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#48931

KENYA - Correspondence & Memos 1988-1989

BOX 136 FILE 1

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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1989 DEC 20 A 10: 29

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CC:

MR. EL KOGALI

MR. BASU, ETR

START TEXT HERE

AS WE ARE ABOUT TO ENTER THE SECOND ANNUAL ARRANGEMENT UNDER THE ESAF WITH THE OBJECTIVE OF ACHIEVING ECONOMIC GROWTH WITH LOW INFLATION AND A VIABLE EXTERNAL POSITION WE ARE ENCOURAGED BY THE STRUCTURAL REFORMS WHICH ARE ONGOING IN AGRICULTURE AND THE FINANCIAL AND INDUSTRIAL SECTORS. DURING THE EXECUTIVE BOARD MEETING ON NOVEMBER 10, 1989 ON THE MID-TERM REVIEW UNDER THE FIRST ANNUAL ARRANGEMENT FOR KENYA UNDER THE ESAF, EXECUTIVE DIRECTORS NOTED THAT KENYA HAD DISPLAYED A STRONG COMMITMENT TO THE ADJUSTMENT PROGRAM. HOWEVER, THEY URGED THE GOVERNMENT TO MAINTAIN ITS FIRM EFFORTS TO AVOID NONCONCESSIONAL EXTERNAL BORROWING. WITH REGARD TO THE LATTER, WE ARE CONCERNED ABOUT RECENT INFORMATION ON THE POSSIBLE CONTRACTING OF SIZABLE NEW FOREIGN COMMERCIAL LOANS WHICH THE GOVERNMENT OF KENYA WOULD GUARANTEE. WE HAVE THREE MAJOR CONCERNS ABOUT THESE FOREIGN COMMERCIAL LOANS. FIRST, SUCH LOANS WOULD INCREASE THE STOCK OF CONTRACTED OUTSTANDING EXTERNAL DEBT TO COMMERCIAL CREDITORS

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TELEX NO.: 22324/22721 NAIROBI KENYA

DRAFTED BY NAME (TYPE): MKatz:djh — EXT.: 7465 — DEPT/DIV: AFR — DATE: 12.19.89

AUTHORIZED BY NAME (TYPE): MAMOUDOU TOURE — AUTHORIZED BY NAME (TYPE):

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Log

EC 48 REV. 2 8-14-87

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IMF OFFICIAL MESSAGE
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(INCLUDING SUPPLIERS' CREDIT) BY SOME 50 PERCENT, AND WOULD REPRESENT A DEPARTURE FROM THE PAST POLICY OF RELYING ON FOREIGN CONCESSIONAL LOANS. THIS POLICY DEPARTURE RUNS COUNTER TO OUR UNDERSTANDING OF KENYA'S POLICY COMMITMENTS REGARDING THE CONTRACTING OF EXTERNAL DEBT UNDER THE CURRENT ESAF PROGRAM. SECOND, SUCH LOANS WOULD RESULT IN A DEBT SERVICE RATIO THAT IS CONSIDERABLY HIGHER THAN THE ONE TARGETED UNDER THE PROGRAM. THE PROJECTS THAT THESE FOREIGN COMMERCIAL LOANS WOULD FINANCE ARE NOT LIKELY TO GENERATE THE FOREIGN EXCHANGE REQUIRED TO SERVICE THEIR DEBT AND COULD THUS MAKE KENYA'S EXTERNAL FINANCIAL POSITION MORE VULNERABLE. THIRD, WHILE THE MATURITIES OF SOME OF THESE LOANS MAY BE OUTSIDE THE FORMAL DEBT LIMITS OF THE IMF SUPPORTED PROGRAM, THEY WOULD NONETHELESS BE INCOMPATIBLE WITH THE MEDIUM TERM FRAMEWORK WHICH WAS APPROVED BY OUR EXECUTIVE BOARD. SUCH LOANS TOGETHER WITH COUNTERPART DOMESTIC FUNDS WOULD PUT PRESSURE ON DOMESTIC DEMAND, MAKE IT MORE DIFFICULT TO

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PAGE 3

KENYA

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REDUCE INFLATION AND WOULD UNDERMINE THE DEVELOPMENT OF NONTRADITIONAL EXPORTS BY COMPETING FOR SCARCE RESOURCES. WE REGARD THESE PROSPECTIVE LOANS AS AN IMPEDIMENT WHICH COULD HAMPER THE NEGOTIATIONS FOR THE SECOND YEAR PROGRAM. THEREFORE, WE WOULD STRONGLY RECOMMEND THE AVOIDANCE OF SUCH FOREIGN BORROWING. WE REMAIN CONFIDENT THAT KENYA WILL CONTINUE TO PURSUE PRUDENT POLICIES AND THAT THE PROGRAM FOR THE REMAINING TWO YEARS UNDER THE ESAF WILL BE CARRIED OUT SUCCESSFULLY.

HIGHEST REGARDS

TOURE

COUNSELLOR AND DIRECTOR

AFRICAN DEPARTMENT

INTERFUND

IF REQUIRED INITIAL BELOW

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LIST OF TWO
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1989 DEC 20 A 10: 29

THE HONORABLE GEORGE SAITOTI
VICE-PRESIDENT AND MINISTER OF FINANCE
MINISTRY OF FINANCE
NAIROBI, KENYA

MR. ERIC KOTUT
GOVERNOR
CENTRAL BANK OF KENYA
NAIROBI, KENYA

Mr. Whittome
cc: Mr. Rodman
Mr. Leddy
Mr. Basu

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

December 1, 1989

FROM: A. F. Mohammed

SUBJECT: Press Contacts in Kenya, Zambia & Zimbabwe

Messrs. Abushadi and Falcone visited three African countries during the period November 6-14, 1989. As you will note from the attached report from Mr. Abushadi, the attitude towards the Fund appaears positive, more so in Zambia. He found that the high expectations about the Fund held in non-governmental circles is the most difficult aspect to deal with, particularly in Zambia, where the Fund is regarded as the last resort.

I consider this tour to be particularly successful since it involved joint briefings in Paris, London and Frankfurt with two senior staff from the African Department, Messrs. Calamitsis and Bornemann, who combined this assignment with travel on other missions. Both Mr. Calamitsis and Mr. Bornemann have reported the joint briefings useful and recommended that they be repeated in the future.

The three briefings in Europe, as well as the meetings in the three African countries were an appropriate occasion to introduce Mr. Falcone and explain his assignment in the Paris Office.

Attachment

cc: Mr. Beza
Mr. Frenkel
Mr. Touré
Mr. Van Houtven
Mr. Whittome
Mr. Beith
Mrs. Junz
Mr. H. Simpson

Office Memorandum

TO: Mr. Mohammed

November 30, 1989

FROM: Ahmed M. Abushadi

SUBJECT: Information Mission to Kenya, Zambia and Zimbabwe

During November 6-14, 1989, Paul Falcone and I visited Nairobi (Nov. 6-7), Lusaka (Nov. 9-11) and Harare (Nov. 13-14), for contacts with the economic press and NGOs' interested in the work of the Fund. Ahead of this African tour, we conducted background press briefings in Paris and London with Mr. Calamitsis, and in Frankfurt with Mr. Bornemann on our way back. Messrs. Calamitsis and Bornemann have reported separately on these briefings, which proved highly effective due to the participation of senior staff from the African Department with operational experience in many of the countries concerned. The briefings in Europe and Africa offered an opportunity to introduce Mr. Falcone and explain his assignment to the participants.

In all the African countries visited, we met with the economic and financial press, academics, economists' associations, bankers, trade unionists and private businessmen. We were warmly received particularly in Zambia, where the private groups went out of their way to underline the importance they attach to the Fund's role in helping Zambia, and in guiding its policy makers. The press in the three countries was receptive to Fund views, and reported quite fairly on the discussions.

In all three countries, we pointed to the extent of Fund involvement in Africa, as evidenced by the large number of programs supported by various Fund facilities. We highlighted their concessional nature, the amounts still available in the SAF/ESAF purse and the deadline for use of ESAF resources. We stressed that the Fund stands ready with appropriate resources to support programs designed to achieve real per capita growth. Most of those we met with, both in the media and elsewhere, seemed unware of the terms and extent of SAF and ESAF funds, which invariably led them to question the countries' reluctance to benefit from the facility.

In Kenya, our first stop, we met with members of the East African Foreign Correspondents Association, the largest such group in Sub-Saharan Africa. The London Financial Times correspondent was strongly critical of Fund missions refusing to speak to the press. While he understood the need for prudence, a policy of not talking to the press altogether leaves him and his colleagues open to being fed incorrect information planted by interested parties. He recalled an instance earlier this year when an unnamed official gave him wrong information about the alleged failure of Kenya's negotiations with the Fund, which upset Vice President Saitoti as well as Fund staff. He argued both during the briefing, and at a meeting afterwards, for a degree of openness that would assure the Fund as well as the authorities that only the correct information will get published.

Most of the questions posed by the foreign, as well as the domestic press, in Nairobi dealt with the then pending Executive Board review of Kenya's ESAF arrangement, which dominated published reports in subsequent days. Other questions dealt with the effectiveness of Fund programs in Africa, the role of the Fund in dealing with the debt question, and the so-called African alternative to Fund adjustment. In responding to the latter question, we used quotations from the ECA document itself stating agreement with the objectives of Fund programs, but challenged the findings of the ECA report based on the staff critique of the document. We argued that the Fund adapts its approaches to member country situations both in the design of individual growth-oriented programs, as well as the terms of financial support available to them.

We met with the Chief Editors of Kenya's leading dailies: The Standard; The Nation; and, Kenya Times. The editor of Kenya Times, the youngest and fastest-growing of the three, raised the question of the Fund's relations with South Africa, but we found it difficult to convince him of the Fund's rationale regarding its relations with South Africa. However, no mention was made by him of this issue in a lengthy report published the following day which focussed primarily on the improvement in Kenya's economic performance under the ESAF program.

Our visit to Zambia was notable for various reasons:

(1) Despite the country's economic decline, the problem of large arrears to the Fund and Bank, and the well publicized difficulties with the Fund prior to recent developments, most Zambians with whom we met made no attempt to blame the Fund for the country's difficulties. Instead, they expressed confidence in the Fund, with some urging that Fund negotiators insist on a sound program for 1990.

(2) Zambian economists were familiar with, and were engaged in a lively debate over current policies, including Zambia's Policy Framework Paper, which they perceive, however, as strictly a Fund/Bank document. While they agreed with its objectives, they felt strongly that there should have been a larger Zambian input. Some were critical of their Government for not providing them an opportunity to participate in the process of developing such a policy paper, as was the case with some of their colleagues in other African countries.

(3) Zambian economists, were clearly interested in meeting with Fund representatives, to debate issues related to Fund policies, and to make specific comments on measures introduced by the Zambian Government. A meeting with the Zambian Economists Association lasted close to three hours on a Saturday morning, with some staying on for additional discussions following the meeting. They expressed the hope that the Fund will convey their comments to the Zambian authorities, since, as they put it, "the Fund's views will carry more weight," than their own!

One of these comments related to the need to adjust corporate taxes for inflation in line with a similar measure affecting individual income taxes. A second issue related to the need to phase out fuel allowances for senior Government officials, which are augmented every time fuel prices are adjusted upwards. Another point related to the continued mis-allocation of scarce foreign exchange, where on several occasions Zambians criticized the Government for buying a large number of Mercedez-Benz cars for senior officials, at a time when various industries, such as the trucking industry, are operating at considerably below capacity for lack of spare-parts and other imported requirements. At another meeting, the President of the Zambian Commercial Farmers' Bureau, which represents the interests of private farm owners, pointed out that the recently introduced "maize coupons," intended to help the urban poor cope with producer price increases, has immediately created a shortage of farm labor, with many farm hands opting to queue for coupons and other subsidized consumer goods which they can resell at a profit, rather than work on the farms.

(4) We were interviewed on Zambian national TV, for a Sunday morning talk show, and asked to explain the work of the Fund. The 15-minute interview was broadcast in its entirety. Zambian TV has also requested for a broadcast quality copy of the Fund's film "The IMF at Work," to show at a later date.

In Zimbabwe, we met with similar groups as in Kenya and Zambia, but in conrast to both countries, the mood was pessimistic regarding Government policy intentions. Several economists, African and expatriate alike, believe that the situation will continue to deteriorate, and that the Government has no intention of lifting the controls stifling economic activity.

The Zimbabwean press took great interest in the Article IV consultation process which had just been concluded. We took this opportunity to explain the consultation process, and how the surveillance function works for the developing as well as the industrial countries. This as well as other information on the Fund were carried by the press and reported on the national television.

Mr. Basu

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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

RECEIVED
89 NOV 16 AM 9:51
EXCHANGE AND TRADE
RELATIONS DEPT.

DISPATCHED IMF
1989 NOV 14 P 6:00

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MR.EL KOGALI
AFR
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TRE
MR.H.SIMPSON

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Executive Board took following decision November 14, 1989:
quote

The Fund finds, after consultation with the authorities of Kenya, that the representative exchange rate for the Kenya shilling under Rule O-2(b)(i) against the U.S. dollar is the midpoint of the Central Bank of Kenya's buying and selling rates for the U.S. dollar.

unquote
Van Houtven, Secretary, Interfund

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C TELEX NO.:

D DRAFTED BY NAME (TYPE): BJOwen:jrw — EXT.: 6712 — DEPT/DIV: SEC — DATE: 11/14/89

E AUTHORIZED BY NAME (TYPE): Leo Van Houtven — AUTHORIZED BY NAME (TYPE): — (**)

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G B. J. Owen
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Mr. Basu

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WASHINGTON, D. C. 20431

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THE TREASURY
MINISTRY OF FINANCE
P.O. BOX 30007
TREASURY BUILDING, HARAMBEE AVENUE
NAIROBI, KENYA

RECEIVED 89 NOV 13 AM 10:58 EXCHANGE AND TRADE RELATIONS DEPT.

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EXECUTIVE BOARD TOOK FOLLOWING DECISION NOVEMBER 10, 1989:

QUOTE

THE FUND DETERMINES THAT THE MIDTERM REVIEW SPECIFIED IN PARAGRAPH 2(c) OF THE FIRST ANNUAL ARRANGEMENT UNDER THE ENHANCED STRUCTURAL ADJUSTMENT FACILITY (EBS/89/84, SUP. 1, 5/26/89) HAS BEEN COMPLETED. UNQUOTE

VAN HOUTVEN, SECRETARY, INTERFUND

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AUTHORIZED BY NAME (TYPE): Leo Van Houtven AUTHORIZED BY NAME (TYPE): (**)

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SEC. 48 REV. 2 8-14-87

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cc: Mr. Basu
Mr. Acqual

File

Office Memorandum

89 NOV -8 AM 9:06
EXCHANGE AND TRADE RELATIONS DEPT.

To: The Managing Director
The Deputy Managing Director

November 6, 1989

From: Gerhard Laske

Subject: Kenya - Change in the Representative Rate of the Currency

Attached for your approval is a paper proposing a new definition of the representative rate of the currency of Kenya. The paper is to circulate for a lapse of time decision by the Executive Board.

The change in the definition of the representative rate for the Kenya shilling is necessary as the Central Bank of Kenya no longer maintains a fixed relationship between the Kenya shilling and the SDR as is stipulated in the current definition, adopted in March 1981. The new definition of the representative rate of the Kenya shilling reflects their adopting a flexible peg to a basket of currencies.

The paper has been cleared with the African , Exchange and Trade Relations and Legal Departments.

Attachments

cc: Mr. Touré
Mr. Whittome
Mr. Gianviti
Mr. Simpson

DRAFT 11/6/89, 5:12 pm

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

Change in Representative Rate for the Currency of Kenya

Prepared by the Treasurer's Department

(In consultation with African, Exchange and Trade Relations and Legal Departments)

Approved by Gerhard Laske

November , 1989

The representative exchange rate for the Kenyan currency was last established in March 1981 and was based on the fixed relationship of the Kenya shilling to the SDR (Executive Board Decision No. 6766-(81/32) G/S, adopted March 2, 1981).

