed purchase. The excess in cereal import costs was caused by the severe drought which sharply reduced domestic cereal production. Production of export commodities was also adversely affected by the drought but export earnings were in excess because of favorable world market conditions for key exports, especially tea.

Attachment

cc: Mr. Habermeier
Mr. Finch
Mr. Nicoletopoulos
Mr. Ouattara
Mr. Brown

INTERNATIONAL MONETARY FUND

November 4, 1985

Mr. Beveridge:

<u>Kenya: Briefing Paper Comments</u>

Attached are comments on the briefing paper for Kenya which was reviewed by Mr. Floros.

cc: Mr. Brachet
Mr. Johnson
Mr. Nowak

K. Burke Dillon KBD

November 4, 1985

Kenya: Briefing Paper

The brief describes the objectives of a new program (extended arrangement or one-year SBA) in very general terms (pages 7-10)--understandably so because of the preliminary nature of the discussions. According to the brief (page 10), the policy content will be developed during the forthcoming mission. The brief should, nevertheless, incorporate some discussion of the mission's view of the medium-term debt situation and the constraints that would impose on the programming exercise.

Specific points

1. Table 3 (Balance of Payments) is rather uninformative on debt and debt service. In particular, it should (a) provide information on projected interest payments, (b) break down net capital flows into gross disbursements and amortization, and (c) in the case of private long-term capital distinguish between debt and investment. Alternatively, a separate table on debt and debt service projections could be included.

2. Even allowing for special factors operating in 1986 and 1987, the medium-term projections (Table 3) incorporate a large increase in net official long-term capital over the period 1986-89. The brief should be more specific on new concessional and nonconcessional disbursements to be assumed under the program.

3. No short-term debt ceiling has been included in the current program. Any successor arrangement should incorporate a short-term debt program ceiling and the mission should at this time discuss with the authorities how such a ceiling would be designed and monitored.

4. In the present stand-by arrangement for Kenya (paragraph 4d(i)); the imprecise term "debt on commercial terms" is used. The term "nonconcessional debt," for which there is a Board-sanctioned definition, should be used in the program being negotiated.

INTERNATIONAL MONETARY FUND

November 4, 1985

Mr. Beveridge:

Kenya--Comments on Briefing

Attached are comments on the briefing paper for Kenya which was reviewed by Mr. Chopra.

cc: Ms. Dillon
Mr. Johnson
Mr. Nowak

Christian Brachet CB.

November 4, 1985

Kenya--Comments on Briefing Paper on Preliminary Discussions for the Use of Fund Resources

I. General Comments

The coverage and scope of the paper are fairly broad ranging, yet the paper lacks bizarrely in depth. This may reflect the preliminary character of the forthcoming discussions. Nonetheless, one would have hoped that the current brief be not quite so vague on several substantive points.

II. Specific Comments

1. The Fund's continued support to Kenya will occur either in the framework of an extended or of another stand-by arrangement. The brief, however--and quite surprisingly--does not elaborate upon what would determine the choice of one form of assistance over the other, an issue which is important from a policy viewpoint (at 42 percent of quota, it is proposed that yearly access be the same under either type of arrangement). Given that improvements in resource use are of primary concern in Kenya, and that the degree of specificity expected from the authorities regarding medium-term resource allocation policies presumably would be different under an EFF or a stand-by arrangement, the brief should clearly discuss the pros and cons of an EFF or another SBA in terms of (1) the criteria laid out in the decision of September 1984 and subsequent amendments and (2) the particular circumstances of Kenya.

2. The section on recent developments is too short. There is practically no discussion of exchange rate developments, money and credit policies, debt accumulation, the balance of payments outcome etc. in 1985.

3. The brief states that inflationary pressures have subsidized (page 3). This may be true relative to inflation in 1981-82. However, price increases in 1985 are expected to be higher than in either 1983 or 1984, indicating that inflation has not been brought fully under control.

4. The brief notes that real per capita GDP fell slightly between 1980 and 1985 (page 6). Since the economy grew at about 3.6 percent a year during the same period, clearly population growth was responsible for the decline in per capita GDP. It would therefore be useful if the brief provided some statistics or at least alluded to the population growth rate (one of the highest in the world if our information is correct).

5. In the fiscal area, the brief states that the objective would be to reduce the overall budgetary deficit to a level consistent with domestic

financing of about 2.5 percent of GDP. The level of the overall deficit, however, would be dependent on the amount of concessionary development assistance that could be obtained. The implication is that there is no intention to limit the overall deficit. This is a dangerous approach to follow since even concessionary foreign financing could have serious implications for the debt service ratio. It also is conceptually strange given that the overall deficit is the operative fiscal variable for the control of domestic spending. (This is one more instance where the fiscal targets should be couched in terms of cumulative limits on the PSBR--measured, if necessary for methodological reasons, from below the line.)

6. The reasons for the decline in the ratio of government revenues to GDP, and the "additional revenue measures" envisaged to reverse this decline, should be elaborated upon.

7. The brief makes a vague reference to introducing "a mechanism for setting at least some of the interest rates in a competitive manner" (page 9). Since a proper interest rate policy is fundamental for more efficient allocation of resources, it would be preferable if the brief provided more details on existing inefficiencies and the specific policies that would remedy these inefficiencies.

III. Presentation

1. Footnotes 5 and 7 in Table 1, regarding severe constraints on foreign exchange availability, should be explained more fully.

2. The reference to Table 1 on page 3 is inappropriate and should be deleted. The reference to Table 2 on the same page should be changed to Table 1, since the statistics cited in the text appear in Table 1 and not Table 2.

3. The phrase "sectoral loan in the agricultural sector" (pages 8 and 10), should be changed to either "sectoral loan for agriculture," or "loan for the agricultural sector."

4. The meaning of the phrase "deepen their production processes" (page 8) is not clear and hence needs fuller explanation.

Since the brief does not as yet discuss a new quantified program, the comparator table does not need updating.

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WASHINGTON, D. C. 20431

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RECEIVED OCT 24 1985 EXCHANGE TRADE RELATIONS

START ADDRESS IN THE BOX

The Treasury
Ministry of Finance and Planning
P.O. Box 30007
Treasury Building, Harambee Avenue
Nairobi, Kenya

START TEXT HERE

Executive Board took following decisions October 21: Quote

I. <u>1985 Consultation</u>

1. The Fund Takes this decision relating to Kenya's exchange measures subject to Article VIII, Section 2 and in concluding the 1985 Article XIV consultation with Kenya, in the light of the 1985 Article IV consultation with Kenya, conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Kenya maintains restrictions on payments and transfers for current international transactions subject to approval under Article VIII, Section 2, arising from limitations on foreign exchange for certain imports and rental income remittances. In the circumstances of Kenya, the Fund grants approval for their retention until October 31, 1986, or the next Article IV consultation with Kenya, whichever is earlier.

II. <u>Review Under Stand-By Arrangement</u>

1. Kenya has consulted with the Fund in accordance with

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MD
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MR.MTEI
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MR.S.COLLINS
MR.R.BROWN

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BWA

DRAFTED BY NAME (TYPE): BJOwens:BWAmes:SAS	EXT.: 6709	DEPT.: SEC	DATE: 10/21/85
AUTHORIZED BY NAME (TYPE): Leo Van Houtven, Secretary	AUTHORIZED BY NAME (TYPE):		

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SEC. 48 REV 1 11-18-82

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IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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paragraph 4 of the stand-by arrangement for Kenya (EBS/84/261, Sup. 2, 1/10/85) and paragraph 19 of the letter of the Minister of Finance and the Governor of the Central Bank of Kenya dated November 21, 1984 annexed thereto, in order to review policies and establish performance criteria for the remaining period of the arrangement.

2. The letter dated September 6, 1985 from the Minister of Finance and the Governor of the Central Bank of Kenya shall be annexed to the stand-by arrangement for Kenya and the letter of November 21, 1984 shall read as supplemented by the letter dated September 6, 1985.

3. Accordingly, and pursuant to decision No. 7918-(85/26) of February 20, 1985 on overdue payments to the Fund, the stand-by arrangement for Kenya shall be replaced by the revised arrangement in Attachment IV of EBS/85/217. Unquote

Leo Van Houtven, Secretary

Interfund

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WITHDRAWAL NOTICE

PROJECT

Project number	2008-011
Project name	African Dept Mission Files
Project tab number	95
Project box number	2

DOCUMENT

Series / File	AFR/Division Mission Files/Ke
Original box /file No	112/5
Date	September 6, 1985
Type	Letter
From	Ndegwa & Saitori
To	Mr. de Larosiere
Subject / Title	Ref ZZ/IMF/32: The arrival of adequate rainfall this year...
Number of pages	6
Classification	SECRET
Authority	Office of Executive Director Africa Group I

COMMENTS

also in ETR/AI/ETR Files/Kenya Correspondence and Memos 1985-86/box 135 file 4

THIS DOCUMENT IS IN THE COURSE OF A SYSTEMATIC PUBLIC DISCLOSURE REVIEW PROCESS

Entered by vsmallen Entered on 9/24/2008

INTERNATIONAL MONETARY FUND

August 30, 1985

Mr. Beveridge:

Kenya--Draft Staff Report

Attached are comments on the draft staff report for Kenya which I reviewed myself.

PN

Paulo Neuhaus

cc: Ms. Dillon
Mr. Johnson
Mr. Nowak (o/r)

August 30, 1985

Kenya--Comments on Draft Staff Report

1. The discussion on price performance (page 9) should be tightened and linked to the discussion of monetary developments. In particular, the statement that "food preferences . . . have stimulated inflationary pressures" (page 9) is not particularly illuminating (in spite of the digression on consumer preference for white versus yellow maize), and the statement that "most of the emerging pressures are traceable to the food sector" is somewhat tautological, in that food probably accounts for a large weight in the CPI. We also found the statement on page 28, that monetary policy has tended to be tighter than necessary, quite puzzling, in light of the recent inflationary surge. In any event, the section on money and credit should be accompanied by a standard monetary survey table and should include a reference to the annualized growth rates of money and credit in mid-1985 (e.g., as of end-June), to shed light on recent price performance.

As regards interest rates, the staff appraisal injunction on the maintenance of positive interest rates (page 44) could perhaps be more forceful and it should also refer to positive real lending rates.

2. Although the real effective exchange rate has returned to its December 1982 level following the April-July 1985 adjustments, we wonder whether the December 1982 is still an appropriate benchmark in light of the remaining unfinanced gaps in the medium-term balance of payments, as well as the ongoing and prospective liberalization of imports that should result in a more depreciated equilibrium real rate. Our concern seems to be shared by the cryptic and inconspicuous remark on page 57 calling for integration of tariff and exchange rate policies in the continued process of import liberalization. This remark should be elaborated and brought into the main text. Incidentally, the main views of the World Bank on other key aspects of the program should also be brought into the text, as indicated in our comments on the earlier draft.

3. In the fiscal area, there is virtually no quantification of the finances of public enterprises, even though they were seen as inefficient and as an area of concern by the Kenyan officials (page 27). We wonder whether an early consolidation of public enterprises with the rest of the public sector accounts is at all envisaged, but at least the report could elaborate on the situation of the major enterprises, the adequacy of their pricing and other policies, and the trends in credit obtained from the banking system (which should be explicitly identified in the monetary survey). We also feel that the report should be more forthcoming on the question of possible measures to reverse the steadily declining ratio of budget revenues to GDP, particularly as there are passing references (e.g., page 35) on the need for additional domestic resource mobilization as well as a reduction of the budget deficit below 4 percent of GDP in the medium term.

4. Given the very high annual rate of population growth in Kenya, of 3.8 percent (page 9), and its obvious bearing on issues such as growth of per capita income, unemployment, local and imported food requirements, and the medium-term prospects, we wonder whether the report could elaborate on the issue, beyond the passing reference to the World Bank's involvement in the development of a more effective population program (page 57).

5. As regards presentation:

   a. The report should include a table of contents.

   b. Tables 2 and 5 could be merged.

INTERNATIONAL MONETARY FUND

August 30, 1985

Mr. Beveridge:

Kenya--Draft Staff Report

Attached are comments on the draft staff report for Kenya which was reviewed by Ms. Puckahtikom.

Attachment

cc: Mr. Brachet
Mr. Johnson
Mr. Nowak

K. Burke Dillon KBD

August 30, 1985

Kenya--Comments on Draft Staff Report

The staff should provide a clearer discussion of the 1986 balance of payments since financial policies for 1985/86 are already in place and only 3 months will remain in 1985 by the time of the Board discussion. The very brief reference made (paragraph 3, page 6) is very ambiguous and the various pieces of information scattered in the section on the medium-term could add to the confusion. For clarity and completeness, section 1 (describing the performance and targets under the stand-by) could conveniently be expanded to indicate that: (i) the current account target for 1986 would be higher than in 1985 because of certain exceptional import need; (ii) on the basis of financing already secured and planned (including new commercial borrowing), a small financing gap would remain; (iii) this gap, nonetheless, could be expected to be filled by a combination of any additional concessional assistance above the budgeted level, and if necessary by further commercial borrowing combined with some use of reserves; and (iv) the resulting debt service burden over the medium-term is sustainable.