In view of the change in the exchange rate arrangements of Kenya, from a fixed relationship between the Kenya shilling and the SDR to a flexible peg to a basket of currencies (EBS/88/15), the Fund has consulted with the authorities of Kenya under Rule O-2(c) regarding the determination of the representative exchange rate for the Kenya shilling. As a result, it is proposed that the representative exchange rate for the Kenya shilling under Rule O-2(b)(i), against the U.S. dollar, be the mid-point of buying and selling rates for U.S. dollars by the Central Bank of Kenya. The mid-point of the buying and selling rates for the U.S. dollar by the Central Bank of Kenya on October 3, 1989 was one U.S. dollar equal to Kenya shillings 21.7775 (see Attachment I). The Central Bank of Kenya has agreed to inform the Fund periodically of changes in this rate and advise the Fund immediately of any change in the exchange system.

The following draft decision is proposed for adoption by the Executive Board:

> The Fund finds, after consultation with the authorities of Kenya, that the representative exchange rate for the Kenya shilling under Rule O-2(b)(i) against the U.S. dollar is the mid-point of the Central Bank of Kenya's buying and selling rates for the U.S. dollar.

Attachments

Attachment I

FROM CENTRAL BANK OF KENYA
TO: IMF, WASHINGTON, D.C.
AS: OCTOBER 3, 1989

THE U.S. DOLLAR/KENYA SHILLING REPRESENTATIVE RATE AS AT CLOSE OF BUSINESS ON 9/29/89 WAS KSHS 21.7775 TO ONE U.S. DOLLAR.

CENTRAL BANK OF KENYA
NAIROBI
PWW
NNNN

Received in Cable Room: October 3, 1989.

Attachment II

FROM CENTRAL BANK OF KENYA
TO: IMF, WASHINGTON, D.C.
AS: OCTOBER 27, 1989

YOUR GRA NO. 44 OF 10/25/89 REFERS.
QUOTE
THE REPRESENTATIVE RATE FOR THE KENYA SHILLING UNDER RULE O-2, PARAGRAPH B (1), AGAINST THE US DOLLAR, IS THE MID-POINT OF THE CENTRAL BANK OF KENYA'S BUYING AND SELLING RATES FOR SPOT DELIVERY OF KENYA SHILLINGS AGAINST THE US DOLLAR. THE CENTRAL BANK OF KENYA WILL IMMEDIATELY COMMUNICATE TO THE FUND ANY CHANGE IN THE REPRESENTATIVE RATE FOR THE KENYA SHILLING. UNQUOTE

J W MUMELO
CENTRAL BANK OF KENYA
NAIROBI
PWN
NNNNN

Received in Cable Room: October 27, 1989

cc, Mr. Aguel
Ms. Puckahtikom
Mr. Pujol
I.O.
Mr. Feldman

Office Memorandum

TO: Mr. Bornemann

October 10, 1989

FROM: A Basu AB

SUBJECT: Kenya--Comments on Draft Staff Report

We have the following comments for your consideration.

1. Balance of payments projections

As already commented on the occasion of the review of the letter of intent, the staff report should focus on balance of payments data for 1989 and 1990 only in order not to prejudge the discussion for the medium-term adjustment path under the second annual ESAF arrangement. Perhaps one could point out the key factors that suggest a weak or external outlook for 1991-92, without going into detailed figures.

How do the projected coffee prices for 1990 compare with the price today? The projected increase in coffee prices in 1990 over the average of 1989 (p. 21, line 3 from bottom) must imply a sharp rebound from the present low level, given that coffee prices were still high in the first half of 1989. A footnote indicating the impact of unchanged coffee prices as of today for 1990 would be useful.

2. External unguaranteed borrowing by public enterprises

In Mr. Touré's memorandum to management (September 21, 1989), it is indicated that "several public enterprises are able to borrow on commercial terms without a government guarantee or letter of awareness" (e.g., the borrowing by the Coffee Board in March 1989). If this were the case, some reference should be made in the staff report, consistent with the authorities assurance referred to in Mr. Touré's memorandum, that there are no plans for public enterprises to engage in such borrowing for the rest of this year.

"1989" should be changed to "1990" (page 14, second line from the bottom).

3. Wage bill

The wage bill for 1988/89 is now projected to grow by 16 percent, compared with the program target of 10 percent (page 8 and Table 4). An explanation should be given for this discrepancy as containment of the wage bill was an important element of the program. The report (page 27) and the letter of intent (paragraph 12) both state that the system for the monthly monitoring of the wage bill and operating expenses will be implemented during 1989 (emphasis added).

Does this mean that the system is yet to begin implementation? If so, we are concerned whether the containment of the increase in the 1989/90 wage bill to within the benchmark figure (7.5 percent) is realistic. If the system is already in effect, the sentence should read "the system...is in effect and will continue throughout 1989/90." More generally, the staff should evaluate whether measures that are now in place are adequate to prevent the wage bill to be exceeded as in 1988/89.

4. Capital expenditure

The report should be more specific on the timing of the preparation of the public sector project list (page 27). Unless the list is prepared very soon, it may not be useful in planning the 1989/90 expenditure.

5. Public enterprise reform

Public enterprises within the development finance institutions' portfolios were originally programmed to be restructured or rehabilitated, with the streamlining of those to be retained and action plans for the remainder, by June 1989 (EBS/89/84, page 18). In the revised program, the decision to privatize, restructure or liquidate these institutions will be taken only by June 1990 (page 30). The staff report should explain the delay and the progress so far in this reform.

6. Private savings

The report refers to the projected decline in private savings in 1989 (page 19). The report should discuss the reasons for such a decline, whether it is expected to be only temporary, and whether any measures are being taken to correct the situation. The adequacy of the interest rate policy should also be discussed in this context.

7. Exchange rate developments

On page 23, there is a reference to a real effective depreciation of the exchange rate by 4.7 percent in the first seven months of 1989. According to the latest INS run of September 25, 1989, the rate of depreciation is only 2.9 percent over that period including the July exchange rate action.

8. Staff appraisal

The last paragraph dealing with the areas where further progress with structural reform will be necessary appears to miss out a few points. We should point out that further progress should be achieved with reforms of the public enterprise sector, the tax system, the financial sector, and the remaining price controls.

cc: Mr. Heller

file by Kenya

Mr. Baju

009020

OFFICE OF THE VICE PRESIDENT
AND
MINISTER FOR FINANCE

Telegraphic Address:
FINANCE - NAIROBI
Telephone: 338111
When replying please quote:

THE TREASURY
P.O. BOX 30007
NAIROBI, KENYA

Ref. No..
and date

Date Sept. 26, 1989

ORIG: AFR
CC: MD
DMD
MR. EL KOGALI
ETR
FAD
LEG
RES
SEC
TRE
MR.H.SIMPSON

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Camdessus:

1. The Memorandum on Economic and Financial Policies, which accompanied our letter of April 18, 1989, outlined the structural adjustment program that the Kenyan Government intended to pursue during the three year period January 1989-December 1991, and presented in detail the objectives, policies, and measures for the first year of this program. In support of this program, on May 15, 1989 the Fund approved a three-year structural adjustment arrangement under the enhanced structural adjustment facility (ESAF) in an amount equivalent to SDR 241.4 million, 170 percent of Kenya's quota, and the first annual arrangement thereunder.

2. During the first half of 1989, considerable progress was made in program policy implementation and the program remains essentially on track. The program's fiscal target for 1988/89 (July-June) was achieved, restraint in overall credit policy was maintained, flexible exchange and interest rate policies were continued, and significant reforms were introduced under the financial sector restructuring and industrial sector adjustment programs. The program's quantitative benchmarks for end-June 1989 were observed and the structural benchmarks are being implemented as scheduled.

3. The overall economic growth target for 1989 has been reduced slightly from 5.2 percent to 4.9 percent. This reduction mainly reflects less favorable weather conditions at the beginning of 1989, lower than anticipated coffee production, and higher oil prices. The inflation rate during the first half of 1989 has remained relatively high; at the end of June 1989, the weighted month-on-month rate of inflation was 10.3 percent (viz., end-June 1989 relative to end-June, 1988). This development may be attributed to increases in producer and consumer prices in February and April, increased excise and sales tax rates brought forward from the 1989/90 budget to April 1989, and a somewhat greater-than-anticipated growth in broad money. While the inflation rate has begun to abate since the peak of 11.5 percent in May to 8.9 percent in August, the weighted month-on-month rate of inflation in 1989

is still estimated to be about 9 percent instead of the targeted 8 percent. In the external sector, net official reserves, excluding the external borrowing by the Coffee Board of Kenya, increased by SDR 30 million during the first half of 1989, compared with the target of SDR 42 million, despite preliminary customs data which indicate strong import growth in the first five months of this year. The Coffee Board, which operates on a commercial basis, borrowed SDR 50 million in April 1989 to finance large inventories of coffee that had built up when export quotas were in effect and to facilitate payment to producers. This loan, which will be repaid in less than one year, was not guaranteed by the government, and was backed by collateral in the form of the Coffee Board's coffee stocks.

4. Based upon preliminary actual data, the 1988/89 fiscal program target of an overall cash deficit of 4.5 percent of GDP (6.9 percent excluding grants), was attained, with a cash deficit of 3.9 percent of GDP (6.1 percent excluding grants). Government revenues were K Sh 88 million below the program target, while total expenditure was K Sh 1.2 billion (0.7 percent of revised GDP) less than originally anticipated. External financing of the budget amounted to K Sh 4.6 billion (2.8 percent of GDP), compared with K Sh 3.9 billion in the program. The bulk of the K Sh 1.8 billion of domestic financing, in contrast to the program, was from nonbank sources. As a result, net bank credit to the Government at end-June 1989 was about K Sh 2.0 billion below the program benchmark. However, the stock of unpresented cheques increased from K Sh 1.1 billion at the end of June 1988 to K Sh 2.95 billion at the end of June 1989.

5. Overall domestic credit developments through the first half of 1989 were more contractionary than programmed. Net domestic credit grew by 8.3 percent in 1988/89 (July-June), compared with 13.7 percent in the program. Credit to the Government increased by only 2.3 percent during this period, in contrast to the targeted 12.8 percent, while credit to the nongovernment sector rose by 11.6 percent, compared with the programmed 14.2 percent. Broad money, however, expanded by 17.8 percent in 1988/89, in contrast to a growth of 17.0 percent in the program, while net foreign assets were higher than projected. Positive real interest rates continued to be maintained.

6. External sector policies during the first half of 1989 were in line with the program. The exchange rate was flexibly managed, depreciating by 2.7 percent in real effective terms during this period. At the same time, official external borrowing on nonconcessional terms was confined to US$56.4 million for loans in the 1-12 year maturity range at the end of June, 1989.

7. Progress was also made during the first half of 1989 in implementing the program's structural policy measures. Producer prices were raised in February for beans and in July for maize and wheat to improve the incentives for agricultural producers to expand production. In the area of parastatals, the financial and organizational restructuring of the National Cereals and Produce Board (NCPB) has proceeded essentially as scheduled. The Government also began to charge market rates of interest on direct loans to public enterprises, completed the study of development finance institutions, and began to allow Kenya Railways to operate on commercial principles. Fiscal

structural reforms introduced in mid-1989 included the elimination of the export tax on coffee and tea, the lowering of the effective corporate tax rate and the top rate of personal income tax, an increase in income tax allowances, and, to widen the income tax net, the introduction of a tax on the value of gross sales of agricultural produce.

8. Within the context of the Government's financial sector adjustment program, a number of policy actions have been taken. To ensure positive real interest rates, the minimum savings deposit rate for commercial banks was raised 2 percentage points to 12 percent in April. At the same time, with a view to encouraging commercial banks to make longer term loans, the maximum lending rate for loans with maturities greater than four years was raised from 15 percent to 18 percent. In mid-1989, a revised Banking Bill was passed by Parliament and is awaiting Presidential assent. It should strengthen the supervisory role of the Central Bank vis-a-vis the commercial banks, limit advances to insiders, and redefine exposure and capital adequacy requirements. At the same time, legislation was tabled to establish a Capital Markets Authority, a semipublic institution to promote, develop, and regulate the securities market. In support of these reforms, in June 1989 the World Bank approved for Kenya a US$125 million financial sector adjustment credit and financial sector technical credit.

9. The implementation of the industrial sector adjustment program, which came into effect in mid-1988 and is being supported by the IDA and other multilateral and bilateral donors, continued in 1989. In line with the program's aims of encouraging investment and nontraditional exports, the quantitative restrictions on import items in Schedule IIIB were removed in mid-1989, and replaced by tariffs as the sole form of protection. At the same time, the number of tariff categories for all import schedules was rationalized and reduced from 17 to 12. In the process, the weighted average of tariffs for items in Schedules I, II, and IIIA combined were reduced. While average tariffs were raised for the items in Schedule IIIB, the actual increases in these tariffs were, with only three exceptions out of a thousand, smaller than those proposed by the recent consultants' study on tariff equivalents. Moreover, the import licensing system has been streamlined; the weekly data provided by the new monitoring system indicate that the time it takes from applying for an import license to acquiring the corresponding foreign exchange has been reduced considerably and there has been an improvement in confidence in the system. As a result of these measures, the program's structural performance criterion relating to import liberalization has been met before the targeted end-September 1989 date. With an eye toward further enhancing export prospects, a study was completed on export incentives for Kenyan industry. The Government has taken several measures to strengthen the functioning of the investment approval process, which can also play an important role in enhancing export prospects through foreign participation in, for example, manufacturing-in-bond and export processing zones. A Cabinet Sub-Committee on Investment, headed by the Vice President, has been established to remove some of the bottlenecks in the investment project approval process. At the same time, the management of the Investment Promotion Centre has been strengthened. It is expected that project approval delays will be significantly reduced. With respect to the restructuring of

development finance institutions (DFIs), a study on this topic was completed in June 1989. Cabinet approval was obtained on the principles and guidelines to guide the restructuring program, and a detailed DFI action plan has been prepared and approved.

Policies for 1989/90

10. In line with the program's objectives, the program fiscal target for 1989/90 is to be confined to an overall cash deficit of K Sh 7.65 billion, or 4.2 percent of GDP (6.8 percent excluding grants). Net external financing of the program cash deficit will amount to K Sh 5.6 billion or 3.1 percent of GDP (K Sh 204 million, net of Appropriations-in-Aid (A in A) financing), while domestic financing will be about K Sh 2 billion or 1.1 percent of GDP (with K Sh 1.1 billion or 0.6 percent of GDP from the banking system). In the event that the net external financing (excluding A in A financing) or domestic nonbank financing of the budget deficit exceeds that programmed, the target for net bank credit to the Government during 1989/90 as measured at the end of June 1990 will be adjusted downward by the amount of the excess. Consistent with the Government's intention to limit the size of the float, the level of unpresented cheques at the end of June 1990 will be no larger than their end-June 1989 level. In formulating the 1990 annual program, the fiscal targets will be reviewed in the light of macroeconomic considerations, fiscal and balance of payments prospects, and the availability of additional external concessional assistance.

11. Total revenue will be raised by 0.9 percent of GDP to 24.1 percent of GDP in 1989/90; or about 0.4 percent of GDP is expected to be raised from newly introduced user charges in health, education, and other public services, while the remainder is projected to come primarily from additional tax receipts from import duties and sales tax on imports. As in the previous fiscal year, about 0.6 percent of GDP is projected to come from new discretionary tax measures, with about 40 percent of the increase in revenue from these measures from the increase in the sales tax on beer in April 1989 together with the reform of sales taxation, while the remainder is to be derived from tariffs, excises, and miscellaneous other measures. The introduction of a presumptive tax of 5 percent levied on the value of gross sales of agricultural goods is expected to yield revenue of about K Sh 812 million, and this tax will more than offset the projected loss in receipts of about K Sh 510 million from the elimination of the export tax on coffee and tea. A bill to replace the sales tax by a multiple tax rate value added tax (VAT) on manufactured goods and a 17 percent tax on business services was tabled in mid-1989, and the VAT will be implemented on January 1, 1990. The introduction of the VAT is projected to yield K Sh 180 million (0.1 percent of GDP) in net additional revenue in 1989/90. It is intended that the VAT will be extended to the retail level. Moreover, during 1989/90, K Sh 860 million will be raised from newly introduced user charges for health, education, and other public services. In particular, K Sh 228 million will be raised from the introduction of additional charges for hospital services in district and provincial hospitals as well at the Kenyatta National Hospital. In the education sector, higher fees for tuition and boarding at the universities, reduced allowances at the teacher training colleges, and the netting out of existing charges on parents

from budgetary grants to some secondary schools, will yield about K Sh 564 million to the budget.

12. In terms of expenditure policy, the Government will continue with its budget rationalization program. In line with the fiscal program's aims to restrain expenditure growth and to begin to correct the prevailing imbalance between wage and nonwage operating and maintenance expenditure in recurrent outlays, the increase in the wage bill (personnel emoluments in all Ministries, including subventions to Teachers Service Commission) will be limited to 7.5 percent in 1989/90, compared with the preliminary estimate of 16 percent in 1988/89. This will require a deceleration in the growth of government employment to about 3.5 percent and a containment of average wage increases to the 4 percent normally arising from within-grade salary movements. The following measures have been introduced to help achieve this target: (1) the freezing of all posts which have been vacant for more than six months as of April 26, 1989; (2) a ban on further upgrading or creating of posts during 1989/90, except with specific authority from the Treasury; (3) control over recruitment of non-technical and lower grade job groups; (4) the withdrawal of guaranteed employment in Government for trainees from Government training institutions; and (5) a reduction in the number of untrained teachers. The Government will also provide for a real increase in outlays for operating expenses in priority sectors, including education, health, road maintenance, water supply, and agricultural services. A system for the monthly monitoring of the wage bill and operating expenses will be implemented during 1989.

13. With regard to public enterprise reform, the financial restructuring of the NCPB has been completed with a write-off of K Sh 5.3 billion in the 1988/89 budget. The ongoing organizational restructuring of the NCPB (including cereal sector reform) is expected to be completed in 1991. The financial restructuring of the Kenya Railways and the South Nyanza Sugar Company are expected to be completed by 1991/92. During 1989, the Government began to monitor the financial performance and flow of funds of 10 sample nonfinancial public enterprises with the intention of extending the coverage so as to facilitate measurement of the consolidated public sector deficit by 1990/91. The Government has also initiated work to formulate a policy framework for public enterprises with technical assistance support from the UNDP. A draft of the proposed policy paper is expected to be completed in December 1989. An action plan for restructuring (or divesting) two development finance institutions and their portfolios--the Industrial Development Bank (IDB) and the Industrial and Commercial Development Corporation (ICDC)--has been prepared. By June 1990, a decision will be taken as to the subsidiaries of these institutions that will be privatized, restructured or liquidated. Finally, the Government is concerned about the operating situation of Kenya Airways and believes that a substantial infusion of equity capital will be required in the next three years to upgrade equipment, strengthen management, and improve maintenance capacity. Additional borrowing to address these problems will be consistent with the overall program targets to be negotiated, and will be the subject of close consultation with the Fund and the World Bank in view of the heavy capital borrowing requirements.

14. During the remainder of 1989 the Government will continue with its reform of the financial system, with a view to improving the efficiency of resource mobilization and allocation and to broadening the range of financial instruments available to savers and investors. In particular, with technical assistance from the Fund, reserve money management will be introduced gradually and active use of available monetary policy instruments through the Monetary Policy Committee will be initiated. The available monetary policy instruments will be refined. Interest rates will be maintained positive in real terms. In pursuit of the program's target of market determination of interest rates by June 1991, and in view of the recent inflationary pressures, the minimum savings deposit rate for commercial banks will be raised by one half percentage point to 12.5 percent by October 15, 1989. Simultaneously, the commercial banks' maximum lending rate for maturities of three years or less will be raised to 15.5 percent and the maximum lending rate for maturities in excess of three years will be 18 percent. This latter adjustment raises the interest rate on loans of maturities between three and four years from 15 percent to 18 percent. If at the end of November, the annual weighted average inflation rate is above 10 percent, the Government will further raise the interest rate ceiling on loans of three years or less to 16 percent by the middle of January. Interest rate policies will be reviewed further at the time of the discussions for the second annual arrangement under the ESAF. Finally, an effort will be made to remove some of the inefficiencies in the financial system by strengthening the capacity of the Central Bank's staff to supervise banking institutions. Restructuring programs have been prepared for weaker financial institutions. To encourage the development of a capital market, the Capital Market Authority will be established by early 1990 and the Capital Issues Committee's jurisdiction over the pricing of domestic equity issues will be removed shortly thereafter.

15. Monetary policy will continue to be geared toward reducing inflationary pressures and with a view toward achieving a manageable external account position. For the first half of 1990, the credit targets will be as indicated in attached Table 1. These indicative targets, which will be reviewed at the time of the elaboration of the annual program to be supported by the second annual arrangement under the ESAF in early 1990, are projected to be consistent with a 8.2 percent increase in broad money in 1989/90.

16. In the external sector, the current account deficit in 1989 is expected to be wider than originally programmed; it is now expected to widen slightly from 5.3 percent of GDP in 1988 (revised) to 5.5 percent in 1989 (rather than falling to 4.0 percent of GDP from 4.5 percent as envisaged in the program). Exports receipts are now projected to be less than originally envisaged, reflecting lower coffee exports in the light of recent trends in coffee prices in July and August following the collapse of the International Coffee Agreement, as well as lower net services receipts. It appears that import growth for the year as a whole will be higher than originally projected, in part reflecting the import liberalization measures discussed earlier but also that government imports, while falling, are higher than originally foreseen. Receipts from tourism are anticipated to be only slightly lower than programmed since recent developments appear not to have much of an adverse effect on the tourism industry. The programmed build-up in net official

reserves of SDR 58 million, however, is expected to be achieved, since external capital inflows are likely to be substantially higher than originally projected. The exchange rate will continue to be flexibly managed; by the end of July it had depreciated by 4.7 percent in real terms from its end-1988 level, based on provisional estimates.

17. Within the context of the industrial sector adjustment program, the study commissioned to calculate equivalent tariffs also contained a section examining the impact on domestic industry of unrestricted import licensing. More detailed work in this latter area has started and will be ultimately directed toward the preparation of an action program for restructuring viable public enterprises adversely affected by liberalization. A proposal to study and recommend policies for restructuring the textile industry in particular has already been approved by IDA for funding through its Project Preparation Facility. As regards the export compensation scheme, the Government clearly recognizes the need to improve administrative arrangements to ensure prompt payment of export compensation. The aim is to reduce delays in receiving compensation, targeting one month as the maximum time for receiving reimbursement. Further work contributing to a comprehensive medium-term export promotion program is currently in the pipeline. In this connection, an initial study to evaluate the enabling environment for an export processing zone near Mombasa has been commissioned and should be completed before the end of the year; another study financed through a World Bank Special Project Preparation Facility and a Project Preparation Facility to evaluate and design another export processing zone near Nairobi will be commissioned by the end of 1989 and completed by mid-1990. The Government expects to formulate a program for export processing zones by June 1990. With regard to price controls, in September, the price of animal feed was decontrolled, reducing the number of controlled items to 19 under the General Order.

18. Finally, we would like to assure you that the Government of Kenya is firmly committed to achieve the objectives set out in our structural adjustment program and will take any further measures that are necessary in this regard.

Sincerely yours,

Professor George Saitoti
Vice President and Minister for Finance

Eric C. Kotut
Governor
Central Bank of Kenya

Attachment

Table 1. Kenya: Quantitative Performance Criteria and Benchmarks Under the First Annual Arrangement Under the Enhanced Structural Adjustment Facility 1989

Performance criteria and benchmarks	1988	1989 June Benchmark	1989 September Performance criteria	1989 December Benchmark	1990 March Indicative target	1990 June Indicative target
			(In millions of Kenya shillings)			
Total domestic credit 1/						
Ceiling	...	55,044	56,897	58,080	57,371	57,712
Actual	52,666	52,422	...	...	...	...
Net credit to the Government 2/						
Ceiling	...	15,620	17,420	17,270	15,631	14,772 5/
Banking system	...	(19,321)	(21,891)	(21,741)	(20,241)	(19,382)
CSFC	...	(-3,701)	(-3,701)	(-3,701)	(-3,840)	(-3,840)
Debt assumed of parastatals	...	...	(-770)	(-770)	(-770)	(-770)
Actual	14,811	13,670	...	...	...	...
Banking system	(18,512)	(17,510)	...	...	...	...
CSFC	(-3,701)	(-3,840)	...	...	...	...
			(In millions of U.S. dollars)			
New nonconcessional external loans contracted or guaranteed by the Government 3/ (cumulative per calendar year)						
1-12 years' maturity						
Ceiling	...	100.0	100.0	100.0		
Actual	72.8	56.4	...	...		
Less than 1 year's maturity, other than related to imports						
Ceiling	...	—	—	—		
Actual	—	—	...	...		

Benchmark	1988 December Outstanding	1989 June	1989 September	1989 December
			(In millions of SDRs)	
Minimum cumulative increase in net official international reserves from end-December 1988 4/				
Benchmark	...	42	37	58
Actual	-113	80	...	...

Sources: Central Bank of Kenya; and staff estimates.

1/ Total domestic credit of the banking system is the sum of net credit to the Government, other public sector credit, and private sector credit. It includes bank credit utilized by the Cereals and Sugar Finance Corporation (CSFC).

2/ Net credit to the Government is net credit to the Government from the banking sector. The ceiling excludes the operations of the CSFC and excludes the amount of public enterprise debt assumed by the Government, and reclassified from outstanding private sector credit, which as of September 30, should amount to K Sh 770 million (relating to the assumed debt of the following corporations: (i) Kenya Chemical and Food Corporation (K Sh 512 million), Kenya Furfural (K Sh 54 million), The Wheat Board (K Sh 38 million), Fluorspar (K Sh 136 million) and East African Airways (K Sh 30 million).

3/ In conformity with existing regulations, no public enterprise will borrow on nonconcessional terms without government guarantee. For purposes of converting new nonconcessional external loans into U.S. dollars, the U.S. dollar exchange rates cabled to the Central Bank of Kenya from the Federal Reserve Bank of New York for January 3, 1989 will be used.

4/ Net official international reserves are defined as Central Bank's holdings of net foreign assets (excluding use of Fund credit), the Government's holding of net foreign assets (excluding reserve position in the Fund), use of Fund credit, and reserve position in the Fund. The information for the last two items is obtained directly from the Fund.

5/ This target will be adjusted downwards to the extent that net external financing of the deficit during the July 1989 - June 1990 period, excluding A in A financing, exceeds K Sh 204 million, or to the extent that domestic nonbank financing exceeds K Sh 0.9 billion.

cc: Mr. Basu
Mr. Acquah
Mr. Pujol
Mr. Johnson
Ms. Puckahtikom

Office Memorandum

89 SEP 22 AM 10: 14
EXCHANGE AND TRADE RELATIONS DEPT.

TO: The Managing Director
The Deputy Managing Director

DATE: September 21, 1989

FROM: Mamoudou Touré

SUBJECT: Kenya - Letter of Intent for Completion of Mid-Term Review

The letter of intent for completion of the midterm review of the first annual arrangement under the ESAF is attached for your consideration and approval. The letter has been cleared with Mr. Basu (ETR), Mr. Katz (FAD), Mr. Gupta (TRE), and Mr. Elizalde (LEG). If at all possible, we would appreciate your approval by c.o.b. Friday, September 22, so that we can communicate this to the Kenyan authorities during the Annual Meetings.

As indicated in Mr. Heller's back-to-office report of September 14, the recent mission to Kenya found that the 1989 arrangement was basically on track, and that the policies being implemented are in line with those indicated in the briefing paper. All applicable quantitative benchmarks for June 1989 were observed. One issue of concern is the lack of comprehensiveness of the ceiling on external nonconcessional borrowing with respect to public enterprises. Contrary to the understanding reached in April, it now appears that several public enterprises are able to borrow on commercial terms without a government guarantee or letter of awareness (e.g. the borrowing by the Coffee Board in March 1989). ETR has expressed concern that this offers scope to bypass the intent of the ceiling as negotiated. For the remainder of 1989, we have been assured by the authorities that there are no plans for public enterprises to engage in such borrowing for the rest of this year. While recommending acceptance of this assurance for the current arrangement, the staff feels that the issue of a better definition of the public borrowing ceiling will have to be addressed in negotiating the second annual arrangement under the ESAF.

Attachment

cc: ETR
FAD
LEG
TRE
Mr. Sengupta
Mr. H. Simpson

Blue folder cc: Mr. Acquah
Ms. Puckahtikom
Mr. Pujol
Mr. Feldman

Office Memorandum

TO: Mr. Heller

September 19, 1989

FROM: A. Basu AB

SUBJECT: Kenya--Letter of Intent for ESAF Review

We have the following comments and suggestions for your consideration:

1. External borrowing by the Coffee Marketing Board

The end-September 1989 performance criterion on short-term borrowing (less than 1 year's maturity) stipulates that "in conformity with existing regulations, no public enterprise will borrow on nonconcessional terms without government guarantee," and that such borrowing (other than related to imports) should be nil (see EBS/89/84, ESAF arrangements, policy memorandum and accompanying Table 1 in Appendix II). The letter of intent for the review states that the "Coffee Board . . . borrowed SDR 50 million in April 1989," and that the "loan which will be repaid in less than one year, was not guaranteed by the government, and was backed by collateral in the form of the Coffee Board's coffee stocks." Moreover, the borrowing was used "to finance large inventories of coffee . . . and to facilitate payment to producers," and hence was not related to financing imports.

Given these facts, if the loan remains outstanding at end-September 1989, there will be breach of the relevant borrowing performance criterion. The letter of intent and the eventual staff report should set out the justification for a waiver, if the loan is not expected to be fully repaid by September 1989.

2. Credit benchmarks and performance criteria

The observance of the June 1989 credit benchmarks was made possible in part by anticipated foreign borrowing and an increased fiscal float. Between end-December 1988 and end-June 1989, net claims on Government declined by K Sh 1 billion as compared with a programmed increase of K Sh 0.8 billion. Without the increase in the fiscal float alone (of K Sh 1.85 billion), the benchmark on net credit to Government would have been breached. We are concerned that this might turn out to be the case with regard to the observance of the end-September 1989 performance criterion for net credit to Government.

The draft letter of intent for the review stipulates that the target for net bank credit to the Government at end-June 1990 will be adjusted downwards should net external financing or domestic nonbank financing of the budget deficit exceed the programmed amounts (paragraph 10 and footnote 5 of Table 1). Our first suggestion is that the adjustment based on higher-than-programmed domestic nonbank financing should include the hidden financing provided through increases in the fiscal float. Second, we would suggest that the adjustment clause should apply not only to June 1990 but also to December 1989 and March 1990, and furthermore, that it should apply to both overall bank credit as well as credit to Government (as mentioned in the briefing paper).

Table 1 (accompanying the letter of intent for the review) should provide more detail about the adjusted performance criteria and benchmarks and actual data on performance. This should be done for both quantitative as well as structural policy benchmarks and performance criteria (along the lines of Table 12, Appendix I in EBS/89/84).

Both the fiscal table and the monetary survey table show that the banking system's net credit to Government rose by K Sh 389 million in 1988/89. This reconciliation between the two tables is not evident for 1989/90.

We are puzzled by the monetary projections for 1989/90. Other net liabilities are expected to rise by 4.5 percent of beginning period broad money by end-June 1990--thus allowing a larger-than-otherwise expansion in total credit. For the first half of 1989/90, net foreign assets are maintained unchanged relative to the original program, though the external sector projections have been revised so as to incorporate a deterioration. Finally, the composition of credit between the private and the public sector has been revised for the first half of 1989/90 in favor of the latter, despite its overperformance in June (technically at least). The staff report should explain the logic of these changes.

3. Fiscal developments

We are concerned with the continued slippages in the fiscal deficit relative to the program. In 1988/89 the overall cash deficit, inclusive of the increase in the float, was 5.1 percent of GDP against a programmed 4.4 percent. For 1989/90 the program target has been further weakened by 0.2 percentage points of GDP (page 2). In this regard, the draft letter of intent and the staff report should state that total expenditure during 1988/89 was K Sh 0.65 billion more than programmed, rather than K Sh 1.2 billion less than programmed, the float having increased by K Sh 1.85 billion during this period. The staff report should also explain the programmed deterioration in the overall budget deficit for 1989/90.

The letter of intent should provide a reason, if possible, for the sharp increase in the stock of unpresented checks of the Government (paragraph 4). What is the mechanism for controlling these unpresented checks to a level that is no larger than the end-June 1989 level (paragraph 10)?