We would also note that since questions could be raised on recent large borrowing decisions involving commercial terms, it would be expedient for the staff to be neutral on the composition of the financing to fill the gap, and to break the link between the size of concessional assistance and commercial borrowing. In the staff appraisal, it would also be appropriate to tone down the language calling for exceptional donor assistance (page 44, first paragraph), and we would suggest that the second sentence of that paragraph be deleted.

Incidentally, we wonder if there is a certain inconsistency between the staff endorsement of the current Five-Year Development Plan (page 41) and the expression of concern on the air plane and boat purchases (page 44).

INTERNATIONAL MONETARY FUND

August 28, 1985

Mr. Jimenez:

We have no major problems with the letter of intent. Please see comments from the divisions attached.

Attachment

W. A. Beveridge

August 28, 1985

Kenya--Comments on the Debrief and Letter of Intent

The last mission has reached agreement with the authorities on the two outstanding issues, namely the adjustment in the real exchange rate and fiscal policy. The authorities appear to have satisfied the program requirements in the area of exchange rate policy. The agreement on fiscal policy also appears to be in line with Mr. Ouattara's memorandum to management of July 25, 1985, which had allowed an increase in the domestic financing of the budget to 3.6 percent of GDP compared with 2.5 percent of GDP included in the brief of June 18, 1985. We do not have a final copy of the July 25 memorandum but we assume that it was cleared by departments and approved by management.

1. External sector

In paragraph 4 of the letter of intent, it is noted that "a reduction in import duties, for the third year in a row, was also implemented to encourage export promotion and reduce domestic industrial protection." However, according to the draft staff report (8/7/85, page 8) it was import tariffs on raw materials, intermediate inputs, and capital goods (none of them presumably locally produced) that were reduced. Such tariff adjustments, of course, would increase industrial protection and would fail to reduce the anti-export bias of the trade system.

2. Presentational

The letter of intent would benefit significantly from editorial improvements ("redress" would be preferable to "redressment," "aim at" to "aim to," etc.).

August 28, 1985

Comments on Kenya Debrief and Letter of Intent

In the external debt area, there is no update (in the Letter, paragraph 15, nor in the last two back-to-office reports) of the performance to date under the external debt ceilings. In the circumstances of Kenya, such information at this stage would have been useful for two reasons. First, we recall that the program for Kenya provides for an automatic adjustment to the medium- and long-term external debt ceilings for any use of short-term trade credits to finance grain imports. Second, relatively large new debt commitments have been needed for the airplane and boat purchases (as noted in our earlier comments dated August 9). For these reasons, it would be helpful if the staff report, if not the letter itself, could provide a full account of the contracting of external debt to date, including the amounts contracted on short term to finance grain imports, and the amounts contracted for the airplane and boat purchases.

Incidentally, is there any operational content, from the standpoint of the program, to the statement in the letter "Any additional concessionary borrowing which may emerge during the fiscal year will be utilized to reduce the amount of commercial borrowing presently foreseen" (paragraph 10, last sentence)? Is there an automatic provision for reducing the debt ceilings for 1985 for any excess of concessional borrowing above the programmed level covering the 1985 portion of the fiscal year 1985/86?

cc: Mr Brookd
Ms. Dillon

Office Memorandum

To: The Acting Managing Director August 26, 1985

From: A. D. Ouattara

Subject: Kenya--Review of Stand-By Arrangement

Please find attached Mr. Jiménez' back-to-office report. The mission which just returned from Nairobi was able to negotiate the elements for the conclusion of the review of the current arrangement.

The letter of intent will be sent for Management's approval shortly.

Attachment.

cc. The Managing Director (o/r)
Mr. Collins

Office Memorandum

To: The Acting Managing Director — August 26, 1985

From: Julio M. Jiménez

Subject: Kenya--Review of Stand-By Arrangement

A mission 1/ visited Nairobi between August 13-20, 1985, and negotiated the elements for the conclusion of the review of the current stand-by arrangement initiated during the Article IV consultation discussions (June 26-July 10, 1985). The letter of intent is being cleared within interested departments and will be sent to management for approval shortly. The mission was able to confirm that all of the performance criteria established through June 30, 1985 have been observed and helped in the preparation of some of the data needed for a CFF request.

The previous mission had been unable to conclude the review of the arrangement because of two outstanding issues: (i) The effective exchange rate had been allowed to appreciate in real terms by an estimated 8 percent at the end of June 1985; and (ii) the 1985/86 budget, as presented to Parliament, appeared to underestimate expenditure and, consequently, had a potential overall budgetary deficit and domestic financing requirement inconsistent with the objectives of the program.

Although the mission had been authorized to accept a timetable for the reversal of the exchange rate appreciation, such flexibility was not required, as by the end of July, the apprecation had been fully reversed. In addition, a further depreciation of about 3 percent was implemented in the first half of August. The action was carried out quickly following discussions within the Government and the decision by the President that the exchange rate flexibility should be observed.

Prior to the mission, the authorities conducted an extensive review of the budget, and indeed confirmed that expenditure had been underestimated by about K Sh 1.3 billion (1.2 percent of GDP), as follows. The financing requirements of the National Cereals and Produce Marketing Board (NCPB) are estimated at about K Sh 1.3 billion, compared to K Sh 600 million included in the budget. The proposed wage adjustment, authorized by the Public Sector Wage Review Commission, would entail additional resources to those which had been budgeted, and the payments due to Uganda as a result of the settlement of assets and liabilities of the defunct East African Community had not been budgeted. However, some expenditures had been overallocated.

1/ Composed of Mr. Simpson (AFR), Ms. Huyser (AFR-EP), Ms. Hinds (secretary-RES), and myself.

To take care of these additional outlays and to reduce the overall budget and domestic financing requirements to a reasonable level, the Government is taking the following actions: (i) the consumer price of maize is to be raised in September in order to yield a minimum of K Sh 200 million (producer prices had been raised earlier); (ii) a decision has been made to begin to allow private sector participation in grain marketing around March 1986, this will reduce the financing requirements of the NCPB by a further K Sh 200 million; (iii) the accumulated stock of yellow maize will be exported, yielding a minimum of K Sh 300 million, based on an extremely conservative export price. These measures will reduce the requirements of the NCPB to the budgeted level. The authorities have set up a committee to review the financial position of the NCPB on a periodic basis to ascertain that it stays within the available resources. Consequently, NCPB should not need any additional access to the financial system from the levels outstanding at the beginning of the fiscal year, except for seasonal requirements.

The authorities' review of debt service payments uncovered that the budget continued to provide for interest payments for certain loans which have already been fully repaid, while the amortization to Uganda had been excluded. The savings arising from this double counting are to finance half of the payments due to Uganda. Most of the remainder will be met by the transfers, already agreed and budgeted, from the parastatals which have received the East African Community's assets, i.e. the Kenya Port Authority and Kenya Posts and Telecommunications. In addition, the Ministry of Finance has already advised Government Departments that this year's supplementary budget will not allow for an increase in net expenditure, but only for reallocation of authorizations. Consequently, the fiscal program agreed with the authorities targets an overall budgetary deficit slightly under 4.1 percent of GDP, compared to the brief's target of 4.2 percent, and 5.0 percent estimated for the previous fiscal year. This would also permit domestic financing to be constrained at the equivalent to 3.4 percent of GDP, below the level of 3.6 percent authorized in the mission's brief, about 1.6 percent of GDP will be from the banking system and 1.9 from non-banks (Table 1). With respect to the latter, the authorities also agreed to limit non-bank financing from the financial institutions controlled by the Central Bank to half of this amount, with the remainder coming from the national Social Security fund and insurance companies. It is likely that these institutions will be able to provide more resources than presently targeted, allowing for a reduction in other types of financing. The Government will need to borrow about US$50 million from the foreign commercial markets in the coming fiscal year to round out the necessary budgetary financing and for balance of payments purposes. This amount of borrowing had already been programmed into our balance of payments projections, included in the medium-term outlook and in the debt service projections developed at the time of the consultation.

The authorities reiterated their desire of entering into negotiations for an extended arrangement before the year ends, and, consequently, have begun preparing their forward budget program in such a way that budgetary policy would target an overall budgetary deficit in line with the medium-term outlook discussed with the authorities, which could involve a reduction in the overall budgetary deficit to about 3.5 percent of GDP in the coming years.

Attachment: Table 1.

cc. The Managing Director (o/r)
ASD
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Mr. Collins

Table 1. Kenya: Selected Economic and Financial Indicators, 1981-86

	1981	1982	1983	1984		1985		1986
				Program	Estimate	Prog.	Estimate	Prog.
				(Annual percent changes, unless otherwise specified)				
National income and prices								
GDP at constant prices	4.1	0.8	3.9	4.0	0.5	4.0	3.8	4.8
GDP deflator	10.4	10.7	10.4	8.2	10.3	8.0	11.0	10.0
Consumer prices	20.2	14.4	10.1	8.0	10.8	9.0	12.0	9.0
External sector (on the basis of SDRs)								
Exports, f.o.b.	-5.6	-7.5	2.2	9.3	16.6	-1.6	-2.8	8.4
Imports, c.i.f.	-9.7	-15.7	-16.2	9.9	15.7	8.1	2.9	8.2
Non-oil imports, c.i.f.	-16.0	-17.1	-15.7	13.6	25.1	11.1	4.7	11.4
Export volume	-5.2	-2.9	-4.0	2.9	0.8	4.0	5.9	4.0
Import volume	-21.8	-15.3	-21.0	5.1	15.2	5.4	0.7	4.5
Terms of trade (deterioration -)	-13.4	-4.8	-6.0	2.1	17.0	-8.1	-10.2	0.2
Nominal effective exchange rate (depreciation -) 1/	-18.2	-11.0	-3.5	...	-2.4	...	...	--
Real effective exchange rate (depreciation -) 1/	-10.5	-3.7	1.7	...	-3.6	-2.5	...	--
Government budget 2/								
Revenue and grants	20.3	12.4	7.6	10.9	9.8	17.3	12.1	14.2
Total expenditure	24.9	8.4	-3.6	12.2	13.2	18.1	10.4	15.5
Money and credit 2/								
Domestic credit	20.0	26.9	6.4	14.0	8.9	18.0	12.3	14.0
Government	74.6	55.1	-0.8	17.6	3.4	29.0	12.7	19.7
Other sectors	7.7	16.7	9.9	12.0	11.4	13.5	12.2	11.7
Money and quasi-money (M_2)	7.1	8.8	11.3	9.8	11.4	8.1	9.7	12.0
Velocity (GDP relative to M_2) 3/	3.2	3.2	3.4	3.98	3.3	3.52	3.58	3.68
Interest rate (annual rate) 3/								
Savings deposit (min.)	10.00	12.50	12.50	12.50	11.00	10.50	11.1	11.0
Average time deposit	11.0	13.18	13.07	13.75	11.54	11.75	11.75	11.75
Maximum lending rate	14.00	16.00	15.00	15.00	14.00	14.00	14.00	14.00
				(In percent of GDP)				
Government budget 2/								
Revenue and grants	26.2	26.0	24.7	22.4	24.1	26.2	23.8	24.0
Total expenditure and net lending	34.8	33.4	28.4	26.5	28.6	31.4	27.9	28.0
Current expenditure	24.7	23.4	22.3	19.8	21.0	23.6	20.7	20.7
Development expenditure and net lending	10.1	9.9	6.2	6.7	7.6	7.9	7.2	7.3
Overall deficit 4/								
Including grants	9.5	6.7	3.1	4.1	4.2	5.1	5.0	4.1
Excluding grants	10.3	8.1	4.6	5.8	5.4	7.7	6.5	6.2
Domestic bank financing	2.8	2.6	-0.2	1.4	0.8	2.4	0.8	1.5
Foreign financing	4.9	1.7	1.7	1.2	0.9	1.6	1.0	0.7
Gross domestic investment	28.4	22.6	20.9	20.0	21.6	21.5	22.4	22.3
Gross domestic savings	19.4	17.9	19.9	16.2	19.7	18.2	19.9	19.0
External current account deficit 5/								
Including grants	11.1	7.7*	2.3	3.6	3.0	5.6*	4.5*	5.2
Excluding grants	12.3	8.9*	4.4	5.1	5.4	7.8*	6.5*	6.4
External debt								
External debt inclusive of Fund credit (beginning of period)	40	45	50	36	49	46	47	45
Debt service ratio 6/	18	24	28	29	28	31	30	28
Interest payments 6/	10	13	11	10	11	12	10	10
				(In millions of SDRs, unless otherwise specified)				
Overall balance of payments 7/	-198	-150**	89	-24	45	-202**	-100	15
Gross official reserves (months of imports)	1.4	1.6	3.5	2.0	3.3	2.7	2.8	2.7
External payments arrears	--	--	--	--	--	--	--	--

1/ December to December variations.
2/ Fiscal year ending June 30.
3/ Level in percent.
4/ Figures do not add up because of adjustment to cash basis.
5/ *Reflects severe constraint on foreign exchange availability.
6/ In percent of exports of goods and services.
7/ **Reflects severe constraint on foreign exchange availability.

cc: Mr. Beactel
Mrs. Dillon

Office Memorandum

To: Mr. Beveridge
Mr. Yandle
Mr. Chandavarkar
Mr. Francotte

August 26, 1985

From: J.M. Jiménez

Subject: Kenya--Letter of Intent

Attached is the letter of intent for the remainder of the program with Kenya. I would appreciate your comments by close of business August 28, 1985.

Office Memorandum

To: Mr. Ouattara
Mr. Bhatia

August 27, 1985

From: Julio M. Jiménez JMJ

Subject: Kenya--Letter of Intent

Attached is the draft letter of intent for the review of the current stand-by arrangement with Kenya. I would appreciate your comments, if any, by close of business Tuesday, August 27, so that the letter can be circulated to other departments.

Attachment.

cc. Mr. Artus

Mr. J. de Larosiere
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Larosiere:

1. The arrival of adequate rainfall this year has prevented the 1984 drought from turning into a major national disaster. The Government of Kenya was able to surmount the grave difficulties arising from the drought by moving swiftly in mounting a relief effort and adopting the necessary economic and financial policies which facilitated the purchase and distribution of grains. This limited the drought's effect on economic activity and allowed for the continuing adjustment of the economy. In these endeavors, the Government was greatly assisted by many friendly donors. On the basis of the price incentives established over several years, farmers have responded with renewed energy and a large grain crop is now expected in the current year. The short-term economic outlook has improved considerably, as a result of the favorable developments in weather and farm production.

2. The economic policy objectives for the 1985/86 fiscal year seek to further an increased tempo of economic activity within a framework designed to reach a sustainable balance of payments position in the medium term and help reduce domestic price pressures. The growth of real GDP is estimated to rise to 3.8 percent in 1985 from the drought-reduced level of 0.9 percent in 1984. The drought dislocations and the continued increase in administered prices have led to a temporary strengthening of inflationary pressures, from 10 percent in 1984 to 12 percent in 1985. A fall to about 9 percent is expected in 1986 as the food situation improves. The Government is conscious of the need to provide an environment which will lead to a positive real per capita income growth in the medium term to alleviate unemployment and increase the welfare of the population.

3. Since 1980/81, the Government has made substantial progress in reducing the internal and external imbalances which have encumbered the economy. The overall fiscal deficit was reduced from 9.5 percent of GDP in 1980/81 to 4.2 percent of GDP in 1983/84. Drought relief in 1984/85 resulted in a temporary rise in the deficit to 4.8 percent of GDP, but the underlying deficit (excluding drought-related expenditures) recorded a further reduction to about 4.0 percent of GDP. The rise in net domestic credit was adjusted downward during this period, while price inflation fell from 22 percent in 1981 to 10 percent in 1984. At the same time, the external current account deficit was reduced from 11 percent of GDP in 1981 to 3 percent of GDP in 1984. Overall balance of payments surpluses were recorded in 1983 and 1984. These developments allowed for a debt service

ratio which will decline rapidly after 1985. So far in 1985, all of the performance criteria established under the program have been observed. The adjustment of the economy was difficult to attain because it occurred in a period characterized by a deep and protracted recession in the world economy, considerable exchange rate volatility, excessively high real interest rates, and declining external assistance to developing countries. The rapid budgetary adjustment undermined the Government's development effort and rapid cutbacks in real expenditure resulted in administrative inefficiencies. The drought emergency added to the difficulties and delayed the redressment of the resource allocation problems. Real per capita GDP has fallen since 1980.

4. The outlook during the 1985/86 fiscal year continues to be affected by the drought. Expected revenue yields will be depressed from the losses sustained by the private sector, relief operations are still continuing in some parts of the country pending the harvest, which begins in October, and reconstruction and increased maintenance of some assets, such as irrigation works, is needed. The 1985/86 budget included a reduction in the income tax, which offsets some of the inflationary impact of the last few years on tax brackets, to encourage private sector activity. A reduction in import duties, for the third year in a row, was also implemented to encourage export promotion and reduce domestic industrial protection. Although increases in sales and other taxes and fees were put into effect to recoup the revenue loss of the above measures, total revenue is expected to fall in relation to GDP. However, the thrust of tax policy is likely to help promote a more rapid recovery of the private sector economy, improving revenue yields in the medium term.

5. On the expenditure side, the 1985/86 budget includes a program to rationalize budgetary expenditure and to set the framework for a renewed development effort based on improved resources allocation. This requires an increase in recurrent expenditure to provide for the delayed maintenance of government assets to improve their productivity. These expenditures are foreseen to have an important impact in improving services and the growth performance of the economy. In this regard, a special appeal has been made to donors for assistance in covering the recurrent costs of development programs. Negotiations have begun with the World Bank on a sector loan for budget rationalization. In the development budget, priority has been given to speed up the completion of projects which are in an advanced stage of implementation, cancelling projects with low priority, and limiting the initiation of new projects to those that have a high priority. The process of rationalization will improve the capital output ratio in the public sector, but will need the strong support of donors, not only to channel assistance toward recurrent expenditures, but to accept the cancellation or redesign of some of their favored projects.

6. A major statement of economic policy that will incorporate the budget rationalization program to the current five-year development plan and recast the plan's objectives, given the delayed implementation resulting from the drought emergency, is being prepared and will be submitted to Parliament shortly.

7. The magnitude of the costs necessary for the importation and distribution of grains during the drought emergency required the Government to incorporate in the budget the financing of grain importation and drought relief by the National Cereals and Produce Board (NCPB). Some additional outlays will be necessary in the current fiscal year as the crop will not be harvested until October. The recent drought experience has highlighted the need for a strategic grain reserve. Its accumulation is being facilitated by the expected bumper grain harvest, but will increase NCPB's financial requirements during the fiscal year, with an impact on the budget. A financing requirement of K Sh 1,100 million is projected, after allowing for private sector participation in grain marketing. Consumer grain prices have been increased and will reduce the financing requirement by K Sh 200 million, while the export of the stocks of yellow maize are expected to yield a minimum of K Sh 300 million, leaving a residual of K Sh 600 million, which will be provided by the budget, in keeping with the principle established last year of meeting NCPB's requirements from the budget, other than purely seasonal needs, which are met through a revolving overdraft with the banking system.

8. The 1985/86 revised budget is a transitional budget still reflecting the drought difficulties, as it contains special expenditures related to food security and tax measures, aimed at promoting a quicker recovery in the private sector. It includes an allocation for the wage increase recommended by the Public Sector Wage Review Commission. The last wage adjustment was carried out in 1981 and the erosion in pay scales since then has been a grave disincentive in the civil service. The budget has been framed on an overall deficit equivalent to 4.1 percent of GDP. Excluding the outlays for the strategic grain reserve, the underlying budgetary deficit would be 3.7 percent of GDP. The target compares to an overall deficit of 5.0 percent of GDP in 1984/85, including drought-relief expenditures, and 4.1 percent of GDP, excluding these outlays, and is possible only because of an extra ordinary large inflow of foreign grants, equivalent to 2.1 percent of GDP. This has been the result of the counterpart of donor assistance for drought relief being deposited in the Government's accounts only this fiscal year. This also explains the shortfall in grant receipts in the previous fiscal year. New procedures introduced this year will speed up the payment to the treasury of resources arising from commodity assistance, providing a one time gain.

Government departments have been advised early that in the current year the supplementary budget will not allow a net increase in expenditure, but only reallocations of expenditure authorizations.

9. The special circumstances faced by the economy since 1983/84 has not permitted the reduction in the overall deficit and particularly the domestic financing component of the budget considered desirable by the government. The forward budget review to start in November will aim to implement such an adjustment. The Government hopes that the Fund will be able to help in this endeavor. This work is given a high priority because of the difficulties foreseen in maintaining a high level of grants in the future, thus requiring new revenue measures in the 1986/87 budget.

10. Budgetary outlays in terms of GDP will be reduced further in 1985/86 and the rationalization of the development projects will result in a slowdown in the use of previously contracted external loans. The Government is hopeful that during the year some donors will permit the reallocation of their commitments toward recurrent costs or to other projects with a higher priority. This request is already being discussed with donors. At the present time, foreign borrowing is expected at 0.7 percent of GDP and domestic financing at 3.4 percent, compared to 1 percent of GDP and 3.8 percent, respectively in the previous year. Any additional concessionary borrowing which may emerge during the fiscal year will be utilized to reduce the amount of commercial borrowing presently foreseen.

11. Monetary policy in 1985/86 aims at generating increasing financial savings while providing adequate finance to promote a rise in economic activity by limiting net credit to the government. Both net domestic credit and broad money are programmed to expand by less than nominal GDP in order to help reduce inflationary pressures. About 60 percent of the growth in domestic credit will be allocated to the private sector; little growth in credit to public enterprises is expected, as NCPB's financing needs are being supplied through the budget. Consistent with these objectives, net domestic credit which was K Sh 28,113 million on June 30, 1985 will not be allowed to exceed K Sh 31,555 million on September 30, 1985, with an indicative target of K Sh 31,983 million for December 31, 1985. Within these totals, net credit to the Government, net of the deposits with the Treasury of the Cereals and Sugar Finance Corporation (CSFC), which was K Sh 7,278 million on June 30. 1985 will be limited to K Sh 9,625 million on September 30, 1985 with an indicative target of K Sh 9,480 million for December 31, 1985. Interest rates are being kept under review to assure that they remain positive in real terms when compared to the underlying rate of inflation.

12. The current account deficit of the balance of payments is presently projected at 4.5 percent of GDP for 1985 and 5.5 percent for 1986 (3.5 percent, excluding the purchase of airplanes). A further reduction in expected in the medium term. For 1985, a balance of payments deficit of SDR 100 million is presently projected and is fully financed. In order to meet the Government's objective of rebuilding the net reserve position of the banking system in 1986, additional financing presently foreseen at about

SDR 40 million will need to be arranged for 1986. The Government also hopes that a new arrangement with the Fund can be put in place during 1986. The additional financing for 1986 now foreseen is smaller than what was projected when the current program was negotiated, despite the budget rationalization.

13. With the 1985/86 budget, the import system was liberalized further, 317 items (12 percent of all items) were transferred to schedule 1A (freely importable items). After this adjustment, schedule 1 accounts for 42 percent of all items, schedule 1B (liberally licensed items) for a further 23 percent, while schedule 2AS (items freely licensed once approval by supervising agencies, i.e., mainly petroleum products and fertilizers), has 3 percent of items. Thus, 68 percent of items are liberally licensed, while the restricted category only retails 32 percent of items. A further liberalization of the import system through additional shifts of items is expected in 1986. Meanwhile, the implementation of the system will continue in a liberal manner, as characterized in recent years.

14. The Government gives a high priority to the maintenance of an adequate exchange rate, through a flexible exchange rate policy. Actions in July and August have reduced the real effective exchange rate to below the target level of December 1982.

Dare

15. In 1985, Kenya's debt service ratio (including IMF) is estimated at 30 percent of exports of goods and services. The ratio is projected to fall rapidly during the rest of the decade, including the debt service arising from the financing of the projected current account deficit. The Government gives high priority at maintaining an adequate debt service ratio and will make every effort to remain in compliance with the limits established in the program for the contracting of public and publicly guaranteed external debt.

16. Also, for the duration of the program period, the Government does not intend to introduce or modify any new multiple currency practice, impose new, or intensify existing restrictions on payments and transfers for current international transactions, conclude bilateral payments agreements which are inconsistent with the Fund's Article VIII, or introduce new or intensify existing restrictions on imports for balance of payments reasons.

17. The Government of Kenya believes that the policies set forth in this letter are adequate to meet the objectives of its program, but it will take any further measures that may become appropriate for this purpose. Kenya will consult with the Fund on the adoption of any measures that may be appropriate, in accordance with the policies of the Fund.