At the end of paragraph 12 it is stated that a system for the monthly monitoring of the wage bill and operating expenses will be implemented during 1989/90. Since the fiscal year has already started, the timing for the implementation should be more specific, in order to ensure that the target for the year can be achieved. This is particularly important because the authorities doubted (as expressed in the back-to-office report) whether the benchmarks on the wage bill could be observed.

4. Structural policies

The statement at the end of paragraph 17 on price decontrol is too general. The letter should explain in which ways and when the decontrol will be implemented.

The back-to-office report indicates that the structural performance criterion on the development of an effective system for monthly monitoring of the operations of the import liberalization program will clearly be met. The implementation of this measure should be referred to in the letter.

5. Balance of Payments

In view of the significant changes in the balance of payments arising from the more adverse external environment, the staff report should explain how domestic policies have been adjusted to offset some of the adverse effects of a weaker external environment. In so doing, one should focus on BOP data for only 1989 and 1990, leaving the discussion of later years to be covered in the staff reports for the next annual ESAF arrangement.

6. Presentational points

Paragraph 16 states that the current account deficit in 1989 is expected to be wider than originally programmed; the magnitude of both original and current projections should be given.

Paragraph 11 states that total revenue will be raised to 24.1 percent of GDP in 1989/90; the ratio for 1988/89 would be helpful for this comparison.

Paragraph 3 discusses price developments in terms of month-on-month rate of inflation. Paragraph 14, however, discusses the interest rate policy in the context of the annual weighted average inflation rate. We would suggest to use one measure consistently in the letter of intent.

We have some problems with the REER references in the draft. First, in paragraph 6 the REER is said to have depreciated by 2.7 percent in the first half of 1989. In paragraph 16 it is estimated to have depreciated by 4.7 percent in the first seven months of 1989.

Only one reference need be made. However, according to the latest INS data, the real depreciation in the first half of 1989 was 1.7 percent and 2.9 percent in the first seven months.

Presumably the program target referred to at the outset of paragraph 10 is the fiscal one.

The reference to close consultation with the Fund and Bank concerning additional foreign borrowing for Kenya Airways in paragraph 13 is vague and could be made more explicit.

cc: Mr. Bornemann

Office Memorandum

September 8, 1989
Point 5 added on
September 15, 1989

MEMORANDUM FOR FILES

SUBJECT: Points Relevant for the Monitoring of External Debt Ceilings in Kenya

On September 6, 1989, there was a meeting at the Ministry of Finance to discuss Kenya's performance under the first annual arrangement under the ESAF. In addition to the Fund staff, the Kenyan representatives included Mr. Mbindyo (P.S., Ministry of Finance), Mr. Ali (Financial Secretary, Ministry of Finance), Professor Ryan (Economic Secretary, Ministry of Finance) and Mr. Kanga (Director of Research, Central Bank of Kenya). The following points were made, for the most part by Mr. Ali but elaborated on by Mr. Mbindyo. Mr. Ali verified the content of this memorandum on September 8.

1. No parastatal can borrow externally without Treasury approval, whether or not the loan is Government guaranteed. Government guarantees take the form of a sessional paper submitted to Parliament; it takes about two days to prepare the sessional paper and about seven days if all goes well for it to clear Parliament.

2. The program's external debt ceiling as they understand it covers nonconcessional borrowing by the Central Government or by parastatals where borrowing has been guaranteed or a letter of awareness has been issued. Letters of awareness, also referred to as letters of comfort, basically indicate to the lender that the Central Government is aware of a borrowing. While they do not imply a legal guarantee in any way, they are valued by creditors because of Kenya's payment record and commitment to maintain it; Mr. Ali also said that the present Government treats these letters like a moral obligation. Mr. Mbindyo said that he would provide to the mission by Friday (9/8/89) a copy of the letter of awareness for external borrowing by Kenya Post and Telecommunications in financial year 1988/89 (calendar year 1988).

3. Mr. Ali stressed that very few parastatals could borrow without a Government guarantee or a letter of awareness. Four possible exceptions are the Coffee Board of Kenya, the Post Office, the National Oil Company, and the Kenya Pipeline Company. So far in 1989, no borrowing on commercial terms has taken place by public enterprises in the 1-12 year maturity range, without a guarantee or letter of awareness. Mr. Ali added that there were no plans for public enterprises to engage in such borrowing for the rest of this year. According to the data provided to the mission for the period from January 1 to end-August 1989, external debt contracted on nonconcessional terms in the 1-12 year

range by the Government or by public enterprises on the basis of Government guarantees or letters of awareness stood at $68 million (mostly defense).

4. The Coffee Board of Kenya borrowed US$62 million in March 1989 on commercial terms. The loan will be repaid in less than one year and was made without a guarantee by the Government or on the basis of a letter of awareness. The loan was made solely on the strength of the Coffee Board; the stock of coffee it held served as collateral.

Addition

5. On Monday morning (9/11/89) I met with Mr. Mbindyo in his office, at which time he indicated to me that the letter of awareness for external borrowing by Kenya Post and Telecommunications did not exist, as he had originally thought, because the borrowing had been cancelled. When I asked for another example of a letter of awareness I was told that a copy would be made available to me at 4:00 p.m. at his office. I returned at that time and waited until 6:00 p.m. Mr. Ali came by and said that they had not yet been able to find an example of a letter of awareness in their files; he said that they would bring a copy of one to the Annual Meetings for the African Department.

Robert A. Feld

Robert A. Feldman
Economist, Exchange and
Trade Relations Department

cc: Mr. Bornemann
Mr. Basu
Mr. Heller
Ms. Horne
Ms. Calika
Mr. Hiwatashi

IMF OFFICIAL MESSAGE
WASHINGTON, D. C. 20431

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REFERENCE YOUR CABLE DATED AUGUST 3, 1989 REGARDING DRAWINGS BY KENYA UNDER THE STRUCTURAL ADJUSTMENT FACILITY OF THE FUND'S SPECIAL DISBURSEMENT ACCOUNT AND THE ENHANCED ADJUSTMENT FACILITY TRUST.

A. UNLIKE PURCHASES UNDER THE GENERAL RESOURCES ACCOUNT, WHICH ARE AN EXCHANGE OF ASSETS INVOLVING A CREDIT OF A MEMBER'S LOCAL CURRENCY TO THE FUND'S NO. 1 ACCOUNT AT THE TIME OF PURCHASE, DISBURSEMENTS UNDER THE SAF AND ESAF ARE LOANS AND DO NOT INVOLVE AN EXCHANGE OF ASSETS. LOANS UNDER THE SAF AND ESAF SHOULD BE TREATED IN A SIMILAR MANNER AS LOAN UNDER THE IMF TRUST FUND AND SHOULD BE RECOGNIZED IN YOUR ACCOUNTS AS LIABILITIES TO THE FUND.

B. LOANS UNDER THE SAF AND ESAF ARE TO BE REPAID IN TEN EQUAL SEMIANNUAL INSTALLMENTS WHICH BEGIN FIVE AND ONE-HALF YEARS AFTER THE DATE OF THE LOAN AND ARE TO BE COMPLETED BY THE END OF THE TENTH YEAR AFTER THE DATE OF DISBURSEMENT.

C. THE INTEREST RATE OF SAF LOANS IS FIXED AT ONE-HALF OF

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AUTHORIZED BY NAME (TYPE): MICHAEL FITZPATRICK AUTHORIZED BY NAME (TYPE):

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ONE PERCENT PER ANNUM. THE INTEREST RATE OF ESAF LOANS MAY VARY BUT IS CURRENTLY SET AT ONE-HALF OF ONE PERCENT PER ANNUM. INTEREST ON SAF AND ESAF LOANS IS PAYABLE SEMIANNUALLY EACH JUNE 30 AND DECEMBER 31.

TREASURER'S

INTERFUND

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EC. 48 (a) REV. 3 11-21-88 CONTINUOUS

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WASHINGTON, D. C. 20431

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1.

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THE TREASURY

MINISTRY OF FINANCE

NAIROBI (KENYA)

2.

REPEAT TO:

KE.D

CENTRAL BANK OF KENYA

NAIROBI (KENYA)

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Cable Room ID: MC1A862401 Page: 1	Distribution
Processed: August 03, 1989 11:44 Sender: Central Bank of Kenya Nairobi (Kenya)	ORIG: TRE CC: MR.EL KOGALI AFR ETR LEG

RECEIVED
89 AUG -3 PM 2:50
EXCHANGE AND TRADE RELATIONS DEPT.

cc: Mr Boorman
Ms. Puckahtikom

INCOMING MESSAGE

22324 KENYABANK

IMF
WASHINGTON DC
3.8.89

SAF AND ESAF LOANS

WE REFER TO SAF LOAN OF SDR 28,400,000 EQUIVALENT TO SHS 597,242,171.20 AT 0.0475519 OF FEBRUARY 4, 1988 AND ESAF LOAN OF SDR 40,233,334 EQUIVALENT TO SHS 1,022,692,434.80 AT 0.0393406 OF MAY 31, 1989. IN THE PAST, WHENEVER WE HAVE BORROWED FROM THE VARIOUS FACILITIES ,, THE PRACTICE HAS BEEN TO CREDIT THE FUND'S IMF NO. 1 ACCOUNTWITH THE SHILLING EQUIVALENT OF THE LOAN.
THEREFORE, WHEN WE BORROWED UNDER SAF AND ESAF, WE CREDITED THE SHILLING EQUIVALENTS TO THE NO. 1 ACCOUNT WITH THE SHILLING EQUIVALENT. HOWEVER, ON EXAMINING YOUR FEBRUARY, 1988 AND MAY 1989 STATEMENTS, THE AMOUNTS ARE NOT REFLECTED.
IN THE REPURCHASES DUE BY KENYA, REPAYMENTS OF THE LOANS DO NOT APPEAR.
AS A RESULT, CURRENCY VALUATION ADJUSTMENTS DO NOT AGREE DUE TO THE INCLUSION OF THE TWO LOANS IN THE IMF NO. 1 ACCOUNT.

WE WOULD BE GRATEFUL IF YOU COULD PROVIDE US WITH THE FOLLOWING INFORMATION:-

A. WHICH ACCOUNT WAS CREDITED REFLECTING KENYA'S INDEBTEDNESS TO THE FUND IN RESPECT OF SAF AND ESAF?

B. REPAYMENT PROCEDURE

C. INTEREST RATE ON THE LOANS

PLEASE REPLY AS SOON AS POSSIBLE SO THAT WE CAN FINALISE THIS MATTER ONCE AND FOR ALL.

CENTRAL BANK OF KENYA
NAIROBI

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22324 KENYABANK

Note:
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I N C O M I N G M E S S A G E

Office Memorandum

Mr. Bass

RECEIVED
89 APR 27 PM 4:53
EXCHANGE AND TRADE
RELATIONS DEPT.

TO: The Managing Director
The Deputy Managing Director

DATE: April 27, 1989

FROM: G.E. Gondwe

SUBJECT: Kenya - Attached Letter from the Governor of the Central Bank of Kenya

For your information, the attached letter from the Governor was delivered to us through the World Bank pouch from Nairobi. As you may recall, it had been agreed to include the understandings on exchange rate policy in a side letter to management.

At the request of the Kenyan authorities, this letter should be treated as secret.

Attachment

cc: Mr. Whittome
Mr. Gianviti

THE INTERNATIONAL MONETARY FUND ARCHIVES

RECORD CLOSURE NOTICE

The item identified below has been closed in accordance with the International Monetary Fund's IMF's Open Archives Policy (Decision No. 14498 – (09/126), adopted 12/17/09 and effective 03/17/10, as amended. This policy can be found on the International Monetary Fund website.

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Archival Ref No.:	48931
File Title & Dates:	Kenya - Correspondence and Memos, 1988-1989
Fonds:	Exchange and Trade Relations Department Records, 1946-1995
Sous-fonds:	Exchange and Trade Relations Department Immediate Office Records, 1946-1992
Series:	ETRAI Country Files / "ETR Files", 1953-1990
Box Number:	136
File Number:	1
Date Reviewed:	2022-09-30

DETAILS OF WITHDRAWN MATERIAL

Date:	1989-04-19
Type:	Letter and Attachment
To:	Michel Camdessus, Managing Director, IMF
From:	E.C. Kotut, Governor, Central Bank of Kenya
Subject/Title:	Regarding Flexible Exchange Rate Policy
No. of Pages:	2
Authority:	Central Bank of Kenya
Language:	English

cc. Mr. Hino
Mr. Duyol
Mr. Chick
I.O.

Office Memorandum

TO: Mr. Bornemann

April 11, 1989

FROM: A. Basu

SUBJECT: Kenya--PFP and ESAF Policy Memorandum

We have only a few comments on the above well-written documents.

1. Table I (Policy memorandum)

Shows that the benchmarks for net credit to Government are subject to downward adjustment for higher than programmed inflows of net foreign financing. This adjuster is shown for June and December of 1989, but not for the September 1989 performance criterion; an appropriate correction should be made.

We would also like you to consider whether this adjuster should apply also to total domestic credit. If it is decided that it should not be applied to total credit, then the staff report should explain why it was so decided.

The downward adjustment of the credit ceilings in the event of higher than programmed net external financing excludes "A in A financing." This term should be defined. Furthermore, the exclusion of this item (presumably on the expenditure side, as well as the finanicng side) appears out of line with the effort to consolidate the fiscal accounts.

With regard to the "minimum increase in net official international reserves from end-December 1988," we would suggest inserting the word "cumulative" after "minimum."

The reference to CSFC in the table could be clarified in a footnote to give the full name.

2. Paragraph 19 (Policy Memorandum)

In the third line from the bottom, could one include an estimate of the amount of debt cancelled?

3. Paragraph 23 (Policy Memorandum)

Please replace "Government" by "public sector" in lines 5 and 6 of the paragraph.

4. Paragraph 24 (Policy memorandum)

Under 24(i), before the opening words "the position...," please insert "the implementation of the import liberalization program described in paragraph 20 above, and..."

In line 2 of page 17, please consider changing the completion date for the review from "end-September 1989" to "end-November 1989." This will allow end-September data to become available by the time of the Board discussion of the review paper.

In the last four lines of the paragraph one should refer to assessing performance up to end-September 1989 and setting quantitative benchmarks for all the aggregates specified in paragraph 23 for March and June of 1990.

5. PFP (paragraphs 16 and 49).

One should indicate the denominator of the debt service ratio as exports or an alternative broader aggregate.

Reserves should be indicated in relation to total imports rather than nongovernment imports.

In the penultimate line of paragraph 49, please insert "by the public sector" after the words "nonconcessional loans..."

6. PFP (paragraph 50)

The external financing requirement (US$2.9 billion), the existing loan and grant commitments (US$1.2 billion), the expected new commitments (US$2.1 billion) and the financing gap (US$0.2 billion) do not add up (page 37). The size of the financial sector adjustment loan, the main source for the gap filling throughout the program period, should be specified.

The standard external financing requirements table is missing and should be added to the PFP.

7. PFP (Table 2)

The current account is presumably in millions of U.S. dollars. "Inflation rate" should indicate whether consumer prices or GDP deflator. Some indication of reserves and the growth of money and credit would be useful.

6. Policy matrix

It should be made clear that the study on the impact of unrestrictive licensing (2.b) will be completed by May 1989 (page 15 of the letter of intent).

5-CW

Cable Room ID: MC1A430601 Page: 1	Distribution
Processed: May 09, 1989 11:21 Sender: Central Bank of Kenya Nairobi (Kenya)	ORIG: TRE CC: MR. EL KOGALI AFR ETR LEG

RECEIVED
89 MAY -9 PM 2:45
EXCHANGE AND TRADE RELATIONS DEPT.

Mr. Basu

INCOMING MESSAGE

22324 KENYABANK

INTERNATIONAL MONETARY FUND
WASHINGTON DC

9.5.89

YOUR SPO (EDIS) NO. 35 OF MAY 8, 1989 REFERS.

QUOTE

PRIMO: AS FISCAL AGENCY FOR KENYA, WE REQUEST DISBURSEMENT OF THE FIRST LOAN IN A TOTAL AMOUNT EQUIVALENT TO SDR 40,233,334 UPON FUND APPROVAL OF THE FIRST ANNUAL ARRANGEMENT FOR KENYA UNDER THE ENHANCED STRUCTURAL FACILITY (ESAF).