Yours sincerely,

/s/
P. Ndegwa
Governor of the Central
Bank of Kenya

/s/
Professor George Saitoti
Minister of Finance

Office Memorandum

To: Mr. Artus

From: W.A. Beveridge

Subject: Kenya

August 20, 1985

It is not my intention to check on whether suitable care has been taken with respect to my earlier comments on the Kenyan draft. I can only assume that they have been or else I am sure you would have advised me accordingly.

cc: Mr. Quirk

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MR.DANNEMANN
MR.S.COLLINS

I.M.F.
WSHINGTON DC

19TH AUGUST 1985

ATTN: TREASURY

FURTHER TO OUR CABLE OF 28 JUNE 1985 WE WISH TO INFORM YOU THAT THE CENTRAL RATE OF THE KENYA SHILLING IS NOW SHS 17.737761 TO ONE SDR EFFECTIVE 16 AUGUST 1985 AND IS SUBJECT TO MARGINS OF 2.25 PERCENT ON EITHER SIDE OF THE PEG STOP

REGARDS

PHILIP NDEGWA
GOVERNOR
CENTRAL BANK OF KENYA
NAIROBI

C.C. MR MTEI

22721 KENYABANK
440040 FUND UI

...
REPLY VIA ITT

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TIME: 02:28 08/19/85 EDT
CONNECT TIME : 201 SECONDS

INCOMING CABLE/TELEX

Office Memorandum

To: Mr. Jimenez

From: W.A. Beveridge

August 9, 1985

Subject: Kenya--Draft Staff Report

Before dealing with more specific comments on the draft report, let me make three observations of a general nature.

First, I found the report to be rather long and repetitive. A modest reduction in length (perhaps of about 10 percent) would enhance its clarity and coherence without loss of substance. The section on resource allocation in particular could be cut considerably.

Second, the medium-term balance of payments scenario cannot satisfactorily be discussed in isolation from prospective developments in other sectors of the economy. If the case for medium-term viability is to be convincing, it must be supported by a discussion of demand management and structural policies that are consistent with the attainment of viability. This will require explicit identification of the size of budget deficit that the staff regards as sustainable and financeable over the medium term, in the context of the expected role for the private sector, and assumptions regarding monetary growth (inflation plus real growth). Moreover, in view of the impending request for an EFF, the structural problems that have to be addressed over the medium term should be clearly identified. Most especially, Directors will want to know if Kenya's need to grow at a rate no less than the population growth is consistent with financial viability.

Third, if the staff report and review paper are to be issued separately, then the reasons why the midterm review and Article IV consultation cannot be completed concurrently need to be stated. In doing so, the report will have to go into the problems that the staff presently has with the 1985/86 budget, particularly the weakness in the revenue and expenditure estimates and the unacceptably high overall deficit.

I have a number of specific comments.

1. The staff's appraisal of the external competitiveness of the Kenyan economy is rather narrow in scope, being confined largely to a discussion of recent movements in the real exchange rate. The report's coverage of this issue really needs to include an assessment of profitability in the nontraditional export sector, the adequacy of producer prices, and the structural impedements to improved competitiveness. It is essential that the views of the World Bank in this area to be obtained and included in the report.

2. While I acknowledge that progress has been made in dismantling quantitative restrictions on imports, the staff assessment is far too positive in tone. In particular, there is an inference that, because

only 6 percent of 1983/84 import values are at present in the restrictive category 2B, the system is being administered in a relatively liberal manner. While clearly it is not possible to measure the actual demand for imports in the restrictive category, the fact that they include one third of all items would appear to provide prima facie evidence that a substantial portion of demand is not being satisfied and that the import regime is still predominantly restrictive in nature. If liberalization is to proceed at an acceptable pace, the authorities must be pressed into taking substantive action in the 2B category. This position should be stated clearly in the staff appraisal.

3. The airplane and boat purchases on nonconcessional terms represent possibly the beginning of a dangerous trend. A stronger expression of the staff's concern is needed.

4. There is no assessment in the staff appraisal on the adequacy of the level of interest rates. A forceful statement is required to the effect that deposit, as well as lending rates, need to be maintained at positive levels in real terms.

5. The section dealing with exchange rate policy will presumably have to be modified to take into account the real depreciation that I understand has recently occurred. The staff appraisal should, however, make it clear that the authorities will need to be vigilant in ensuring that no further losses in competitiveness arise.

cc: Mr. Ouattara, Mr. Artus

To : The Managing Director
The Deputy Managing Director

Date: July 25, 1985

From : A.D. Ouattara

Subject : Kenya - Review of Stand-By Arrangement

As you will recall Mr. Jiménez in his back-to-office report, explained that the recent mission to Kenya had been unable to complete the review of the stand-by arrangement due to two outstanding issues. The authorities made some suggestions to deal with these issues which we have now reviewed. Below is our proposed strategy for finalizing the review.

Their proposals are formulated against the background that Kenya appears to have met all the performance criteria set through June 30, 1985. Apart from some appreciation of the real effective exchange rate, there are no departures from the objectives of the program. It should be noted that over the last few years Kenya has made substantial progress in adjusting the economy.

The mission found that the budget for 1985/86 (July-June) underestimates possible expenditures and that there is an excessive reliance on domestic financing, which will be inconsistent with the balance of payments projections and the monetary program. The authorities agreed to review possible expenditure commitments in order to derive a more comprehensive expenditure level.

The budget as presented included an overall deficit equivalent to 4.3 percent of GDP. However, as a result of underestimating expenditures and some revenue overestimation, the overall deficit is in fact about 5.2 percent of GDP. Given the expected bumper harvest and drought difficulties encountered last year, the authorities are eager to take this opportunity to build-up a strategic grain reserve. However, the budget only provided for about half of the needed resources (K. Sh. 400 million or 0.4 percent of GDP). The mission indicated to the authorities that all of the finance for the strategic grain reserve should be provided through the budget and that adequate allowances be made for all expected expenditures. We propose that measures of about 1 percent of GDP be implemented to reduce the overall deficit. These measures should be in place prior to the Board's discussion and, in order to improve the quality of the adjustment, emphasis will need to be given to new revenues, due to the large reduction in the ratio of expenditures to GDP that has already taken place. This would leave the overall deficit at about 4.2 percent of GDP, which would involve a slight increase in the budgetary objective included in the briefing paper of 4.0 percent of

GDP. However, net of the extraordinary, non-recurring outlays for the strategic grain reserve, the underlying deficit will only be 3.5 percent of GDP. Bank financing as in the briefing paper will need to be limited to 1.7 percent of GDP and nonbank financing (including the National Social Security Fund) to 1.9 percent. Foreign financing will account for the remaining 0.6 percent of GDP, about half of which will be on commercial terms. These resources are included in the 1986 balance of payments forecast and their use is consistent with a declining debt service ratio.

Despite frequent adjustments in the exchange rate since the program began (1.7 percent of which took place in June), the real effective exchange rate of the shilling has appreciated, and at the end of June it was some 8 percent above its target level. The authorities recognized that they have fallen short of the exchange rate commitments under the program, but indicated that this had been a temporary departure to limit the impact of the adjustments on prices at a time when wage contracts were under negotiation, and that it should not be construed as an abandonment of the flexible exchange rate policy. The authorities stressed that they would reverse the appreciation over several months and hoped that the Fund would show flexibility in agreeing to such a schedule rather than requiring that the full amount be reversed quickly. The mission's brief had stressed that no additional drawings would be made until the exchange rate was brought down to its required level. At the present time, two drawings are outstanding. The one based on end of June performance criteria and the completion of the present review of the arrangement and a final drawing to be made on the basis of end-September performance criteria. In order to give the authorities the needed flexibility to move the exchange rate in small amounts, we propose to accept a schedule of adjustments which will bring the exchange rate to its required level by mid-November. This proposal would allow the first drawing on the basis of end of June performance criteria to be carried out, but would make the final drawing subject to the attainment of the exchange rate objective. Consequently, we would require that 5 percentage points of the required adjustment be effected by mid-September, a further 2 percentage points by mid-October, and that the exchange rate be fully adjusted by mid-November.

If you agree with the above proposals, a mission could return to Nairobi as soon as the authorities have revised the budget to finalise the letter of intent. As you will remember, the authorities are interested in an extended arrangement to follow the present stand-by arrangement and, therefore, we would have a continuing opportunity to review developments in Kenya and ascertain that imbalances do not re-emerge.

This memorandum has been cleared by ETR (Mr. Beveridge) and FAD (Mr. Yandle).

cc: Mr. Collins

JMJiménez:ekf
7/25/85

Office Memorandum

TO: Mr. Jiménez

FROM: W.A. Beveridge

July 24, 1985

SUBJECT: Kenya--Review of Stand-By Arrangement

Let me answer in turn your proposals regarding the fiscal and exchange rate actions that must be undertaken for the review to be completed.

1. I can go along with the proposal for a budget deficit in 1985/86 of 4.2 percent of GDP though it clearly represents a departure from the original program projections. You might however clarify the assumptions that have been made, if any, regarding the financing of the strategic grain reserve by exports of existing stocks of yellow maize which, I understand, cannot be sold domestically. I would also strongly suggest that, as a matter of course, expenditure related to the replenishment of grain reserves be treated as a budgetary item. This type of expenditure can hardly be regarded as a one-time, nonrecurrent outlay and should, like all other budgetary expenditures, be constrained by the availability of bank credit to the Government.

2. I remain concerned that the commitment with regard to exchange rate policy has not been complied with and am, quite frankly, somewhat reluctant to agree to a further delay in bringing the real rate down to the level agreed. However, before any decision can be made, we need to know precisely what schedule of adjustments you have in mind and when you expect the Board discussion of the paper to take place.

cc: Mr. Ouattara
Mr. Bhatia
Mr. Yandle

Mr. Bereridge

Office Memorandum

TO: Mr. Jimenez July 24, 1985

FROM: C.A. Yandle

SUBJECT: Kenya--Review of Stand-by Arrangement

I have only a few comments on the draft memorandum to Management evaluated this morning.

1. As a point of analysis, stocking of foodgrain is expenditure just the same as purchasing stocks of any other commodity or government requisite, and should be seen as such. For this reason, the special category being afforded these outlays, as outlined on page 2 of your draft, is not appropriate. Revised wording which removes the special category implications is attached.

2. While the briefing fiscal deficit target would be preferable, I can accept the small increase proposed, provided this is an absolute maximum. I am concerned at the change in the financing pattern, though. In this connection, an important strengthening of the memorandum would be to (i) include a statement on the degree of private sector crowding likely to result from the higher nonbank borrowing (in comparison with the briefing position), and (ii) the change in the debt service ratio likely to result from the higher foreign borrowing.

3. The quality of the additional one percent to GDP in fiscal measures is important, and it would be helpful to address this issue in the memorandum. As I recall, petroleum taxation was reduced last February and the 1985/86 budget contained little in the way of revenue measures, resulting in a declining revenue ratio. We consider, therefore, that the bulk of the measures should be on the revenue side, and that these measures should contribute to an improved longer-term revenue structure. They also should be in place prior to Board discussion.

4. On the exchange rate adjustment, it would be helpful if the "important proportion" (page 3) to be required before Board discussion could be specified (e.g., at least half).

Attachment

cc: Mr. Ouattara
Mr. Tait (o/r)
Mr. Mahler

from the banking system and 2.2 percent from nonbanks. The remainder was to be financed by external loans.

At the present time, the budget includes K. Sh. 400 million (0.4 percent of GDP) for drought relief and a strategic grain reserve, but about twice this amount is likely to be needed. The mission indicated to ~~encouraged~~ the authorities that all of the finance for the strategic grain reserve should be provided through, and accounted in, the budget and that adequate allowance be made for these outlays. There is also an additional likely underestimate of the deficit of about K. Sh. 600 million. Consequently, the budget deficit is likely to be about 5.2 percent of GDP, if additional measures are not taken. The briefing paper had authorised the mission to set the overall budgetary deficit objective at 4.0 percent of GDP, but given the position as outlined above ~~that expenditures of almost 0.7 percent of GDP will go toward the strategic grain reserve, which would not usually be a budgetary item~~, we would recommend increasing the budgetary target slightly to a maximum of 4.2 percent of GDP. ~~This would keep the underlying budget deficit, excluding the outlays for grain, at about 3.5 percent of GDP.~~ This will still require a combination of additional revenue and expenditure measures of almost 1 percent of GDP. The domestic financing components will also have to be adjusted downwards from the budget levels. Bank financing as in the briefing paper will need to be limited to 1.7 percent of GDP and nonbank financing (including the National Social Security Fund) to 1.9 percent. Foreign financing will account for the remaining 0.6 percent of GDP, about half of which will be on commercial terms. This financing is consistent with a declining debt service ratio.

Office Memorandum

vb.

To : Mr. Beveridge
Mr. Yandle

Date: July 23, 1985

From : Julio M. Jiménez JMJ

Subject : Kenya - Review of Stand-By Arrangement

Mr. Bhatia has asked me to circulate the attached note for your comments, which I would appreciate early in the afternoon of July 24, 1985.

Attachment

DRAFT
JMJ:ekf
7/23/85

To : The Managing Director
The Deputy Managing Director

From : A.D. Ouattara

Subject : Kenya - Review of Stand-By Arrangement

As you will recall Mr. Jiménez in his back-to-office report, explained that the recent mission to Kenya had been unable to complete the review of the stand-by arrangement due to two outstanding issues. The authorities made some suggestions to deal with these issues which we have now reviewed. Below is our proposed strategy for finalizing the review.

Their proposals are formulated against the background that Kenya appears to have met all the performance criteria set through June 30, 1985. Apart from some appreciation of the real effective exchange rate, there are no departures from the objectives of the program. Over the last few years Kenya has made substantial progress in adjusting the economy. This record would suggest that we could show some flexibility.

specify

The mission found that the budget for 1985/86 (July-June) underestimates possible expenditures and that there is an excessive reliance on domestic financing, which will be inconsistent with the balance of payments projections and the monetary program. The authorities agreed to review possible expenditure commitments in order to derive a more comprehensive expenditure level.

The budget as presented included an overall deficit equivalent to 4.3 percent of GDP, of which 1.9 percent of GDP was to be financed from the banking system and 2.2 percent from nonbanks. The remainder was to be financed by external loans.

At the present time, the budget includes K. Sh. 400 million (0.4 percent of GDP) for drought relief and a strategic grain reserve, but about twice this amount is likely to be needed. The mission encouraged the authorities that all of the finance for the strategic grain reserve be provided through, and accounted in, the budget and that adequate allowance be made for these outlays. There is also an additional likely underestimate of the deficit of about K. Sh. 600 million. Consequently, the budget deficit is likely to be about 5.2 percent of GDP, if additional measures are not taken. The briefing paper had authorised the mission to set the overall budgetary deficit objective at 4.0 percent of GDP, but given that expenditures of almost 0.7 percent of GDP will go toward the strategic grain reserve, which would not usually be a budgetary item, we would recommend increasing the budgetary target slightly to 4.2 percent of GDP. This would keep the underlying budget deficit, excluding the outlays for grain, at about 3.5 percent of GDP. This will still require a combination of additional revenue and expenditure measures of almost 1 percent of GDP. The domestic financing components will also have to be adjusted downwards from the budget levels. Bank financing as in the briefing paper will need to be limited to 1.7 percent of GDP and nonbank financing (including the National Social Security Fund) to 1.9 percent. Foreign financing will account for the remaining 0.6 percent of GDP, about half of which will be on commercial terms. This financing is consistent with a declining debt service ratio.

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Despite frequent adjustments in the exchange rate since the program began (1.7 percent of which took place in June), the real effective exchange rate of the shilling has appreciated, and at the end of June it was some 8 percent above its target level. The authorities recognized that they have fallen short of the exchange rate commitments under the program, but indicated that this had been a temporary departure to limit the impact of the adjustments on prices at a time when wage contracts were under negotiation and that it should not be construed as an abandonment of the flexible exchange rate policy. The authorities stressed that they would reverse the appreciation over several months and hoped that the Fund would show flexibility in agreeing to such a schedule rather than requiring that the full amount to be reversed quickly. The mission's brief had stressed that no additional drawings would be made until the exchange rate was brought down to its required level. At the present time, two drawings are outstanding. The one based on end of June performance criteria and the completion of the present review of the arrangement and a final drawing to be made on the basis of end-September performance criteria. In order to give the the authorities the needed flexibility to move the exchange rate in small amounts, we propose to accept a schedule of adjustments which will bring the exchange rate to its required level by mid-November. This proposal would allow the first drawing on the basis of end of June performance criteria to be carried out, but would make the final drawing subject to the attainment of the exchange rate objective. We would press for an important proportion of the required adjustment to be carried out prior to the Board's discussion of the paper.

Bd meeting early Oct

If you agree with the above proposals, a mission could return to Nairobi as soon as the authorities have revised the budget to finalise the letter of intent. As you will remember, the authorities are interested in an extended arrangement to follow the present stand-by arrangement and, therefore, we would have a continuing opportunity to review developments in Kenya and ascertain that imbalances do not re-emerge.

This memorandum has been cleared by ETR (Mr. Beveridge) and FAD (Mr. Yandle).

INTERNATIONAL MONETARY FUND

July 23, 1985

Mr. Beveridge:

Kenya--Debrief

Attached are comments on the debrief for Kenya which was reviewed by Ms. Meesook.

PN

Paulo Neuhaus

cc: Ms. Dillon
Mr. Johnson
Mr. Nowak

July 23, 1985

Kenya--Comments on Debriefing

The debrief pointed to two policy issues on which agreement could not be reached between the authorities and the mission. However, the information contained in the debrief is neither detailed nor clear to allow a proper review of these issues.

1. Fiscal deficit

a. The debrief states that the 1985/86 budget underestimates the likely outturn for expenditures and the overall deficit (page 2). In the mission's view, some revenue measures or savings on budgeted expenditures will be required to keep the budget deficit at an appropriate level. The debrief, however, does not specify the extent of this underestimation and possible revenue measures or areas of expenditure cut.

b. The mission appears to accept the Government's proposal that, in the financial program, drought-related expenditures and the strategic grain reserve outlays be separated from the underlying budgetary operations of the Government, thereby allowing a relaxation of fiscal policy, while maintaining the overall credit ceiling (page 3). In order to evaluate the merit of this proposal, it is necessary to know the magnitude of these accounts in the context of the overall credit policy.

2. Exchange rate policy

The debrief proposes a relaxation of the requirement included in the briefing paper that the real effective exchange rate be adjusted to the targets included under the program, which will involve an additional devaluation of about 8 percent (page 3). The argument for this weakening of exchange rate action is not convincing. The need for a relatively large adjustment at this time appears to be justified by the inflexible exchange rate policy in the past six months, contrary to a commitment under the program. Given the projected rate of inflation at 12 percent, any delayed action would result in the need for larger adjustments between now and mid-November, the proposed date to effect the necessary action. Additionally, the mission was to analyze the role of the exchange rate in providing export incentives (briefing paper, page 10); it is unclear whether or not the maintenance of an appreciated real effective exchange rate, albeit for the relatively short time, will have an adverse impact on Kenya's emerging nontraditional exports. Furthermore, the overvalued exchange may jeopardize the import liberalization measures recently undertaken.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE June 28, 1985

TO Mr. W.A. Beveridge, IMF

FROM Anne O. Krueger

EXTENSION 6-9001

SUBJECT Kenya

On receipt of your memo I spoke with Mr. Jaycox. He indicated that the process that has been agreed upon for determining the competitiveness of the exchange rate is one that should bring the issue to a satisfactory resolution.

cc. Mr. D. Finch, IMF; Mr. Jaycox(ESAVP).

RECEIVED
JUL 1 1985
EXCHANGE & TRADE RELATIONS

Mr. Finch

Office Memorandum

To: Mrs. Krueger

From: W. A. Beveridge

Subject: Kenya

June 27, 1985

I understand from Mr. Finch that you believe there continue to be questions raised within the Bank regarding the adequacy of the Fund position on the Kenyan exchange rate. There have been recent discussions between the Fund's African Department and the Bank's Eastern and Southern Africa Regional Office (please see minute of meeting attached). Also, you may be aware that the Fund mission in Nairobi will be determining whether Kenya's real effective exchange rate remains competitive and whether a more flexible exchange rate policy is called for to support further important liberalization. We expect Kenya will make up for the real appreciation of the exchange rate that has taken place since the start of the previous program in December 1982, estimated at about 10 percent. This was a policy assumption involved in the present program. We would be glad to have quickly any indication that the Bank staff do not agree that this policy assumption is adequate.

cc: Mr. Finch
Mr. Ouattara

INTERNATIONAL MONETARY FUND

Minutes of a Meeting with IBRD, held on June 12, 1985 at 3.30 p.m.

IBRD representatives	IMF representatives
Mr. Jaycox	Mr. Artus
Mr. Messenger	Mr. Jiménez
Mr. Gulhati	Mr. Simpson
Mr. Adams	
Mr. Jones	
Mr. Thomas	
Mr. Cunhal	

Mr. Jaycox stated that structural adjustment in Kenya had not proceeded fast enough nor had it gone far enough to achieve a growth rate of 6 percent. In his view, this is the minimum which should be targeted, given the need to create employment. Much of the new jobs would need to come from the industrial sector; hence the Bank's concern with improving the competitive position of this sector. In this regard, the Bank felt that the 1976 level of the real effective exchange rate did not allow for the elimination of trade restrictions, nor did it provide enough incentive for exports. The level of the exchange rate and the amount of restrictions had contributed to slow growth in industry and to unemployment.

Mr. Artus stated that there was a need to review the exchange rate in light of present conditions rather than just bring it to its 1976 level. He concurred with the objective of dismantling many existing trade restrictions and the need to take this into account in analyzing the exchange rate. He indicated that by now import restrictions in Kenya were not considered as much an instrument to manage the balance of payments, as an instrument to protect the manufacturing sector. He pointed out that as far as the exchange rate was concerned Kenya was out of tune with the target agreed with the Fund for the current period. He asked Mr. Jaycox whether the bank had any reasons to believe that the target was not adequate. He also asked Mr. Jaycox to enumerate other problems confronted by the Bank in Kenya.

Mr. Jimenez interjected that it was not enough for the Bank to isolate two areas where adjustment was needed. Rather, adjustment in any area had to be consistent with overall adjustment in a fully integrated set of policies. Futhermore, he saw the need to quantify the required adjustment. It was not correct for the Bank to simply say that not enough had been done. The Bank should state where they feel Kenya should be at the present time and how that differs from the current situation. In making this comparison account should be taken of the impact of the 1982 balance of payments crisis.

Since 1982, Kenya had moved on several fronts to produce the required external adjustment, including the introduction of a 10 percent surcharge on imports, the export compensation scheme, a flexible exchange rate system and a rather liberally implemented import licensing system. In addition, with every new budget, a number of import items had been transferred from the restricted import tariff schedules to the free ones. These measures had been reflected in a considerable lessening of Kenya's demand for imports, as shown by the difficulty donors were having in disbursing import-related loans. Imports subject to restrictions are relatively few, as imports freely importable and oil imports account for three-fourths of the total. The considerably lower parallel market rates attest to the lack of excess demand for foreign exchange. As to domestic policies, Kenya has succeeded in keeping a tight rein on its incomes policy, while reducing the overall budget in terms of GDP and keeping a tight lid on credit. In the meantime, the Kenyans preserved the consistency of the whole package by preventing devaluation-related inflation from exerting pressures on the level of wages. Kenya had introduced restrictions at end-1982 only because of a massive loss of international reserves. A consistent and serious effort to adjust the economy and to liberalize the system began only in 1983. In fact the Fund stand-bys prior to that date had not been successful. Consequently, despite previous attempts, the adjustment effort only began in 1983 and the progress made so far should be judged on the basis of that date.

Mr. Jaycox said that he recognized the difference being made by the Fund on restrictions for balance of payments purposes and for industrial production. He stressed the Bank was concerned with the latter, because the industrial sector needed to become a leading growth sector in the economy and provide for the employment requirements of a population that was growing too rapidly.

Mr. Gulhati made a similar point by indicating that he agreed with Mr. Artus that the exchange rate assessment should be forward looking but that the need was for a forward looking approach with a high rate of growth and lower unemployment as targets. In addition, he favored an external adjustment approach based on sound fiscal and monetary policies rather than on restrictions.

Mr. Jimenez emphasized that in setting the exchange rate its impact on all of the sectors of the economy needed to be taken into account and that it was not always proper to pitch the rate at a level which was adequate to a small sector (industry accounts for only 14 percent of GDP).

Mr. Jaycox asked his staff if they were able to provide the Fund a quantified view of a desirable exchange rate target. Mr. Jones indicated that toward September-October the ongoing USAID study on effective protection of domestic industry would be completed. The study would cover domestic resource costs and opportunity costs of earning or saving foreign exchange. A by-product of this study would be a measurement of the Kenya shilling shadow real effective exchange rate. The study covers all tradeables using the structure of their inputs.

Mr. Jaycox reiterated the difference between structure and administration and the need to reform the structure. The band of tariff protection should be narrowed with the exchange rate adjustment moving apace. It was essential to proceed as soon as possible to enable the economy to grow at 6 percent, given the high population growth rate.