SECONDO:

1. WE UNDERSTAND THAT THE EQUIVALENT OF SDR 21,300,000 OF THE AMOUNT INDICATED IN PRIMO ABOVE SHALL BE DISBURSED FROM THE STRUCTURAL ADJUSTMENT FACILITY (SAF) WITHIN THE SPECIAL DISBURSEMENT ACCOUNT, FOR WHICH THE TERMS AND CONDITIONS SET FORTH IN THE REGULATIONS FOR THE ADMINISTRATION OF THE SAF (DECISION NO. 8238-(86/56) SAF, ADOPTED MARCH 26 1986, AS AMENDED) SHALL APPLY.

2. WE UNDERSTAND THAT THE EQUIVALENT OF SDR 18,933,334 OF THE AMOUNT INDICATED IN PRIMO ABOVE SHALL BE DISBURSED FORM THE ENHANCED STRUCTURAL ADJUSTMENT FACILITY TRUST (ESAF TRUST), FOR WHICH THE TERMS AND CONDITIONS SET FORTH IN THE INSTRUMENT TO ESTABLISH THE ESAF TRUST (DECISION NO. 8759-87/176), ESAF, ADOPTED DECEMBER 18, 1987) SHALL APPLY.

3. PLEASE ARRANGE TO CREDIT ACCOUNT OF CENTRAL BANK OF KENYA WITH FEDERAL RESERVE BANK OF NEW YORK, NEW YORK WITH U.S. DOLLARS EQUIVALENT TO SDR 40,233,334 FOR VALUEON DATE OF LOAN DISBURSEMENT.

UNQUOTE

Cable Room ID: MC1A430601 Page: 2

CENTRAL BANK OF KENYA
NAIROBI
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64111 IMF UW

Note:
*** Test Accepted ***

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Mr. Baso

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TEST NO.

1. REFERENCE ENHANCED STRUCTURAL ADJUSTMENT FACILITY (ESAF) ARRANGEMENT FOR KENYA TO BE CONSIDERED BY THE EXECUTIVE BOARD SHORTLY.

2. LOANS UNDER THIS ESAF ARRANGEMENT WOULD BE FINANCED PARTLY FROM THE STRUCTURAL ADJUSTMENT FACILITY (SAF) AND PARTLY FROM THE ESAF TRUST. THE EXECUTIVE BOARD HAS DECIDED THAT THESE LOANS SHALL BE DISBURSED IN FREELY USABLE CURRENCY (IN THE CASE OF AMOUNTS FINANCED BY THE SAF, IN U.S. DOLLARS) OR, WITH THE AGREEMENT OF THE MEMBER CONCERNED, IN SDRS. ANY SDRS RECEIVED BY KENYA CAN BE USED IMMEDIATELY AND WITHOUT COST TO OBTAIN A FREELY USABLE CURRENCY IN A TRANSACTION BY AGREEMENT OR WITH DESIGNATION.

3. WE WOULD THEREFORE PROPOSE THAT YOU AGREE TO ACCEPT SDRS AS A MEDIUM OF DISBURSEMENT FOR ESAF LOANS. THE ACTUAL SELECTION OF CURRENCY OR SDRS AS THE MEDIUM OF

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CC:TRE
MR. EL KOGALI
AFR
ETR
LEG

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DRAFTED BY NAME (TYPE): DVPRITCHETT:ts — EXT.: 7640 — DEPT/DIV: TRE — DATE 4/28/89

AUTHORIZED BY NAME (TYPE): James E. Blalock — AUTHORIZED BY NAME (TYPE):

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EC. 48 (a) REV. 3 11-21-88 CONTINUOUS

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DISBURSEMENT WOULD BE MADE BY THE FUND CLOSE TO THE TIME OF EACH DISBURSEMENT, DEPENDING ON THE AVAILABILITY OF SDRS FOR THIS PURPOSE. THE FUND WOULD, PRIOR TO EACH DISBURSEMENT, INFORM YOU OF THE MEDIA TO BE USED FOR THE DISBURSEMENT AS WELL AS PROVIDE INSTRUCTIONS FOR THE CONVERSION OF ANY SDRS RECEIVED INTO A FREELY USABLE CURRENCY. IF YOU AGREE, PLEASE SEND THE FOLLOWING CABLE, BEARING TEST NUMBER, TO THE FUND AS SOON AS POSSIBLE:

QUOTE

REFERENCE THREE-YEAR ESAF ARRANGEMENT FOR KENYA. KENYA AGREES, IN LIGHT OF SDR AVAILABILITY, TO RECEIVE SDRS IN LOAN DISBURSEMENTS UNDER ITS THREE-YEAR ESAF ARRANGEMENT WITH THE FUND.

UNQUOTE

TREASURER'S

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MINISTRY OF FINANCE

NAIROBI (KENYA)

2.

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CENTRAL BANK OF KENYA

NAIROBI (KENYA)

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WITHDRAWAL NOTICE

PROJECT

Project number	2007-001
Project name	AFRAI/African Department froı
Project tab number	136
Project box number	2

DOCUMENT

Series / File	AFRAI/Country Files Kenya Cc
Original box /file No	57/3
Date	April 18, 1989
Type	Letter
From	Finance Ministry
To	Managing Directro
Subject / Title	Letter with attached Economic and Finacial Policies memo
Number of pages	18
Classification	CONFIDENTIAL
Authority	Office of Executive Director Africa Group I

COMMENTS

Send to Peter Gakunu, Executive Director - HQ1 11-718. also in ETR/AI/ETR Files/Kenya Correspondence and Memos 1988-89/box 136 file 1

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Entered by jdurkin Entered on 2/12/2007

Mr. Basu

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88 OCT 25 AM 10: 05

EXCHANGE AND TRADE RELATIONS DEPT.

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

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CC:SEC
MD
DMD
MR.ABDALLAH
AFR
ETR
FAD
LEG
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TRE
MR. H. SIMPSON

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Executive Board took following decisions October 21: quote

A. Review Under Stand-By Arrangement

1. Kenya has consulted with the Fund pursuant to paragraph 4(c) of the stand-by arrangement for Kenya (EBS/88/2, Sup. 2, 2/4/88) and paragraph 19(v) of the annexed memorandum of economic and financial policies to the letter dated November 26, 1987 from the Minister of Finance and the Governor of the Central Bank of Kenya, in order to review progress made under the program supported by the stand-by arrangement and establish performance criteria for the remaining period of the stand-by arrangement.

2. The letter dated September 9, 1988 from the Minister of Finance and the Governor of the Central Bank of Kenya shall be attached to the stand-by arrangement for Kenya, and the letter dated November 26, 1987 and its annexed memorandum shall be read as supplemented by the letter of September 9, 1988.

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E AUTHORIZED BY NAME (TYPE): Leo Van Houtven AUTHORIZED BY NAME (TYPE):

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SEC. 48 REV. 2 8-14-87

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3. Accordingly, paragraphs 4(a)(i) and (ii) and (b)(ii) of the stand-by arrangement for Kenya are amended to read:

"(a) ...

(i) the limit on net domestic credit of the banking system described in paragraph 12 and Table 1 of the letter of September 9, 1988, or

(ii) the limit on net credit to the Government described in paragraph 12 and Table 1 of the letter of September 9, 1988,

...

(b) ...

(i) ...

(ii) any external borrowing on nonconcessional terms in the 1-12 years maturity range in excess of an aggregate limit of US$75 million through December 31, 1988, and US$100 million thereafter; or"

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4. The Fund decides that the first review contemplated in paragraph 4(c) of the stand-by arrangement for Kenya is completed.

B. Compensatory Financing Facility

1. The Fund has received a request from the Government of Kenya for a purchase equivalent to SDR 40.0 million on account of an export shortfall. In accordance with paragraph 42 of Decision No. 8955-(88/126), adopted August 23, 1988, this purchase shall be governed by Decision No. 6860-(81/81), as amended.

2. The Fund notes the representation of Kenya and approves the purchase in accordance with the request.

3. The Fund waives the limitation of Article V, Section 3(b)(iii). unquote

Van Houtven, Secretary, Interfund

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Mr. Basu - 5-100 8-418

Cable Room ID: MC1A7045 Page: 1	Distribution
Processed: October 21, 1988 09:22 Sender: Ministry of Finance Nairobi (Kenya)	ORIG: AFR CC: MR. BORNEMANN

CG
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22921 MINFIN KE
MR BORNEMANN
INTERFUND
WASHINGTON DC

THANK YOU FOR YOUR TELEX OF 13TH OCTOBER REGARDING OUR FEGOTIATIONS FOR THE 7TH FRANCO-KENYAN FINANCIAL PROTOCOL STOP AS REQUESTED WE WISH TO INFORM YOU THAT (1) GRANT OF FF 25.0 MILLION IS DIRECTLY TIED TO THE BUYER'S CREDIT, (2) GRANT IS NOT AVAILABLE TO GOK WITHOUT THE LOAN AND THE CREDIT, (3) THE THREE COMPONENTS ARE FOR FINANCING THE SAME PROJECT STOP FROM THIS YOU CAN SEE THAT THE ONLY OPTION IS EITHERTO ACCEPT IN TOTO OR REJECT IN TOTO STOP PLEASE ADVISE WHETHER THIS CAN BE CONSIDERED AS SOFT LOANS STOP

REGARDS A H ALI FINANCIAL SECRETARY/FINANCE

22921 MINFIN KE
64111 IMF UW
MMM

INCOMING MESSAGE

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MR. A.H. ALI
FINANCIAL SECRETARY
MINISTRY OF FINANCE
NAIROBI, KENYA

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THANK YOU FOR YOUR TELEX OF OCTOBER 6 REGARDING KENYA GOVERNMENT NEGOTIATIONS FOR SEVENTH FRANCO-KENYAN FINANCIAL PROTOCOL.

ON THE BASIS OF YOUR EXPLANATION IN THE TELEX, EACH OF THE THREE COMPONENTS OF THE FINANCIAL PACKAGE APPEARS TO STAND ON ITS OWN, WITH ITS OWN TERMS AND CONDITIONS. AS SUCH THE FF 90.25 MILLION BUYER'S CREDIT WHICH CARRIES AN INTEREST RATE OF 7.4 PERCENT AND MATURITY OF 10 YEARS WOULD FALL WITHIN THE PROGRAM'S LIMIT ON EXTERNAL NONCONCESSIONAL BORROWING. HOWEVER, BEFORE MAKING A DEFINITIVE DETERMINATION, WE WOULD APPRECIATE KNOWING (1) WHETHER THE GRANT OF FF 25.00 MILLION IS DIRECTLY TIED EITHER TO THE TREASURY LOAN OR TO THE BUYER'S CREDIT; (2) WOULD THE GRANT BE AVAILABLE TO GOK WITHOUT THE LOAN AND

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CLEARED WITH MR. BASU (ETR)

TELEX NO.:

DRAFTED BY NAME (TYPE): DBallali:djh — EXT.: 6939 — DEPT.: AFR — DATE: 10.13.88

AUTHORIZED BY NAME (TYPE): E.L. BORNEMANN — AUTHORIZED BY NAME (TYPE):

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SEC 48 REV 1 11-18-82

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THE CREDIT; AND (3) WHETHER THE THREE COMPONENTS OF THE FINANCIAL PACKAGE ARE FOR SEPARATE PROJECTS.

REGARDS

BORNEMANN

INTERFUND

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Th. Whittome

Office Memorandum

October 7, 1988

MEMORANDUM FOR FILES

SUBJECT: Kenya--CF Request (Under the Transitional Provisions the CCFF)

A meeting was held in Mr. Erb's office this morning with Messrs. Gondwe, Crockett, Artus, Ballali, Pownall, and myself.

Background

In Berlin the Kenyan authorities had met with the Managing Director to discuss the possibility of Fund support for covering a net export shortfall of SDR 94.2 million. The Managing Director at first encouraged the Kenyans to go the ESAF route with an appropriately strengthened policy package. However, after the Kenyans pressed their request for CF resources, the Managing Director asked the staff to explore this option. At that point, the staff mentioned that while exploring this option, one should consider limiting the purchase to about SDR 33.1 million, so that the outstanding amount of CF purchases does not exceed 50 percent of Kenya's quota. Kenya's CF request would be discussed at the Board along with a staff report on the review of the current (upper credit tranche) stand-by program; and performance under the program has been satisfactory. Given the large shortfall (SDR 94.2 million), the issues considered were the reasons for limiting the purchase to a smaller amount and the basis for arriving at the amount itself.

Staff Views

Mr. Gondwe stated that the Kenyans should be responding to the shortfall by strengthening budgetary policies, and that the African Department had hoped that they would not persist with a request for a larger CF purchase (than SDR 33.1 million). Mr. Artus also felt that the Kenyans should be encouraged to adopt stronger policies (to move eventually to an ESAF), and should be discouraged from viewing the present problem as one of simply financing a shortfall (instead of adjustment).

Mr. Crockett suggested two grounds for limiting the purchase: the first related to safeguarding use of Fund resources and the second concerned the BOP financing need. He also mentioned a few cases (Cameroon and Zaire) where the size of the CF purchase was limited (as in the present case of Kenya).

On the first of these points, while agreeing that it was an important consideration, I indicated that we could face an awkward position at the time of the Board discussion. While asking the Board to complete a SBA review, we should not be arguing that the underlying program would have needed further strengthening to merit a CF purchase equal to the full CF shortfall. We should instead present the case on the basis of BOP need.

The discussion basically focused on BOP need. Mr. Gondwe indicated that of the current year's financing gap of SDR 50 million, Kenya has strong prospects of mobilizing about SDR 17 million in the form of concessional external assistance. This argued for limiting the CF purchase (and thus avoid crowding out concessional donor assistance). Mr. Erb asked about Kenya's foreign reserves in relation to import cover, and whether this needed some strengthening. Mr. Ballali said that the present reserve position in relation to imports (about two months' of imports) was relatively weak. Mr. Erb indicated that we could provide some support for strengthening Kenya's reserve position by increasing the proposed CF purchase slightly (up to a point that raises outstanding CF purchases to 55 percent of quota). Mr. Erb concluded the meeting by noting that he would be explaining this position to Mr. Abdallah in an afternoon meeting.

A. Basu
Advisor
Exchange and Trade Relations Department

cc: ETR Immediate Office
Mr. Hino
Mr. Pujol
Mr. Stuart
Mr. Feldman

Blue Folder
Mr. Hino
Mr. Johnson
Mr. Quinn
Mr. Puyol
Mr. Stuart

Office Memorandum

TO: Mr. Pownall

October 3, 1988

FROM: A. Basu

SUBJECT: Kenya--CFF Drawing

Our comments are as follows:

1. Page 1 (first sentence). The opening sentence should perhaps reflect the fact that an actual request has been received. Also, is the wording "decision on compensatory financing fluctations in the cost of cereal imports" appropriate in this case?

2. Page 2. The sentence at the top on the Fund's holdings of the member's currency refers to percent of quota figures which are difficult to reconcile with Table 1 in the stand-by review paper (EBS/88/201). Also, adding the appropriate dates to the figures would be helpful.

3. Page 4 (middle paragraph). After the first sentence of the paragraph (regarding Article XIV status), we suggest that the rest of the text of the paragraph be rephrased as follows:

> "It maintains restrictions on payments and transfers for current international transactions subject to approval under Article VIII, Section 2(a), arising from limitations on foreign exchange allocations for imports and for the remittances of rental incomes of nonresident individual property owners. In concluding the 1987 Article XIV consultation with Kenya, the Fund granted approval for the retention of these restrictions until December 31, 1988, or the conclusion of the next Article IV consultation with Kenya, whichever is earlier."

4. Page 9, 6th line from the end of the page. Should the 3.2 million tons refer to 1985/86 or 1986/87?

5. Staff Appraisal. This section should include a sentence noting the temporary and reversible character of the net shortfall.

More importantly, it should include an explanation as to why Kenya would request a purchase that would take them only to 50 percent of quota. Kenya has an upper credit tranche SBA in place and a review of that SBA is to take place at the same time as Kenya's request for the CF purchase is considered; on that basis, and given the estimated size of the shortfall, Kenya would qualify for a much larger purchase. This comment is not meant to suggest that Kenya should be advised to request a larger purchase, but only to note the need to set out the reasons why the authorities decided to limit their access to the CF.

6. 1988 and 1989 financing gaps. Considering the additional financing requirements in 1988 (SDR 49 million) and in 1989 (SDR 58 million), and the proposed size of the CF drawing, one needs to check that there are sufficient financial assurances for filling the financing gaps before the papers on the review of the SBA and the CF request are discussed by the Board.

7. Annex I. In the third sentence of the first page, one needs to insert the word "trend" after the words "medium term" appear for the first time. The fact that each bag is 60-kilograms should be stated earlier in page 2 than is done at present (page 3, second paragraph). In page 7, three lines from the bottom, insert "year" after the word "shortfall."

cc: Mr. Crockett
Mr. Ballali

bcc Mr. Hino
Mr. Johnson
Mr. Pujol
Blue Folder
Mr. Feldman

Office Memorandum

TO: Mr. Bornemann

September 14, 1988

o/r

FROM: Eduard Brau

SUBJECT: Kenya--Staff Report

The comments at this stage are mainly presentational. In general, the paper has a somewhat complacent flavor concerning the substantial domestic arrears incurred by the Government in late 1987/88 (described in the paper as delayed payments) and the weakening of the external accounts. At the same time, the paper needs to be more specific concerning the feasibility of closing the financing gaps in 1988, especially the portion not related to a possible CFF purchase, and in 1989.

I would ask that the fact that the central government target deficit was achieved through delayed payments be brought upfront in the description of fiscal developments, both in the text (pages 4/5) and in the staff appraisal. As presented now, the text may be regarded by some as trying to submerge this point too much. Related to this, is it correct that the K Sh 2 billion of arrears incurred in 1987/88 are not paid in full in 1988/89? In addition, what answer will the staff give to predictable questions by Directors on program design, i.e., how can such substantial domestic arrears be incurred without triggering performance criteria? Moreover, and of more immediate concern, both the letter of intent and the staff report are silent on a future policy of the authorities in regard to domestic arrears. What is being done to prevent a recurrence?

Given the deterioration of the medium-term outlook, including very large financing gaps in 1989-91, a greater emphasis on the need for additional adjustment--rather than on financing as done in the paper--would seem appropriate. Accordingly, the last sentence of page 24 needs substantial strengthening urging the authorities to adopt a stronger policy stance, including a reduction in non-interest recurrent expenditure which is programmed to grow by 4 percent in real terms. This could be done by developing further the middle paragraph of page 23.

I do not think it is quite appropriate to mention the possibility of replacing the current arrangement with an ESAF. In the letter of intent, the impression is given that Kenya has an entitlement to ESAF resources. I would suggest redrafting the sentence (page 10) as follows: "Moreover, the authorities have expressed a strong interest in entering into an arrangement under the ESAF." The same language could be used on page 21 of the paper. If you wish to mention the ESAF in the staff appraisal, I think it is essential also to say that a strengthening of policies would be necessary.

Could a table on scheduled purchases and related conditions please be included.

cc: Mrs. Junz (o/r)
Mr. Basu (o/r)

WITHDRAWAL NOTICE

PROJECT

Project number	2007-001
Project name	AFRAI/African Department froı
Project tab number	135
Project box number	2

DOCUMENT

Series / File	AFRAI/Country Files Kenya Cc
Original box /file No	57/1
Date	September 9, 1988
Type	Letter
From	Ministry of finance
To	MD
Subject / Title	REf. # ZZ/IMF/32
Number of pages	10
Classification	SECRET
Authority	Office of Executive Director Africa Group I

COMMENTS

Send to Peter Gakunu, Executive Director - HQ1 11-718. also in ETR/AI/ETR Files/Kenya Correspondence and Memos 1988-89/box 136 file 1

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

Entered by jdurkin Entered on 2/9/2007

ETK

Office Memorandum

cc: ✓ Blue Folder
Mrs. Junz
Mr. Basu o/r
Mr. Hume
Mr. Boyd
Mr. Johnson
Mr. Feldman

TO: The Managing Director

FROM: E.L. Bornemann EB.

August 23, 1988

SUBJECT: Kenya - Review of Stand-By Arrangement and Negotiation of Arrangements Under the ESAF

The staff mission 1/ that visited Nairobi during the period August 1-17, 1988 was unable to conclude the discussions for possible arrangements under an ESAF to replace the current 18-month stand-by arrangement and arrangements under the SAF. The mission found that Kenya's overall financial situation was worse than foreseen earlier, and the authorities were neither prepared at this time to take new revenue measures to cover additional expenditure outlays not provided for in the original budget for 1988/89, nor were ready to undertake the necessary restructuring of expenditure. Moreover, policies regarding the reform of public enterprises and the financial sector could not be formulated because the related studies have not yet been finalized.

In the circumstances, and as envisaged in its brief, the mission conducted the discussions related to the first review under the stand-by arrangement, and discussed the progress being made in implementing structural measures related to the SAF. The mission found that all the performance criteria for end-June 1988 had been observed, and most of the benchmarks established under the first annual arrangement under the SAF have been met. The mission negotiated, ad referendum, a letter of intent for the completion of the review. After clearance by the interested departments, it will be sent to you for approval.

Recent economic developments

On the basis of developments during the first half of 1988, it appears that the broad objectives of the program are being met. Real GDP growth in 1988 is estimated to be about 5 percent, slightly above the target, owing to favorable weather conditions and the impact of structural measures introduced in the agricultural sector since 1986. The inflation rate (about 9 percent) is likely to be somewhat higher than targeted, partly as a result of the Government's decision to move faster than programmed toward removing price controls. Kenya has continued its flexible exchange rate policy, and the exchange rate was depreciated by 9.1 percent in real effective terms during the 12-month period ending in June 1988.

1/ Comprising Mr. Ballali (AFR), Ms. Calika (AFR), Mr. Feldman (ETR), Mr. Schiller (FAD), Ms. Jacob (secretary-OMD), and myself. Mr. Faria, Adviser in the Executive Director's office, and Messrs. Mills and Rouis from the World Bank Office in Nairobi participated in some of the discussions.

Despite strong pressures on government expenditures, the overall budget deficit on a cash basis in 1987/88 (July-June) was limited to 4.2 percent of GDP as programmed. This outturn was achieved through better-than-programmed revenue performance and expenditure cuts in various areas, but also by the postponement of cash expenditure toward the end of the fiscal year. In an effort to ensure that the performance criteria for end-June 1988 were respected, the authorities carried over a considerable amount of cash expenditure into the fiscal year 1988/89. Without this action, the overall cash deficit for 1987/88 would probably have been about 5.5 percent of GDP, as expected in the brief. There was practically no expansion in net bank credit to the Government in 1987/88. Net bank credit to the Government at the end of June was K Sh 1.6 billion (1.2 percent of GDP) below the program ceiling, while credit to the rest of the economy was slightly higher than programmed. Overall, the rate of credit and monetary expansion remained below the level envisaged in the program.

The balance of payments situation in 1988 is more difficult than previously anticipated, owing mainly to lower world coffee prices and large payments for dividends held back from earlier years, which were only partially offset by lower oil prices and higher external grants. As a result, Kenya now requires additional financing for 1988 of about SDR 50 million, taking into account the programmed reserve build-up of SDR 35 million. To cover this gap, the Government intends to press for the acceleration of disbursements under existing program loans and to seek Fund resources under the compensatory financing facility. It also appears that the financing gap for 1989 will be larger than envisaged earlier. In this context, the Kenyan authorities emphasized the vulnerability of the program to delays in the disbursement of promised external assistance. They noted, in particular, the long delays experienced in receiving assistance from Japan in the context of cofinancing under the World Bank's agricultural program lending. According to the Kenyan authorities, these delays are in part due to the inexperience of the Japanese authorities with program lending in Africa. They requested the staff's assistance in accelerating disbursements.

The 1988/89 program

The mission found that the projected fiscal situation for 1988/89 was more difficult than envisaged in its brief, mainly because of additional expenditure not provided for in the budget presented to Parliament in mid-June, and the authorities' actions to postpone cash expenditure toward the end of 1987/88. Given the authorities' difficulties in implementing immediate additional revenue measures as proposed by the mission, the staff team pressed for substantial expenditure cuts to bring down the overall deficit for 1988/89 to 4.5 percent of GDP as provided for in the brief. As the deficit will be financed mainly through external resources, net bank credit will be limited to K Sh 2.2 billion (1.4 percent of GDP). The deficit target takes into account some of the expenditures not provided for in the original budget, including the acceleration of the implementation of high priority development projects financed by concessional external resources, increased expenditure necessitated by the doubling of the university intake, and additional defense expenditures, as well as the cash expenditure postponed toward the end of 1987/88. Most of these delayed outlays in fact took place in July-August 1988 and explain the sharp increase in net bank credit to the Government during these months.

Given the strong pressures for increased government expenditure in the face of a rapidly growing population (of some 4 percent per year), there is an emerging political consensus that cost sharing will have to be introduced. The authorities agreed, therefore, to take additional revenue measures in the form of user charges in the areas of health and education during the second half of 1988/89. Although only a relatively small amount of revenue will be raised in 1988/89, the introduction of user charges in the area of health and education represents a major change in government policy (with the potential of raising revenue by over 2 percent of GDP), since health and education services have been provided essentially free of charge since 1965.

The authorities indicated that later in the year they will be in a position to quantify and provide specifics regarding user charges and implementation would begin in early 1989. They also expected that the formulation of policy programs, based on the studies being undertaken on the reform of public enterprises and the financial sector, as well as the preparation of their proposals on restructuring government expenditure, would be completed by the end of the year. In the circumstances, the authorities requested that discussions on an ESAF be resumed in early 1989.

The Kenyan authorities requested the use of Fund resources under the compensatory financing facility. On the advice of their Executive Director, they asked that their request be handled under the old system, and expressed the hope that Board consideration could take place before the end of October. The mission collected the available statistical data on exports and cereal imports, and stated that the data would be turned over to the Research Department for a determination of a possible export shortfall.

cc: The Deputy Managing Director (o/r)

ASD	MED
CBD	PAR
ETR	RES
EUR	SEC
EXR	STA
FAD	TRE
GEN	WHD
INS	Mr. H. Simpson
LEG	

Office Memorandum

August 11, 1988

MEMORANDUM FOR FILES

REVISED (see page 2)

SUBJECT: Forward Exchange Rates in Kenya

I met on two occasions with representatives from the Foreign Department of the Central Bank of Kenya. On August 3, I met with Mr. Kambo, a dealer at the Bank, and on August 11 with Mr. Mumelo, manager of the Foreign Department. The details that follow were provided by these individuals during the two meetings.

1. Forward buying and selling rates for the U.S. dollar against the Kenya shilling were fixed, apparently arbitrarily, by the Governor of the Central Bank more than six years ago, and have remained unchanged since then. The buying and selling rates are:

	Selling Dollars (premium in Sh)	Buying Dollars
1 month	.3000	par
2 months	.6000	par
3 months	.9000	par
4 months	1.2000	par
5 months	1.5000	par
6 months	1.8000	par

The commercial banks call on the telephone and the Central Bank takes all deals, with confirmation by contract letter the next day. There are no fees or commissions.

2. Forward exchange rates are also set by the Central Bank for the pound sterling and the deutsche mark (DM). Similar to those for the dollar, forward buying rates are set at par. Forward selling rates for sterling and DM against the shilling change every day according to forward rates in New York between the dollar and DM, and the dollar and sterling. An example best illustrates how forward premiums are set for the non-dollar currencies. Mr. Kambo explained that the premium for forward sales of sterling has been calculated by:

(i) taking a market quote out of New York for the forward premium on sterling against the dollar (.0036 at the one-month maturity on August 3, 1988);

(ii) then multiplying this by the spot rate for selling dollars against the shilling (Sh 18.2900 on August 3);

(iii) and finally adding to this product what the representatives called a "load factor" of double the premium on forward sales of dollars (2 x 0.3000, or 0.6000 for the one-month maturity).

The premium on one-month forward sales of sterling on August 3 was therefore .6658. A similar procedure, including adding the "load factor" in step (iii) above, has been followed for the DM.

3. Commercial banks are authorized to enter into forward exchange contracts with their customers for up to six months at the premiums set by the Central Bank. For dollars, for example, they would add the respective premiums given in point "1" above to their spot selling rate to derive the forward selling rates at the various maturities. Their forward buying rates are set at par and therefore are the same as their spot buying rate. The Central Bank reports each day to the commercial banks central spot exchange rates, for dollars equal to Sh 18.2626 on August 3. From the central rates, the commercial banks set their spot buying and selling rates; the only constraint is that the spread be no more than 0.7 percent. On August 3, spot rates for buying and selling dollars might have been set by a commercial bank at Sh 18.2626 plus or
** minus .35 percent, or Sh 18.1987 and Sh 18.3265, respectively. At the one-month maturity, the forward buying rate would have been Sh 18.1987, and the forward selling rate would have been Sh 18.6265 (Sh 18.3265 + 0.3000). An analagous procedure is followed for determining forward rates for sterling and DM, with the premiums for forward sales set in the manner described in point "2" above.

4. The Central Bank sets its forward rates for transactions with the commercial banks in a similar fashion, but bases them on spot buying and selling rates that reflect a narrower spread. The Central Bank's spot rates are equal to the central spot exchange rate plus or minus 0.15 percent. Thus on August 3, its spot buying and selling rates were Sh 18.2352 and Sh 18.2900, respectively. The forward buying rate, at par, was Sh 18.2352 and the forward selling rate, at the one-month maturity, was Sh 18.5900 (Sh 18.2900 + .3000).

5. The Central Bank essentially provides at no cost a hedge for the forward foreign currency purchases made by commercial banks from their customers. The following example illustrates this point. On August 3, 1988 the one-month forward exchange rate for dollar purchases by the Central Bank from the commercial banks was Sh 18.2352, while the commercial banks forward rate for dollar purchases from their customers was Sh 18.1987. Thus a commercial bank would buy dollars forward at Sh 18.1987 and simultaneously sell dollars forward to the Central Bank at Sh 18.2352, for a riskless profit.

6. According to Messrs. Mumelo and Kambo, while there are regularly forward purchases of foreign currency by the Central Bank, forward sales are very limited (zero at present) because of the size of the premiums. It was indicated that the "load factors" were introduced as a matter of policy to discourage the forward speculative buying of foreign exchange that was taking place around 1982, at a time when forward sales were made at par. It was noted that there was a time when gross foreign exchange reserves plus outstanding forward purchases by the Central Bank were exceeded by outstanding forward sales.

Robert A. Feldman

Robert A. Feldman
Economist
Exchange and Trade Relations Department

cc: Mr. Basu (o/r)
Mr. Bornemann
Mr. Quirk
Ms. Calika

Office Memorandum

August 11, 1988

MEMORANDUM FOR FILES

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Robert A. Feldman

Robert A. Feldman
Economist
Exchange and Trade Relations Department

cc: Mr. Basu (o/r)
Mr. Bornemann
Mr. Quirk
Ms. Calika

Office Memorandum

August 1, 1988

MEMORANDUM FOR FILES

SUBJECT: Kenyan Trade Policy 1/

1. The sales tax department is not considered to be a prestige department. It tends to be understaffed. It is not yet computerized. It is not very administratively efficient. This situation feeds on itself.

2. It is administratively more efficient to impose, in effect, a sales tax on tradable goods by instead imposing an excise tax on domestically produced goods and a tariff on imported goods. Tariffs and excise taxes are administered by the Customs and Excise Department, a department considered to be many times more efficient and prestigious, thus attracting more qualified workers.

3. The import management committee (IMC) is the first body that screens import licenses, and tentatively rejects or approves them. The reason that the IMC's decision is considered a tentative one is that there is then a higher level committee at the Ministerial level called the Foreign Exchange Allocation Committee (FEAC). In effect, what this committee says goes; it can overrule the IMC, issue licenses that the IMC has not seen, etc. After the FEAC, import licenses go to the central bank (CBK) for issuance of a foreign exchange allocation license (FEAL). There is a time lag, perhaps between one and five weeks, before the FEAL is granted. Such delays can be taken to be a discretionary instrument of trade policy designed to slow imports for reasons of BOP considerations.

It may be noted that there can be an earlier stage in the process, as various supervisory agencies may be involved, either to check technical details as called for under the import schedules or sometimes "less formally". This can also lead to delays.