Both Bank and Fund staff agreed that the time was propitious for an enhanced development effort and in this regard the period ahead was crucial for Bank/Fund cooperation, especially as both institutions would be moving forward with new programs. Cooperation of the forthcoming missions was stressed with close continued contacts after the missions' return to headquarters, so that future programs will be well co-ordinated.

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

CIRC

As we discussed, two copies are attached.

With the Compliments of

A. D. Ouattara

Director

African Department

Cordialement
A. D. Ouattara

INTERNATIONAL MONETARY FUND

Minutes of a Meeting with IBRD, held on June 12, 1985 at 3.30 p.m.

IBRD representatives	IMF representatives
Mr. Jaycox	Mr. Artus
Mr. Messenger	Mr. Jiménez
Mr. Gulhati	Mr. Simpson
Mr. Adams	
Mr. Jones	
Mr. Thomas	
Mr. Cunhal	

Mr. Jaycox stated that structural adjustment in Kenya had not proceeded fast enough nor had it gone far enough to achieve a growth rate of 6 percent. In his view, this is the minimum which should be targeted, given the need to create employment. Much of the new jobs would need to come from the industrial sector; hence the Bank's concern with improving the competitive position of this sector. In this regard, the Bank felt that the 1976 level of the real effective exchange rate did not allow for the elimination of trade restrictions, nor did it provide enough incentive for exports. The level of the exchange rate and the amount of restrictions had contributed to slow growth in industry and to unemployment.

Mr. Artus stated that there was a need to review the exchange rate in light of present conditions rather than just bring it to its 1976 level. He concurred with the objective of dismantling many existing trade restrictions and the need to take this into account in analyzing the exchange rate. He indicated that by now import restrictions in Kenya were not considered as much an instrument to manage the balance of payments, as an instrument to protect the manufacturing sector. He pointed out that as far as the exchange rate was concerned Kenya was out of tune with the target agreed with the Fund for the current period. He asked Mr. Jaycox whether the bank had any reasons to believe that the target was not adequate. He also asked Mr. Jaycox to enumerate other problems confronted by the Bank in Kenya.

Mr. Jimenez interjected that it was not enough for the Bank to isolate two areas where adjustment was needed. Rather, adjustment in any area had to be consistent with overall adjustment in a fully integrated set of policies. Futhermore, he saw the need to quantify the required adjustment. It was not correct for the Bank to simply say that not enough had been done. The Bank should state where they feel Kenya should be at the present time and how that differs from the current situation. In making this comparison account should be taken of the impact of the 1982 balance of payments crisis.

Since 1982, Kenya had moved on several fronts to produce the required external adjustment, including the introduction of a 10 percent surcharge on imports, the export compensation scheme, a flexible exchange rate system and a rather liberally implemented import licensing system. In addition, with every new budget, a number of import items had been transferred from the restricted import tariff schedules to the free ones. These measures had been reflected in a considerable lessening of Kenya's demand for imports, as shown by the difficulty donors were having in disbursing import-related loans. Imports subject to restrictions are relatively few, as imports freely importable and oil imports account for three-fourths of the total. The considerably lower parallel market rates attest to the lack of excess demand for foreign exchange. As to domestic policies, Kenya has succeeded in keeping a tight rein on its incomes policy, while reducing the overall budget in terms of GDP and keeping a tight lid on credit. In the meantime, the Kenyans preserved the consistency of the whole package by preventing devaluation-related inflation from exerting pressures on the level of wages. Kenya had introduced restrictions at end-1982 only because of a massive loss of international reserves. A consistent and serious effort to adjust the economy and to liberalize the system began only in 1983. In fact the Fund stand-bys prior to that date had not been successful. Consequently, despite previous attempts, the adjustment effort only began in 1983 and the progress made so far should be judged on the basis of that date.

Mr. Jaycox said that he recognized the difference being made by the Fund on restrictions for balance of payments purposes and for industrial production. He stressed the Bank was concerned with the latter, because the industrial sector needed to become a leading growth sector in the economy and provide for the employment requirements of a population that was growing too rapidly.

Mr. Gulhati made a similar point by indicating that he agreed with Mr. Artus that the exchange rate assessment should be forward looking but that the need was for a forward looking approach with a high rate of growth and lower unemployment as targets. In addition, he favored an external adjustment approach based on sound fiscal and monetary policies rather than on restrictions.

Mr. Jimenez emphasized that in setting the exchange rate its impact on all of the sectors of the economy needed to be taken into account and that it was not always proper to pitch the rate at a level which was adequate to a small sector (industry accounts for only 14 percent of GDP).

Mr. Jaycox asked his staff if they were able to provide the Fund a quantified view of a desirable exchange rate target. Mr. Jones indicated that toward September-October the ongoing USAID study on effective protection of domestic industry would be completed. The study would cover domestic resource costs and opportunity costs of earning or saving foreign exchange. A by-product of this study would be a measurement of the Kenya shilling shadow real effective exchange rate. The study covers all tradeables using the structure of their inputs.

Mr. Jaycox reiterated the difference between structure and administration and the need to reform the structure. The band of tariff protection should be narrowed with the exchange rate adjustment moving apace. It was essential to proceed as soon as possible to enable the economy to grow at 6 percent, given the high population growth rate.

Both Bank and Fund staff agreed that the time was propitious for an enhanced development effort and in this regard the period ahead was crucial for Bank/Fund cooperation, especially as both institutions would be moving forward with new programs. Cooperation of the forthcoming missions was stressed with close continued contacts after the missions' return to headquarters, so that future programs will be well co-ordinated.

Office Memorandum

TO: Mr. Jiménez June 13, 1985

FROM: W.A. Beveridge

SUBJECT: Kenya--Brief for Review of Stand-By Arrangement

Let me give you some early comments on main points. Views on some minor points together with a number of editorial suggestions will be sent in due course. I am at your disposal to discuss these and other points.

1. Exchange rate policy

The proposal to restore the real exchange rate to the level prevailing at the time the arrangement was approved will apparently involve little, if any, exchange rate correction. Such a proposal would represent a considerable and unacceptable departure from the exchange rate policy described in the original program paper (issued on December 12 1984). The intention of this policy was to maintain the real rate at around the levels ruling immediately after the major exchange rate realignment in December 1982. This would involve an immediate depreciation of the order of 10 percent. I see no reason to deviate from the policy objectives in this area.

2. Budget deficit for 1985/86

The proposed budget deficit of 4.5 percent of GDP for 1985/86 is not an adequate degree of fiscal adjustment. It is higher than the underlying "nondrought" deficit in 1984/85 of 4.1 percent of GDP and in fact represents no improvement in performance over a three-year period. Additional fiscal adjustment beyond that proposed would help sustain the recent improvement in the external current account, a development that is essential if the liberalization of import restrictions is to proceed at an adequate pace and without interference. It would also permit a replenishment of foreign reserves and allow for a lowering of the debt service ratio to more manageable levels. A reduction in the budget deficit to below the nondrought level of 1984/85 would therefore seem essential.

3. Relations with the World Bank

The views of the World Bank on Kenya's performance both during and since the last SAL are not covered sufficiently in the brief and need to be elaborated upon further. In particular, the Bank's present position on exchange rate and import policy should be described.

4. Import policy

The various assertions (e.g., last sentence, page 8) relating to the liberal manner in which the restrictive regime has been operated need substantiating if they are to be included in the brief. The nature of the quota system and the problems involved in estimating actual import demand render it extremely difficult to draw any firm conclusions regarding the size or even direction of shifts in the degree of restrictiveness of the import regime. Incidentally, the downward revision in the estimates for the growth of import volumes in 1985 would not in itself appear to indicate any trend toward greater liberalization.

cc: Mr. Ouattara
Mr. Bhatia (o/r)

Office Memorandum

TO : Mr. Beveridge

DATE: May 13, 1985

FROM : G.E. Gondwe

SUBJECT : Consultation Scheduling--Algeria, Kenya, and Nigeria

Thank you for your note on the above-mentioned subject. I confirm that in the case of Algeria there should not be much difficulty of respecting the deadline of July 18. As regards Kenya, I wish to emphasize that the proposed rescheduling of the mission to June is at the express request of the Kenyan authorities, who will not be ready for a mission prior to their budgetary session of Parliament. The mission is not being rescheduled because of "staff problems." Following your memorandum and our discussions, I asked Mr. Jiménez, who is visiting Kenya, to speak to the authorities again on the matter. I am afraid their position is unchanged. Incidentally, you may be interested to know that the March program ceilings under the Kenya program have been observed.

cc: Mr. Kanesa-Thasan
Mr. Johnson

Office Memorandum

TO : Mr. Beveridge

DATE: May 6, 1985

FROM : Michael Nowak MM

SUBJECT : Kenya--Timing of Program Review Mission

Dates for the midterm review mission to Kenya have yet to be finalized but Mr. Jimenez has indicated that it may not take place until the second half of June or the first half of July. As a result, Board discussion of the review paper is unlikely to be held until the end of September or early October. The reason for the postponement of the mission, which had been previously scheduled for May, appears to be "prior" mission commitments on the part of both Mr. Jimenez 1/ and the desk economist, Mr. Simpson.

A delay in the departure of the mission past the end of May could give rise to a number of difficulties, the most serious of which concerns the input of the Fund staff into the budgetary process. Explicit provision was made in both the brief and the stand-by paper for a midterm review to be conducted during the preparation of the 1985/86 budget which will probably be finalized around the middle of June and presented to Parliament shortly thereafter. For obvious reasons, complications would ensue if the mission arrived in Nairobi after the presentation of a budget that was not consistent with the objectives of the present stand-by arrangement.

Another area of concern relates to the implementation of monetary policy. We have not yet received the final monetary data for end-March but there are strong indications to suggest that problems have been encountered in containing the expansion of private sector credit. It is of some importance therefore that the staff be in a position to evaluate at the earliest possible opportunity the reasons underlying this credit growth and be prepared to recommend any measures that may be necessary to alleviate the situation.

Apart from the implications for fiscal and monetary policy, further delays in the departure of the mission are likely to exacerbate the already fragile foreign exchange situation. The stand-by purchase that is tied to performance at end-June is conditional upon completion of the midterm review, while a CFF drawing, which was originally planned for June, may also have to be postponed; the two purchases together account for the equivalent of nearly 20 percent of Kenya's foreign exchange reserves. The delays could lead to a tighter enforcement of import controls and possibly retard the introduction of import liberalization measures which are due to go into effect in June.

1/ Incidentally, one of these commitments includes participation in the "African and the IMF" symposium in Nairobi, where he will be until May 16.

The last Article IV consultation was completed in mid-May 1984. It thus seems highly probable that the twelve-month consultation cycle will be exceeded by more than the three-month grace period.

In light of these considerations, you might wish to discuss with Mr. Jimenez the timing of the midterm review and raise with him some of the difficulties that may arise if the mission's departure is postponed beyond the end of May.

ETR
1) Mr Nowak
2) circ

Office Memorandum

To: The Managing Director
The Deputy Managing Director

April 10, 1985

From: A.D. Ouattara

Subject: Kenya--Donors Conference

Attached is Mr. Jiménez' back-to-office report on the recent Donors Conference for Kenya. The report does not raise any issues which would require a decision by Management.

Attachment.

cc. ASD
CBD
ETR
EUR
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Mr. Collins

Office Memorandum

To: The Managing Director
The Deputy Managing Director

April 10, 1985

From: Julio M. Jiménez

Subject: Kenya--Donors Conference

Prior to joining the Article IV Consultation mission in Ethiopia, I stopped in Nairobi to participate in a Donors Conference for Kenya on March 21-22, 1985. The meeting was well attended, with 14 donor delegations and 6 delegations from international organizations present. Although, when originally planned, the Donors Conference was organized to garner emergency assistance to meet the needs caused by the drought, the Kenyan authorities successfully arranged substantial food and other aid prior to the conference. Consequently, the aim of the conference was shifted to organize donor assistance for the post-drought period. For this purpose, the authorities presented donors with a forward capital budget covering the next three fiscal years, which detailed the projects which still required donor support for implementation. Although the authorities were hopeful that some donors would show interest in individual projects during the conference, the information and discussion aimed basically at preparing for pledges at the regular Consultative Group meeting for Kenya, scheduled for January 1986. As a background, the Kenyan Government presented a paper detailing the assistance and dispositions of the assistance which has been received for the drought.

All donors were extremely happy at the attendance of high-level Kenyan authorities at the conference, including the Minister of Finance, the Governor of the Central Bank, and the Chief Secretary. This allowed participants to raise questions directly to the policy makers. All speakers referred to the drought relief in highly laudatory terms, stressing the efficiency and dedication which the Government had shown in this undertaking. In addition, several donors (U.S., EEC), stated that they were in a position to offer additional commodity assistance, if it was still required as a result of the drought. My statement, reviewing the current economic situation and the present adjustment program, was well received by donors, and provided the background on which to measure Kenya's development efforts in the next three years.

By and large, donors were supportive of the Kenyans' efforts, but some stressed that the availability of funds for foreign assistance in their countries was being limited by domestic considerations, while the number and needs of claimants were increasing. As Kenya was one of those countries better-off in Africa, its share of assistance could be frozen at current levels or decline, as higher assistance was channelled to countries in greater need. Consequently, Kenya may need to resort to greater degree of commercial borrowing to implement its current development plan.

While in Nairobi, I took the opportunity to review developments under the current stand-by arrangement. In the first quarter of 1985, economic activity has been rising at a slightly faster pace than had been foreseen when the program was framed. In particular, private sector activity has rebounded, after several years of relative stagnation. This has resulted in increased private sector demand for bank credit, as opposed to previous years, when private sector credit growth always remained well below the targets established in previous arrangements. The authorities, who are anxious to encourage increased private sector activity, have allowed banks to meet the higher demand, and have attempted to offset it by reducing the reliance of the budget and public enterprises on the banking system. However, there is a possibility that reduced public sector credit may not completely offset the growth in private sector credit, and the credit ceilings for end of March may have been exceeded. Actual information will not be available, however, until early May, when the balance sheets from commercial banks are reported.

Considerable progress has been recorded in controlling the public enterprises. Since the program began, credit to public enterprises has, in fact, fallen in absolute terms. The financial position of some enterprises has reportedly improved, and the President himself has apparently called in the heads of delinquent public enterprises to encourage them to improve the performance of their entities or face being fired.

Progress is also being made in preparing for the liberalization of the import system scheduled for June. Import authorizations increased by over a third in the last quarter of 1984, and by a further 10 percent in the first two months of 1985. While these figures reflect the increased tempo of economic activity, they also reveal the liberal manner in which the authorities have been applying the import system, despite the current drought difficulties.

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WASHINGTON, D. C. 20431

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The Treasury
P.O. Box 30007
Nairobi, Kenya

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(______) CODE

DISTRIBUTION
Treasurer
Internal Auditor
Mr. Ouattara
Mr. Finch
Mr. Nicoletopoulos

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EXECUTIVE BOARD TOOK FOLLOWING DECISION APRIL 3: QUOTE THE APPROVAL OF KENYA'S EXCHANGE RESTRICTIONS ARISING FROM LIMITATIONS ON FOREIGN EXCHANGE MADE AVAILABLE FOR CERTAIN IMPORTS, AND FOR DIVIDEND AND RENTAL INCOME REMITTANCES UNDER DECISION NO. 7701-(84/78), ADOPTED MAY 16, 1984, IS EXTENDED UNTIL OCTOBER 31, 1985, OR THE COMPLETION OF THE 1985 ARTICLE IV CONSULTATION WITH KENYA, WHICHEVER IS THE EARLIER. UNQUOTE

LEO VAN HOUTVEN, SECRETARY, INTERFUND

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TRANSMIT AFTER 12 noon 4/3/85 (lapse of time)

TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): BJOwen:KFriedman:ag EXT.: 6701 DEPT.: SEC DATE: 4/3/85

AUTHORIZED BY NAME (TYPE): Barbara J. Owen AUTHORIZED BY NAME (TYPE):

(**) TYPE ** ON LAST OR ONLY PAGE OF MESSAGE

Log

B J Owen

SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

REV 1-82

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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The Treasury
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Nairobi, Kenya

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DMD
MR. MTEI
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ETR
LEG
RES
TRE
MR. S. COLLINS

START TEXT HERE

EXECUTIVE BOARD TOOK FOLLOWING DECISION FEBRUARY 8: QUOTE
1. THE FUND NOTES THE ARRANGEMENTS MADE FOR THE FINANCING OF THE EXPECTED BALANCE OF PAYMENTS DEFICIT IN 1985 DESCRIBED IN EBS/84/261, SUPPLEMENT 3, AND FINDS THAT THESE ARRANGEMENTSSARE SATISFACTORY.
2. ACCORDINGLY, THE STAND-BY ARRANGEMENT FOR KENYA SET FORTH IN EBS/84/261, SUPPLEMENT 2, SHALL ENTER INTO EFFECT ON FEBRUARY 8, 1985. UNQUOTE
LEO VAN HOUTVEN, SECRETARY, INTERFUND.

IF REQUIRED INITIAL BELOW

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SPECIAL INSTRUCTIONS

PLEASEETRANSMIT AFTER 5:30 P.M., 2/8/85

TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): BJOwen:ag EXT.: 6701 DEPT.: SEC DATE: 2/8/85

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AUTHORIZED BY NAME (TYPE):

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE ( )

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B. J. Owen

SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

C. 48 REV 1 11-18-82

M: Beveridge

Office Memorandum

o: The Acting Managing Director February 5, 1985

From: A.D. Ouattara Ouattara

Subject: Kenya

As explained in Mr. Jiménez' back-to-office report (February 4, 1985) a combination of favorable circumstances and increased donor support has allowed Kenya virtually to close the financing gap in the balance of payments foreseen in 1985, with only a marginal possible utilization of their reserves. We are confident that the assistance which has been proposed will materialize and in fact, Kenya may be able to obtain additional grain assistance. Since developments have proceeded better than we had foreseen, it is no longer necessary for Kenya to resort to Eurocurrency borrowing (on which offers had already been received by banks), although the authorities may utilize it in lieu of a foreign reserve drawdown.

Given the progress recorded, I would recommend that we proceed to make the stand-by arrangement, approved in principle by the Executive Board on January 9, 1985, effective. Attached for your approval, accordingly, is a draft paper for the Board, so that the matter can be handled on a lapse-of-time basis. In order to meet the 30 day deadline the paper needs to be issued on Wednesday, February 6, 1985 for approval on a lapse-of-time basis Friday, February 8.

It must be noted that an important part of the additional support has resulted from the World Bank and we are heartened at the resumption of better relations between Kenya and the Bank. We have been doing our best to further these developments.

The paper has been cleared with Mr. Bhatia (AFR), Mr. Beveridge (ETR) and Ms. Lachman (LEG).

Attachment

cc. Managing Director (o/r)
Mr. Beveridge
Ms. Lachman
Mr. Collins

CONTAINS CONFIDENTIAL INFORMATION

INTERNATIONAL MONETARY FUND

KENYA

Arrangement With Respect to the Financing of 1985 Balance of Payments Deficit

Prepared by the African Department
(In Consultation with the Exchange and Trade Relations and Legal Departments)

Approved by A.D. Ouattara and W.A. Beveridge

February 6, 1985

On January 9, 1985 the Fund adoped a decision approving Kenya's request for a stand-by arrangement (EBS/84/261). The approval of the arrangement under the decision was to become effective on the date, not later than 30 days after it was approved by the Fund, on which the Fund found that satisfactory arrangements had been made with respect to the financing of the estimated balance of payments deficit for 1985, consistent with an improvement in Kenya's future debt servicing capacity.

It may be recalled that the financing gap estimated in EBS/84/261 was SDR 93 million after Fund support. Due to a combination of favorable circumstances and increased donor support, Kenya has virtually closed the financing gap in the balance of payments foreseen for 1985.

The short rains late last year proved bountiful for agricultural production. The larger grain output, in conjunction with a success in substituting other staples for grains, is estimated to reduce the grain import requirement in 1985 by about 17 percent, leading to an estimated savings of about SDR 21 million. The rains also had a favorable impact on tea exports, which have further benefited from stronger prices than previously projected. Consequently, export earnings are now projected to be higher by about SDR 12.5 million (0.8 percent than projected in EBS/84/261), which, together with the reduced need for grain imports, would lead to an improvement in the trade account of SDR 33.5 million.

Donors have also given clear indications of additional loans and grants totalling SDR 72-80 million. Of this amount grants, largely in the form of grains, are estimated to total SDR 27 million, while the remainder SDR 45-53 million in being provided mainly in concessional loans. Of the loans, the IBRD is estimated to provide SDR 20-25 million through the reprogramming of an agricultural sector loan, with the balance coming from bilateral donors. In addition, one donor has indicated its willingness to provide credit guarantees of up to SDR 42 million for the commercial import of grains, if needed. Other donors have implied that additional grains could be made available if the need was well documented. The financing arrangements for the 1985 financing gap will improve the debt service projections in EBS/84/261, where most of the financing was foreseen to come from commercial sources.

The additional donor support has emerged in the context of bilateral discussions. The authorities still plan to host a Donors Conference but the meeting will aim at a review of recent developments emphasizing the role donors have played in surmounting the drought crisis and especially Kenya's post-drought development prospects. The Conference is to be scheduled for mid-March, as an earlier date proved to be inconvenient to several donors.

The lower grain import requirement and increased donor support for food imports, will have an impact in reducing Kenya's access to the CFF from the estimate included in EBS/84/261. The exact amount of the reduction will be calculated in the near future in a paper requesting such a purchase.

The staff is confident that the arrangements discussed above are satisfactory for filling the financing gap, although Kenya may have to draw down its reserves by a marginally larger amount than originally envisaged. A further reserve use of SDR 20 million, for example, would still leave Kenya's gross reserves equal to 2.5 months of imports at the end of 1985, a level considered generally adequate by the authorities and the staff. Accordingly, the following decision is proposed for consideration by the Executive Directors:

Proposed Decision

1. The Fund notes the arrangements made for the financing of the expected balance of payments deficit in 1985 described in EBS/85/__ and finds that these arrangements are satisfactory.

2. Accordingly, the stand-by arrangement for Kenya set forth in EBS/84/261 shall enter into effect on February 8, 1985.

Mr. Beveridge

MB/F

Office Memorandum

To: The Acting Managing Director

From: Julio M. Jiménez

February 4, 1985

Subject: Kenya--Staff Visit

During January 28-February 2, 1985, I visited Nairobi principally to review progress made in the filling of the projected financing gap in the 1985 balance of payments and developments under the current program. I had very fruitful discussions with the management of the National Cereals and Produce Marketing Board (NCPB), at which time I was able to review their revised grain import program for 1985. While in Nairobi, I also met with representatives of the principal donors. With this revised information I participated in the Intergovernmental Committee charged with the review of the balance of payments, which unfortunately had not met since the previous December. Together we developed an agreed revised balance of payments which we discussed with the Permanent Secretary of the Treasury and the Governor of the Central Bank. The new information indicates that the financing gap can be fully met, without the need to have recourse to the Eurocurrency market. The short rains late last year were bountiful reducing the projected grain deficit and improving tea output, while donor support has come forth in a greater amount than foreseen.

When the program was approved in principle by the Executive Board on January 9, 1985 a financing gap in the balance of payments of about US$93 million was projected in 1985 after Fund support. The good rains, in conjunction with a success in substituting other staples for grains, reduced the grain import requirement in 1985 from about 900,000 metric tons to about 750,000 metric tons, leading to an estimated saving of about US$21 million. Exports for 1985 are now projected on a net basis to be US$12.5 million higher (0.8 percent) than earlier estimated, mainly as a result of increased earnings from the tea sector, reflecting increased output and a smaller fall in prices than originally projected, given the continued control on tea exports from India. Fuel exports will also be greater, given a smaller recourse to thermal electric generation than foreseen earlier.

The Kenyan authorities have been working closely with the donor community since the October mission and significant new assistance has emerged as a result of recent negotiations. Additional loans and grants for which a clear indication has been provided total US$72 million, but could go as high as US$83.9 million (excluding a US$42 million in commercial guarantees for grain imports to be provided by the U.S.) (see Table 1). Donors have provided additional food grants totaling about US$27 million. The main donors are the U.S., Canada, Australia, the EEC, Germany, France, and the World Food Program. The U.S. Government has taken a specially keen interest in Kenya and will be providing most of the increased assistance. A high level U.S. delegation was in Nairobi during my stay reaching agreement on the new assistance. Additional aid in the form of concessional loans has also emerged of between US$45.0-53.4 million. This includes about US$20-25 million from the World Bank and US$20.4-22.4 million from the U.S. The U.S. delegation also indicated its agreement to guarantee commercial credits for an additional US$42 million, if needed, for grain imports.

The new assistance, together with the lower grain imports, have also reduced Kenya's estimated access to the CFF. This reduction can be as much as US$30 million, but the actual calculation will be done later in the year.

Taking into account the reduced access to the CFF, but excluding the credit guarantees offered by the U.S., US$75 million of the necessary resources to fill the gap are relatively certain, with a further US$8.9 million possible. Given these fortunate developments, the authorities postponed the negotiations on the Eurocurrency loans, as the remainder of the financing requirement (US$18-9.1 million) can be met from the Central Bank's reserves, which stood at the equivalent of 3 months of imports at the end of 1984, following a balance of payments surplus of US$56.4 million in 1984, compared to the US$50 million projected in October. On the most pessimistic scenario gross reserves would fall to about 2.5 months of imports. The credit guarantees for grain imports promised by the U.S. will provide a cushion for contingencies. The authorities may also negotiate a stand-by facility in the Eurocurrency market.