4. Under the liberalized system, import license approvals (Ministry of Commerce data) should, in principle, roughly match foreign exchange allocations (CBK data). Three of the possible reasons why they may not are: (i) that Ministry of Defense imports do not necessarily show up in the approvals data although foreign exchange is allocated; (ii) that imports for projects like Turkwell may not get into the

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1/ The points below reflect the informal views expressed by an individual with whom the mission had a discussion. While these views were of sufficient interest to be recorded, it should be stressed that the individual spoke off the record.

license approval data; and, (iii) that for commodity aid no foreign exchange may be involved.

5. The new import schedules were very carefully looked at. There seems to be a very strong committment to freely licensing schedule I (which is smaller than the old 1A). There is also a strong committment to freely licensing Schedule II once Ministerial approval based on technical criteria is obtained. While Ministerial approval is now clearer than it was before, it is still not well specified what such approval can entail or what some Ministries may have in mind when they are deciding whether or not to grant such approval. The point is that there are potential problems with Schedule II. Schedule IIIA was also very carefully examined. The only potential constraint on this schedule being freely licensed would be the availability of foreign exchange. In effect, schedule IIIA could be like the old schedule 1B. The Government, however, does not think that foreign exchange will be a constraint with the IMF and World Bank money coming in. Nevertheless, there does seem to some resistence to changing attitudes from the old way of thinking.

6. There is an active market for buying and selling foreign exchange allocation licenses, suggestive of an overvalued exchange rate and the extent of direct controls.

Robert A. Feldman

Robert A. Feldman
Economist
Exchange and Trade Relations Department

cc: Mrs. Junz
Mr. Basu (o/r)
Mr. Bornemann
Ms. Calika

Blue Folder
copy

Office Memorandum

July 29, 1988

MEMORANDUM FOR FILES

SUBJECT: Kenya--Briefing Paper for ESAF

Mr. Erb asked about the structural content of the proposed program--whether it was sufficiently well specified, the extent of Fund staff involvement in developing it, and the timetable for completing various reforms.

I explained that in almost all the key areas of structural reform (namely, price decontrol, import liberalization, and public expenditure restructuring), the World Bank had taken the lead in formulating the reforms and the timetable for their implementation. I said that we were unhappy that the final phases of price decontrol and import liberalization were now expected to be delayed by one year, and that plans for reforms in the financial sector were not as yet formulated. Mr. Nashashibi also pointed out the need to include structural tax measures from the first year. Mr. Bornemann confirmed that the World Bank had taken the lead in formulating and supporting the structural reforms with special sectoral loans and technical assistance.

Mr. Erb asked why a frontloading of ESAF access (60, 50, 50, with 160 percent of quota) was being proposed. I explained that the first two phases of import liberalization were being accelerated, and that as a result, import volume was expected to increase more than the modest growth rates earlier envisaged (under the existing SBA/SAF arrangements). Moreover, the proposed program provides for a larger early build-up of foreign reserves than earlier envisaged. I, of course, underlined the importance of seeking from the authorities a commitment that the remaining phases of price and import liberalization would not be delayed (even if the World Bank were to accept such a delay).

Mr. Bornemann stated that he expected the authorities to request a larger access (near 200 percent of quota). Mr. Erb raised the question as to what was the justification for the Fund to provide ESAF resources, when the Bank was formulating and financing all the structural reforms. Mr. Bornemann suggested that the Fund's role was mainly limited to advising on a framework of macroeconomic policies.

The mission was authorized to proceed on the basis of the present brief, with the need to progress in the following areas:

(a) a program of structural tax measures (conversion of specific to ad valorem taxes, etc.) would need to be implemented early;

(b) delays in price decontrol and import liberalization programs need to be avoided; and

(c) financial sector reforms need to be formulated (preferably with CBD assistance) and a timetable should be set up.

As a presentational matter, Mr. Erb requested that the policy matrix should clearly indicate the areas of Fund policy advice as distinct from those areas covered by the World Bank.

AB

A. Basu
Advisor
Exchange and Trade Relations Department

cc: Mr. Hino
Mr. Pujol
Mr. Quirk
Mr. Feldman (o/r)

B/F

Office Memorandum

TO: Mr. Boorman July 13, 1988

FROM: A. Basu

SUBJECT: Country Matters Briefing for Executive Directors

The following are a few brief country notes in response to your memorandum of July 11, 1988.

1. Malawi

The request for ESAF (150 percent of quota) will be discussed by the Board on Friday, July 15. The staff papers present two balance of payments scenarios, both of which indicate external viability by the end of the ESAF period (1991), and for the first year, the two scenarios are identical. The first scenario, on which the program is based, has more conservative assumptions regarding concessional aid inflows. If additional amounts of the latter are available, then the second scenario suggests that there would be better prospects for growth of real GDP and exports, and for achieving a larger reduction in debt service ratios. Both scenarios envisage a strong buildup of gross official foreign reserves. The staff prefers not to make an opening statement to the Board on this issue, but to respond appropriately later if the issue is raised by EDs.

2. Sierra Leone

The recent (early June) staff visit was not able to establish a comprehensive shadow program to enable Sierra Leone to clear its arrears to the Fund. In the key areas of exchange rate and pricing policies, the authorities were unwilling to consider taking major actions, largely due to the powerful role of various special interest groups (e.g., the army, the trading community, and other local special interest groups). Would pressure from a group of major donors help?

3. Liberia

With technical assistance from the U.S. (OPEX team), progress is being made in restoring discipline to the budgetary expenditure process. However, the recently issued staff report for the 1988 Article IV consultation stresses the pressing need to implement a comprehensive shadow program that focuses on a reform of the exchange system, a reorientation of pricing and interest rate incentives, improved public sector management, and a restructuring of the public enterprises and the banking system. One has to find a way to get the authorities to implement such a program so that Liberia could benefit from external support and take steps to settle its arrears to the Fund; a stronger effort by donors may help.

4. Somalia

A staff mission is presently in Somalia trying to work out a shadow program for July-December 1988. In this period, foreign exchange earnings and cash assistance are tentatively estimated to total US$45 million and payment obligations to the multilaterals are estimated at US$35 million. With a proper exchange rate policy and more aid (even commodity aid), Somalia could have sufficient cash foreign exchange to prevent a sharp rise in arrears to the Fund.

5. Kenya

The staff is preparing a briefing paper for a mission to discuss ESAF with Kenya; the idea is to replace the present SBA/SAF by ESAF (150 percent of quota) alone. There are two issues: first, in what way will the program be strengthened (import liberalization, parastatal reforms, budget are key areas); and should ESAF access be below average (that is, say, 120 percent of quota) if there is no visible policy strengthening that entails an additional balance of payments cost. One should note that, without an ESAF and with continuation of the existing SBA/SAF, Kenya would have an acess of about 100 percent of quota over the period of the proposed ESAF (October 1988-September 1991).

6. Mali

The staff report on requests for SBA and SAF arrangements is being withheld from issuance until Mali completes the liquidation of Air Mali, which requires the sale of a Boeing 727. Apparently, this action has been postponed year after year, and the staff feel that, given Mali's poor track record in implementing Fund-supported programs, and the recent cabinet reshuffle, the sale of the jet would be an important indication of the authorities' commitment to the program. It should be noted that according to recent offers from buyers, the sale of the jet (as such) may not fetch much money and, hence, may have little consequence for the program.

IMF OFFICIAL MESSAGE
WASHINGTON, D. C. 20431

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MR. EL KOGALI
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SPO (EDIS) NO. 45

TEST NO.

REFERENCE YOUR CABLE DATED MAY 9, 1989 AS AMENDED BY YOUR CABLE OF MAY 25, 1989.

1. AS INDICATED IN A SEPARATE CABLE FROM THE SECRETARY OF THE FUND, THE EXECUTIVE BOARD OF THE FUND ON MAY 15, 1989 APPROVED FOR KENYA A THREE-YEAR ARRANGEMENT UNDER THE ENHANCED STRUCTURAL ADJUSTMENT FACILITY (ESAF) AND THE FIRST ANNUAL ARRANGEMENT THEREUNDER. THE LOAN DISBURSEMENT, EQUIVALENT TO SDR 40,233,334, WILL BE FINANCED WITH SDR 21,300,000 FROM THE SAF AND WITH SDR 18,933,334 FROM THE ESAF TRUST.

2. THE INTEREST ON THE OUTSTANDING LOAN BALANCE OF SAF RESOURCES SHALL BE AT THE RATE OF ONE HALF OF ONE PERCENT PER ANNUM. THE INTEREST ON THE OUTSTANDING LOAN BALANCE OF ESAF TRUST RESOURCES AT THIS TIME IS AT THE RATE OF ONE HALF OF ONE PERCENT PER ANNUM, SUBJECT TO THE PROVISIONS OF THE ESAF TRUST INSTRUMENT.

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TELEX NO.:

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AUTHORIZED BY NAME (TYPE): James E. Blalock — AUTHORIZED BY NAME (TYPE):

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KENYA

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3. WITH RESPECT TO THE FIRST LOAN, KENYA'S SDR ACCOUNT WILL BE CREDITED WITH SDR 18,933,334 FOR VALUE MAY 31, 1989, AND ARRANGEMENTS HAVE BEEN MADE TO CREDIT FOR VALUE MAY 31, 1989 ACCOUNT OF CENTRAL BANK OF KENYA WITH FEDERAL RESERVE BANK OF NEW YORK, NEW YORK WITH U.S. DOLLARS 26,430,143.76 EQUIVALENT TO SDR 21,300,000 BASED ON ONE U.S. DOLLAR EQUALS SDR 0.805893 ON MAY 25, 1989.

TREASURER'S

INTERFUND

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KENYA

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THE TREASURY

MINISTRY OF FINANCE

NAIROBI (KENYA)

2.

REPEAT TO:

KE.D

CENTRAL BANK OF KENYA

NAIROBI (KENYA)

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Mr. Basu

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EXCHANGE AND TRADE RELATIONS DEPT.

1989 MAY -8 ... 41

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SPO (EDIS) NO. 35

TEST NO.

REFERENCE YOUR CABLE DATED MAY 2, 1989.

1. IN ACCORDANCE WITH THE PROPOSED DECISION UNDER THE ENHANCED STRUCTURAL ADJUSTMENT FACILITY (ESAF), UPON APPROVAL BY THE EXECUTIVE BOARD OF THE THREE-YEAR ESAF ARRANGEMENT AND THE FIRST ANNUAL ARRANGEMENT THEREUNDER, THE AMOUNT OF THE FIRST LOAN, EQUIVALENT TO SDR 40,233,334, WILL BE AVAILABLE FOR DISBURSEMENT AT THE REQUEST OF KENYA ON VALUE DATE INDICATED IN PARAGRAPH 2 BELOW. THIS LOAN DISBURSEMENT WILL COMPRISE TWO PARTS (FINANCED FROM THE SAF AND THE ESAF TRUST, RESPECTIVELY). THE SAF PART OF THE LOAN WILL BE DISBURSED IN U.S. DOLLARS, AND THE ESAF TRUST PART CAN BE PROVIDED IN U.S. DOLLARS OR IN THE FIVE COMPONENT CURRENCIES THAT MAKE UP THE SDR. THE TEXT BELOW ASSUMES CONVERSION OF THE ESAF TRUST PART OF THE LOAN TO U.S. DOLLARS. IF INSTEAD YOU PREFER TO RECEIVE THE ESAF TRUST PART IN THE FIVE

DO NOT TYPE HERE

CC: TRE
MR. EL KOGALI
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KENYA

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CURRENCIES THAT MAKE UP THE SDR WITHOUT CONVERSION TO U.S. DOLLARS, PLEASE REVERT BY MAY 10, 1989 AND WE WILL PROVIDE SUBSTITUTE LANGUAGE FOR PARAGRAPH 3 UNDER SECUNDO BELOW.

2. TO RECEIVE LOAN, PLEASE CABLE FOLLOWING REQUEST, BEARING TEST NUMBER, TO BE RECEIVED BY FUND NO LATER THAN MAY 11, 1989, FOR CONTEMPLATED VALUE DATE MAY 31, 1989.

QUOTE

PRIMO. AS FISCAL AGENCY FOR KENYA, WE REQUEST DISBURSEMENT OF THE FIRST LOAN IN A TOTAL AMOUNT EQUIVALENT TO SDR 40,233,334 UPON FUND APPROVAL OF THE FIRST ANNUAL ARRANGEMENT FOR KENYA UNDER THE ENHANCED STRUCTURAL FACILITY (ESAF).

SECUNDO. 1. WE UNDERSTAND THAT THE EQUIVALENT OF SDR 21,300,000 OF THE AMOUNT INDICATED IN PRIMO ABOVE SHALL BE DISBURSED FROM THE STRUCTURAL ADJUSTMENT FACILITY (SAF) WITHIN THE SPECIAL DISBURSEMENT ACCOUNT, FOR WHICH THE TERMS AND CONDITIONS SET FORTH IN THE

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REGULATIONS FOR THE ADMINISTRATION OF THE SAF (DECISION NO. 8238-(86/56) SAF, ADOPTED MARCH 26, 1986, AS AMENDED) SHALL APPLY.

2. WE UNDERSTAND THAT THE EQUIVALENT OF SDR 18,933,334 OF THE AMOUNT INDICATED IN PRIMO ABOVE SHALL BE DISBURSED FROM THE ENHANCED STRUCTURAL ADJUSTMENT FACILITY TRUST (ESAF TRUST), FOR WHICH THE TERMS AND CONDITIONS SET FORTH IN THE INSTRUMENT TO ESTABLISH THE ESAF TRUST (DECISION NO. 8759-(87/176), ESAF, ADOPTED DECEMBER 18, 1987) SHALL APPLY.

3. PLEASE ARRANGE TO CREDIT ACCOUNT OF (OFFICIAL AGENCY) WITH (NAME AND LOCATION OF BANK WHERE ACCOUNT IS MAINTAINED) WITH U.S. DOLLARS EQUIVALENT TO SDR 40,233,334 FOR VALUE ON DATE OF LOAN DISBURSEMENT.

UNQUOTE

TREASURER'S

INTERFUND

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SEC. 48 (a) REV. 3 11-21-88 CONTINUOUS

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KENYA

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1.

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THE TREASURY

MINISTRY OF FINANCE

NAIROBI (KENYA)

2.

REPEAT TO:

KE.D

CENTRAL BANK OF KENYA

NAIROBI (KENYA)

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Office Memorandum

TO: Mr. Ouattara DATE: April 15, 1988

FROM: Daudi Ballali DB

SUBJECT: Kenya

Yesterday afternoon you pointed out the possibility that the Minister of Finance for Kenya could raise with the Managing Director today the issue of allowing an adjustment of the overall deficit targets in the current program in order to accomodate the utilization of concessional financing secured for development projects. This issue emerged earlier this year with respect to European Investment Bank's co-financing of the Third Nairobi Water Supply project, which is being financed by IDA and is expected to affect the 1989/90 budget. When the current program for Kenya, which is being supported by the stand-by arrangement and the structural adjustment facility, was formulated, it was expected that the project would be managed directly by the Nairobi Water Supply Commission. Subsequently, however, because of legal requirements, it was discovered that the resources for the Nairobi Water Commission had to flow through the central government budget, thereby raising the overall budget deficit. The Kenyan authorities requested an increase in the program's medium-term overall budget deficit targets for this project. The staff felt that since the loan did not result in a worsening of the underlying budgetary position and since it fell within capital inflow and debt service projections of the program, there was a case for adjusting the budget targets by the amount of the loan inflow.

However, in the meeting between the Minister of Finance and Mr. Jimenez on April 13, 1988, the Minister widened the scope of this request by including other concessional financing for projects. We understand also from the World Bank staff that the Minister indicated his intention to raise this issue again; in fact, prior to his meeting with Mr. Qureshi on April 14, 1988, it was suggested that IDA resources for projects in the budget be treated as grants above the line.