Commercial banks had provided a firm offer to Kenya for up to US$100 million in Eurocurrencies. This loan, if it had been accepted by the Kenyan authorities, would have been the largest transaction for sub-Saharan African in a number of years. The willingness of banks to enter into such an arrangement speaks well of their perception of developments in Kenya. The lead bank and some of the participants have local offices.

The EEC representative to Nairobi also expressed the view that the EEC was in a position to provide additional wheat in grant form, if the need was documented by the authorities. The possibility of additional assistance was also voiced by other donor representatives.

Given the progress in meeting the drought-related difficulties, the authorities have achieved a further measurement of success in their economic management, with the cooperation of the donor community. Especially important has been the move towards the resumption of more cordial relations with the World Bank. The authorities still plan to host a Donors Conference in March, not to raise balance of payments support for it is no longer a pressing problem, but rather to provide donors with a reporting of how the assistance given by donors has resolved the drought emergency and especially to set the stage for donor support for Kenya's development effort in the post-drought period. This meeting will be followed in early 1986 with a scheduled consultative group meeting, where the authorities hope to receive a positive reaction from donors in support of a readjusted five year development plan. The authorities restated their hope that this effort would be supported by the Fund through an EFF.

The performance criteria for December 1984 appeared to have been observed and the program is on target.

On the basis of developments to-date, I would suggest that we proceed in recommending to the Board full approval of the stand-by arrangement.

Attachment

cc. Managing Director (on return)
Mr. Collins

Table 1. Kenya: Additional Balance of Payments Support for 1985

(In millions of U.S. dollars)

	Low estimate	High estimate
Grants		
Grain grants	24.5	24.5
Milk and other food grants	2.5	2.5
Total grants	27.0	27.0
Loans		
IBRD	20.0	25.0
USAID 1/	20.4	22.4
Housing	(10.0)	(12.0)
Grain	(10.4)	(10.4)
Other donors	4.6	6.0
Total loans	45.0	53.4
Total grants and loans	72.0	80.4
Import savings	21.0	21.0
Additional export earnings (net)	12.5	12.5
Total	105.5	113.9
Loss of CFF	30.0	30.0
	75.0	83.9
Use of additional reserves to close gap	18.0 2/	9.1 3/
Gap	93.0	93.0

1/ Excluses possible credit guarantees of up to US$42.0 million.
2/ Would leave gross reserves at about 2.5 months of imports.
3/ Would leave gross reserves at about 2.65 months of imports.

INTERNATIONAL MONETARY FUND

1/24/85

<u>Comments by DMD</u>:

p. 2: (1) I agree with this approach subject to below

(2) Are the donors in Nairobi? I suppose he would go before the mid-March meeting?

(3) $50 million - $34-39 million would provide up to$84-89 million, or $9-3 million less than the $93 m. gap. Then I don't think we should indicat[e] that the $34-39 m. is adequat[e] <u>before</u> the donors' meeting. I would simply indicate that we are <u>reasonably confident at this time</u> that the remaind[er] of the gap (beyond $50 m.) is likely to be closed by donor support.

Yes it is essential not to gi[ve] the impression that 34-39 is enough

Julio M. Jiménez

cc: EA

DMD ①

Office Memorandum

To: The Managing Director
The Deputy Managing Director

January 18, 1985

JAN 22 1985

From: G.E. Gondwe

Subject: Kenya--Donor Conference and Financing Gap

We have recently been informed by the Kenyan authorities that the date for the prospective Donor Conference will have to be changed from early February to mid-March. The decision to postpone the Donor Conference, which was looking for resources to close a projected $93 million financing gap, does not suggest that there will be a reluctance on the part of donors to provide finance to close the projected gap. It follows preliminary discussions between the Kenyan authorities and principal donors, including the British Foreign Secretary and the Canadian Secretary for Overseas Development, both of whom visited Nairobi last week. These and other principal donors have expressed the view that in order to guarantee the success of the meeting a delay of about a month would be useful. Meanwhile the U.K., Canada, and others have come forward with indications of additional support presently estimated at about $24 million.

Our indications late last year were that not more than $25-30 million additional support would be forthcoming from donors, and therefore, given the immediate cash needs, the arranging of commercial borrowing needed to proceed quickly. As you will recall all of the calculations in the program were based on the gap being closed on commercial terms, and the Kenyan authorities so understood it.

In addition, the Kenyan authorities have informed us that their discussions with the World Bank are proceeding successfully. The Bank has proposed to reprogram an agricultural loan by allowing it to be used for fertilizer imports and seasonal credit. This will permit a more rapid disbursement of the credit by $10-15 million, reducing the financing gap by a similar amount. The Bank has also indicated that they are looking into other sectoral programs in order to arrange for a quick disbursement of funds. The Bank has confirmed these proposals to us 1/.

Given the donor support (including IBRD) which has emerged, equivalent to $34-39 million, the authorities have altered their Eurocurrency borrowing. Rather than borrow the full US$100 million, as earlier agreed with the banks, they now intend to borrow half this amount outright and

1/ They have also indicated the fielding of a mission at the end of January to review the forward budget and investment program.

arrange for a stand-by facility with the same banks for the other half. The lead bank has confirmed this approach to us, indicating that the arrangement should be finalized soon. Given the resources which are emerging from donors, the Kenyan authorities do not foresee the need to utilize the stand-by portion of the proposed credit arrangement. The use of $50 million will have little effect on the debt service ratio which will still record a large reduction from about 29 percent in 1985 to under 20 percent at the beginning of the 1990's.

The Board approved the proposed stand-by arrangement, in principle, on January 9, provided that within 30 days the Fund would be assured that the financing had been arranged. This time period will expire before the proposed Donor Conference and a strategy in dealing with the problem needs to be developed. We could ask the Board for an extension of the date for approval in principle. This would give rise to problems since the delay in the stand-by arrangement coming into effect would require a change in the phasing of the proposed stand-by arrangement, leading to a shift in purchases into 1986, which would involve an increase in the financing gap for 1985. It would moreover delay drawings under the arrangement beyond the end of March, whereas the greatest cash flow needs are occuring in the first quarter of the year.

We could on the other hand propose that the stand-by arrangement become effective at the time the Kenyans certify the completion of the arrangement for the Eurocurrency loan (i.e. end-January), provided, of course, we can assure ourselves that the progress which the Kenyan authorities are reporting on their negotiations with the donors is verified. To do this we would have to represent to the Board that the $34-39 million of donor/World Bank support is generally adequate and that the $50 million of Eurocurrency loan will not be negative on the debt service position. This approach has advantages, but it does entail going to the Board (presumably on a lapse of time basis), before the donor meeting, however we feel that that meeting will as a minimum formalize the arrangements with donors.

If the second option were accepted, I propose that Mr. Jiménez visit Nairobi for about a week to discuss with the donors the scale of their prospective support. He would also help the Kenyans in putting together the documentation for the conference, check the progress on the Eurocurrency loan and review the expected disbursement schedule of the new loans to ascertain that they are in line with Kenya's cash flow needs. I may also note this would accomplish the purposes to be served by a staff visit to review the foreign borrowing program which has already been approved in the six-month mission schedule.

This note has been cleared by Mr. Beveridge.

cc. Mr. Beveridge
Mr. Collins

Office Memorandum

MEMORANDUM TO FILES

January 18, 1985

SUBJECT: Memorandum to Managing Director--
Kenya Financing Gap

Following are comments on the above memorandum:

1. The financing gap in the program as approved was SDR 92.5 million. At that time the staff (but not the Executive Board) were aware of possible financing from the United States of US$21 million ($16 million PL.480 and $5 million from the Economic Support Fund). Potential financing of $10-15 million from the IBRD and $24 million from Canada, U.K. and other sources is mentioned in the draft memorandum It is not clear what has happened to the US$21 million of U.S. financing.

2. There still appears to be "substantial uncertainties" in the financing to be provided by donors.

3. The phasing approved under the arrangement was:

		Performance Ceiling
SDR 8.5 million	when arrangement becomes effective	
SDR 21.3 million	February 15, 1985	December 1984
SDR 21.3 million	May 15, 1985	March 1985
SDR 17 million	August 15, 1985	June 1985
SDR 17 million	November 15, 1985	September 1985

The phasing argument in the draft memorandum is not strong. It would be possible to have a mid-December drawing based on an end-October performance test and keep all Fund drawings within 1985.

Margaret R Kelly
Margaret R. Kelly
Advisor
Exchange and Trade Relations Department

cc: Mr. Beveridge

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WASHINGTON, D. C. 20431

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EXECUTIVE BOARD TOOK FOLLOWING DECISION JANUARY 9:

QUOTE

1. THE GOVERNMENT OF KENYA HAS REQUESTED A STAND-BY ARRANGEMENT FOR A PERIOD OF ONE YEAR FOR AN AMOUNT EQUIVALENT TO SDR 85.2 MILLION.

2. THE FUND APPROVES THE STAND-BY ARRANGEMENT SET FORTH IN EBS/84/261, SUPPLEMENT 2, SUBJECT TO PARAGRAPH 3 BELOW, AND WAIVES THE LIMITATION IN ARTICLE V, SECTION 3(b)(iii).

3. THE STAND-BY ARRANGEMENT SHALL BECOME EFFECTIVE, NOT LATER THAN 30 DAYS AFTER THE DATE OF THIS DECISION, ON THE DATE ON WHICH THE FUND FINDS THAT SATISFACTORY ARRANGEMENTS HAVE BEEN MADE FOR THE FINANCING OF THE EXPECTED BALANCE OF PAYMENTS DEFICIT IN 1985.

UNQUOTE

VAN HOUTVEN, SECRETARY, INTERFUND

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PLEASE SEND TODAY, JANUARY 9.

TELEX NO.:

CABLE ADDRESS:

DRAFTED BY NAME (TYPE): R. Franklin:crw

EXT.: 6711 DEPT.: SEC DATE: 1/9/85

AUTHORIZED BY NAME (TYPE): Leo Van Houtven

AUTHORIZED BY NAME (TYPE):

(**)

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SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

C. 48 REV 1 11-18-82

/ Beveridge

Office Memorandum

To: The Managing Director January 8, 1985
The Deputy Managing Director

From: A. D. Ouattara Ouattara

Subject: Kenya: Financing Gap

The medium-term balance of payments and the debt service ratio projections for the medium-term included in the program assumed that the financing gap for 1985 would be met on commercial terms. At the time in which the program was designed, it was felt that it was more prudent to project an outcome which would improve as donors support was obtained rather than one which would deteriorate as less donors support than expected emerged. Consequently, if the Kenyan authorities meet the financing gap through Eurocurrency borrowing, the debt service and balance of payments projections would not change. If, on the other hand, additional donor support is obtained, and less Eurocurrency borrowing is utilized, there would be a reduction in the financing gap and in the debt service ratio.

It has been unfortunate for Kenya that international support for the current drought crisis has not emerged to the extent that it has in other neighboring countries. It appears that this is the result of the lack of press coverage which Kenya has received compared to that of other countries. This, however, does not make the situation any less difficult. It is also true that, in comparison to other affected African countries, Kenya could be classified as being "better of" to meet the crisis because of its stronger economy, higher level of gross reserves and better borrowing capacity. In addition, there are political problems with respect to a potential major donor, the United States, concerning The Mombasa Naval Facility Arrangement which is to be renegotiated in the very near future.

Clearly, the utilization of Eurocurrency borrowing to meet the financing gap is a second best solution. It would have been better, if donors would have responded more adequately to the present crisis. On the other hand, the period of greatest financial need for Kenya to meet the import of grains will fall in the first half of 1985 and any further delay in establishing a consistent and fully financeable plan of action would have great implications on the whole policy stance of the Government. Delays could also result in Fund resources spilling over into 1986, thereby, increasing the size of the financing gap for 1985. The program is viable without additional donor support but additional donor support would have been more helpful. The debt service ratio is projected to fall after 1985 <u>even</u> with the Eurocurrency borrowing.

The use of the full amount of Eurocurrency borrowing will have the effect of preempting the debt service ceiling and would require the Kenyans to readjust their budget in order to keep to the target established for the overall budgetary deficit. In the past, they have been very concerned at meeting this objective, even though it is not a performance criteria. A review of the program is scheduled for May.

We have been invited to attend the Donors meeting which will be organized by the Government of Kenya and held in the first week of February in Nairobi. We intend to give our strong support to the Kenyan authorities in obtaining additional donor support in that forum.

cc. Mr. Beveridge
Mr. Collins