On our part, we could take the position that as far as the disbursements for the Third Nairobi Water Supply project are concerned, we are inclined to exclude them from the overall budget target. However, as far as IDA resources generally or other concessional financing, we will have to take them on a case by case basis because any changes in the fiscal program would have to be considered in terms of their impact not only on recurrent expenditures but also on the external sector and inflation, and that the forthcoming mission to Kenya will review any proposed projects involving concessional resources and assess their macroeconomic implications before determining the appropriate treatment in the fiscal program.

cc: Mr. Gondwe
Mr. Bornemann (on return)
Mr. Artus
Mr. Jiménez (on return)

TO: Mr. Ouattara DATE: April 13, 1988

FROM: Julio M. Jiménez

SUBJECT: Kenya

This morning I had a long meeting with Professor Saitoti and other members of the Kenyan delegation. They informed me that they believe that they had met the end-March performance criteria. They have achieved this by placing a large amount of Treasury bills with the nonbank sector at the closing weeks of March. The implication is that expenditures and the overall deficit are in excess of the program targets. He pointed out that the elections and the slow reimbursement of the resources being given to the National Cereals Produce Marketing Board (NCPB-Grain Marketing Board) from the European Community has resulted in a higher level of expenditures. He fears that he would be unable to meet the end-June performance criteria. I advised the Minister that although the overall budgetary deficit target is not a performance criteria as such, that the Fund places a great deal of importance in its observance, and that they should take whatever measures are still available to them in the remaining weeks of the fiscal year to cut down expenditures and try to observe these targets.

The Minister also raised the issue that they are finding the medium-term overall deficit targets in the current program difficult to observe. He pointed out that he has been very fortunate in obtaining a substantial increase in concessional financing for priority development projects which were putting pressure on the overall deficit figure. In his view, without the implementation of these projects the program's rate of growth would be difficult to attain. I reminded the Minister that the overall deficit targets in the program were consistent with an improvement in the external position and the maintenance of a low inflation rate in Kenya. A key aim of the program was a significant reduction in the level of domestic financing of the budget over the medium term because from balance of payments requirements, the level of domestic credit over the next two years would have to be much smaller than in the recent past. Within this reduced level, a larger proportion was to be apportioned to the private sector which was expected to be an important engine of growth during the medium term. While the Fund was concerned in maintaining an adequate rate of growth over the medium term, it was also important to bring about the necessary adjustment in the balance of payments and in maintaining a low inflation rate. Any proposal by the Kenyan authorities to alter the fiscal program would always be tested on the impact it would have on the external sector and inflation.

The Minister is likely to raise this issue with you, or with the Managing Director during his meeting.

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Archival Reference No.	48931
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SERIES	ETRAI Country Files / "ETR Files", 1953-1990
BOX NUMBER	A41291-136
FILE NUMBER	1

CLASSIFICATION	Personal
DATE REVIEWED	2022-09-30

DETAILS OF WITHDRAWN MATERIAL

DATE	1988-04-12
TYPE	Office Memorandum
TO	Mr. Basu
FROM	S.J. Anjaria
SUBJECT/TITLE	Kenya
NO. OF PAGES	1
AUTHORITY	International Monetary Fund
LANGUAGE	English

Office Memorandum

TO: Messrs. Bornemann and Jimenez (o/r) March 25, 1988

FROM: S.J. Anjaria SJA

SUBJECT: Kenya--ESAF

Some time ago I asked Mr. Feldman to reflect upon how the structural component of Kenya's current SAF program could be prioritized and made more ambitious in order to warrant support under the ESAF.

Mr. Feldman's first attempt at recasting the policy matrix contained in EBD/88/5 is shown in the attached table. I would be happy to discuss this with you at your convenience, including the related question of whether such an "enhanced" policy matrix would warrant additional access under the ESAF. In any event, I feel it is important to have some kind of agreed framework in mind and to launch discussions on the ESAF with the authorities as soon as possible.

Attachment

bcc: Mr. Basu
Ms. Dillon
Mr. Hino
Mr. Pujol
Mr. Feldman
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DRAFT/R. Feldman/3/25/88

Table . Kenya: Summary of Possible Strengthened Policy Measures Under an ESAF Arrangement, 1988-90 1/

	Measures	Timing	Remarks
1. Pricing Policy			
a. Exchange rate	Flexible exchange rate policy. Commitment to depreciate annually in real terms in anticipation of balance of payments developments.	June 1988	Present commitment to depreciate by a specified percentage in real terms during July 1987-December 1988 may have to be accelerated or made larger.
	Adjust exchange rate with the aim of increasing the competitiveness of the tradeable goods sector and in keeping with the major import liberalization steps scheduled in 1988 and 1989 (see 2 below).	Dec. 1988, Dec. 1989	
b. Domestic prices			
(i) Price controls	Decontrol all prices under the General Order as follows:		Accelerates timing compared with SAF.
	Decontrol 15 prices. Decontrol additional 15 prices. Decontrol prices of remaining items.	June 1988 Dec. 1988 June 1989	PFP under SAF seems to exclude decontrolling prices on about 10 of the items under the Special Order, mainly food and beverage items for which the Government wants to protect the purchasing power of low-income groups. Price controls on these items should also be removed.
(ii) Subsidies	Work out and commit to specific timetable for the elimination of subvention to public enterprises. See 3b below for more details.	June 1988	

Table (continued) . Kenya: Summary of Possible Strengthened Policy Measures Under an ESAF Arrangement, 1988-90 1/

	Measures	Timing	Remarks
c. Interest rates	Allow financial institutions to negotiate the level of interest rates on long-term loans and deposits in line with free market forces.	Dec. 1988	Accelerates what was called for under SAF. Abolish or adjust maximum lending rates as appropriate, so that rates can reflect risk and other market conditions.
	Maintain minimum savings interest rate at a specified level (say 2 percentage points) above inflation rate.	June 1988	
2. Trade Policy	Lift controls on items for which quantitative restrictions not binding.	Prior action	
a. Import liberalization	Abolish all quantitative restrictions for BOP reasons and establish an open general license policy. These measures to be completed by end-1990 and accomplished in three stages.		
	(i) Implement the new import licensing system. Eliminate quantitative restrictions on one-third of the import items subject to quantitative restrictions	Dec. 1988	Quotas may be converted to tariffs that are roughly equivalent or less restrictive. The new import licensing system refers to the one negotiated under the ISAC with the World Bank.
	(ii) Eliminate quantitative restrictions on most (three-fourths?) of the restricted import items that remain.	Dec. 1989	
	(iii) Eliminate any remaining quantitative restrictions.	Dec. 1990	Except those for well-defined items for health, public safety, social reasons.

Table (continued) . Kenya: Summary of Possible Strengthened Policy Measures Under an ESAF Arrangement, 1988-90 1/

	Measures	Timing	Remarks
b. Tariffs	Protection to be provided solely by tariffs. Reduce the number of tariff levels substantially as outlined below, mainly at the top of the range, taking into account 2a above, as well as the goal of moving toward a uniform tariff structure.	--	Any quantitative restrictions on individual items to be removed before tariffs on those items are reduced.
	Commitment to reduce the number of tariff levels from 26 to 5.	June 1988	Specific targets for the average level of tariffs should be established with a preannounced timetable as to their implementation.
	Reduce the number of tariff levels to 10, by eliminating tariffs at the high end.	June 1989	
	Reduce the number of tariff levels to 5, reducing further the average height of tariffs.	June 1990	
c. Export incentives	Dismantle export compensation scheme and begin to replace it with a simplified duty drawback/duty exemption scheme.	June 1988	Instead of strengthening the administration of the compensation scheme as called for under the SAF.
	Expand manufacturing-in-bond or establish free trade zones.	Dec. 1988	
3. Fiscal Policy			
a. Tax Reform	Undertake a comprehensive study of tax system aimed at raising revenue, including increasing user charges.	Complete ongoing study by April 1988	
	Formulate revenue/GDP targets and implement recommendations of study, consistent with achieving these targets and the fiscal deficit targets.	Begin in FY 1988/89 budget and complete in FY 1989/90 budget.	Targets to be formulated along the lines suggested in the Government's "Memorandum of Economic and Financial Policies."

Table (concluded) . Kenya: Summary of Possible Strengthened Policy Measures Under an ESAF Arrangement, 1988-90 1/

	Measures	Timing	Remarks
b. Public enterprises	Put together (publish?) a list of enterprises to be restructured and divested, and define procedures for restructuring and divesture.	June 1988	
	Indicate timetable for restructuring and divesture, and begin process.	Sept. 1988	Desirable to complete by Dec. 1989
	For industrial enterprises remaining in public sector, formulate procedures for streamlining the monitoring of performance. List which public enterprises should operate without subvention, and which may need subvention for social reasons.	June 1988	
	Establish annual targets for the reduction of subvention paid to public enterprises, consistent with eliminating such subvention in the (after?) FY 1989/90 budget.	Sept. 1988	

1/ To be read in conjunction with "Summary and Timeframe for Macroeconomic and Structural Adjustment licies, 1987-90" in Kenya-Policy Framework Paper, EBD/88/5 (1/7/88), pp. 17-22. This present table mmarizes some "additional" policy measures which could form part of an ESAF program, either in terms of a shortened timeframe or being more specific in policy actions to be undertaken. Certain studies or reviews called for under the SAF arrangement (e.g., on the tax system, sugar industry, civil service staffing requirements) may need to be linked to more specific actions to be undertaken under an ESAF arrangement, pending the outcome of such undertakings.

cc: R. Basu

Office Memorandum

TO: Mr. Anjaria

FROM: J. Pujol

SUBJECT: Kenya--ESAF

March 14, 1988

You asked what might constitute a "more ambitious" structural adjustment program for Kenya under the ESAF. In our view, two areas in particular would merit additional attention under an ESAF--import liberalization and interest rate policy.

On import liberalization it would seem that there is scope for significantly strengthening the commitment under the SAF, and we are in agreement with Mr. Feldman's proposal on abolishing all quantitative restrictions for balance of payments purposes and establishing an OGL system. Specific targets for the average level of tariffs should be established with a preannounced timetable as to their implementation. The exchange rate, of course, would need to be adjusted in tandem with the import liberalization effort.

Regarding interest rate policy, it would appear that the prompt introduction of a market-oriented mechanism for the determination of interest rates is called for. The current commitment to "move toward greater reliance on market forces in allocating financial resources" and to "begin freeing long-term rates" is vague and clearly needs to be recast in stronger and more precise terms.

As pointed out in the matrix prepared by Mr. Feldman, there is also scope for accelerating the timing of the decontrol of prices and in strengthening the policy measures in the area of tariffs, export incentives, tax reform and public enterprises. We do have some doubts, however, as to how realistic is the proposed target date of December 1989 for a "complete restructuring and divesture" of public enterprises. As a general point, wherever the SAF calls for a study (e.g., of the tax system and of the sugar industry) or a review (e.g., of civil service staffing requirements), the ESAF should indicate the specific actions to be undertaken.

Office Memorandum

TO: Mr. Boorman

March 9, 1988

FROM: S.J. Anjaria SJA

SUBJECT: Kenya and Ghana--ESAF

Attached please find a table prepared by Messrs. Feldman and Leeahtam on the evolution of Fund exposure in Kenya and Ghana under alternative assumptions. This exercise may be of some use in deciding whether the two countries should switch to an ESAF-only arrangement.

The two cases are not strictly comparable, in part because Ghana has already obtained a three-year EFF, whereas Kenya's use of GRA resources is limited to a stand-by arrangement which expires on August 1, 1989. In addition, Fund credit outstanding in Ghana is substantially higher than that in Kenya.

Even under the present option--i.e., SBA plus SAF for Kenya, and SBA plus EFF for Ghana--there is a relatively sharp decline in Fund credit outstanding under tranche policies over the next three to four years in the case of Kenya, and a more moderate decline in Ghana. If the present SBA and EFF were continued in the two countries but the SAF was replaced with an ESAF of 100 percent of quota--Option 1--the evolution of Fund credit outstanding under tranche policies would, of course, remain unchanged. Under Option 2, however, substituting an ESAF of 150 percent of quota for <u>all</u> use of GRA resources would produce a dramatic decline in Fund credit outstanding under tranche policies (to 20 percent and 74 percent of quota for Kenya and Ghana, respectively, in 1991). One issue in examining the options is, therefore, whether such a sharp reduction in outstanding use of regular Fund resources is desirable for its own sake in the two countries.

Under either the present option or Option 1, the Fund would be withdrawing net from both countries over the medium term (however, in Ghana under Option 1 total Fund credit outstanding increases by 15 percent of quota in 1990, before resuming its downward trend). In contrast, under Option 2, the Fund would not be making a significant net withdrawal over at least some of the next few years--1989-91 in Kenya, 1990-91 in Ghana. A second question is, therefore, the extent to which net use of Fund resources in the medium term should have a bearing on the option chosen.

Attachment

cc: Mr. Hino
Mr. Pujol
Mr. Feldman
Mr. Leeahtam

Kenya and Ghana: Fund Credit Outstanding

(end of period; as percent of quota)

	Present Option		Option 1 (ESAF 100% of quota with SBA/EFF)		Option 2 (ESAF 150% of quota no SBA/EFF)	
	Kenya 1/	Ghana 2/	Kenya	Ghana	Kenya	Ghana 3/
Total Fund financing						
(SDR million)	175	375	255	449	272	405
(% of quota)	(123)	(183)	(180)	(220)	(192)	(198)
Total FCO						
1988	206	271	222	281	209	271
1989	182	253	202	280	190	253
1990	142	238	182	295	186	243
1991	120	210	177	266	190	244
1992	88	191	145	248	174	225
1993	64	175	121	231	168	209
Under tranche policies						
1988	159	207	159	207	137	195
1989	119	190	119	190	81	143
1990	79	175	79	175	41	103
1991	57	146	57	146	20	74
1992	25	128	25	128	4	55
1993	3	115	3	115	--	43
Under special facilities						
1988	27	14	27	14	27	14
1989	13	--	13	--	13	--
1990	--	--	--	--	--	--
Under SAF/ESAF						
1988	20	50	37	60	45	62
1989	50	64	70	90	95	110
1990	64	64	103	120	145	140
1991	64	64	120	120	170	170
1992	64	64	120	120	170	170
1993	62	60	118	116	168	166

1/ Kenya: 18-month SBA from February 1, 1988 for 60 percent of quota (40 percent annual access), plus three-year SAF arrangement from same date.

2/ Ghana: three-year EFF for 120 percent of quota (40 percent annual access) plus three-year SAF arrangement from November 6, 1987.

3/ Ghana: EFF terminates as of August 15, 1988.

Office Memorandum

TO: Mr. Boorman March 8, 1988

FROM: S.J. Anjaria SJA

SUBJECT: Kenya--ESAF

We did not discuss the issue of access under ESAF for Kenya on the last occasion--please see my earlier memorandum, attached.

Apart from access, I would like to discuss with you the tactics for encouraging further discussion and reflection within the Fund and with the World Bank on what "more ambitious" structural reform really means in the case of Kenya. A revised policy matrix (also attached) prepared by Mr. Feldman is being reviewed by Messrs. Hino and Pujol.

Finally, you will be interested in the attached memorandum for files on a recent meeting of AFR staff with the Governor of the Central Bank of Kenya. It would be helpful to signal to our colleagues in the African Department that countries should not be discouraged from being among the first ESAF cases.

Attachments

cc: Mr. Hino
Mr. Pujol

Office Memorandum

TO: Mr. Boorman   February 25, 1988

FROM: S.J. Anjaria SJA

SUBJECT: Ghana, Kenya, Pakistan: Access Under ESAF

Following our discussion, the attached table puts together some indicators against which the question of "blending" ESAF and GRA resources to these three countries might be examined. Needless to say, the indicators themselves are somewhat arbitrary and duplicative, and the absolute value of the ratios may not be comparable across countries. However, they do seem to provide an interesting rough and ready basis for further discussion.

Under each indicator in the attached table the three countries are ranked in descending order of the case for reliance on concessional, as opposed to nonconcessional financing, (e.g., a low GDP per capita or a high debt to GDP ratio is considered to strengthen a country's case for concessional assistance). Ghana seems to have the "strongest" case for ESAF only: in seven out of nine indicators it is ranked number one. Kenya is second, and Pakistan the weakest.

Ranked Number 1	
Ghana	7 out of 9
Kenya	2 out of 9

Ranked Number 2	
Kenya	6 out of 9
Pakistan	3 out of 9

Ranked Number 3	
Pakistan	6 out of 9
Ghana	2 out of 9

I might add that the above also confirms two of my preconceptions. First, Pakistan is in a somewhat different category than the other two countries in terms of the justification for concessional assistance: in terms of the indicators selected, it is ranked low more consistently than the other two countries. Second, and linked to this, it would probably be sensible "objectively" to treat Ghana and Kenya in roughly the same way, i.e., to go for ESAF-only in both, if we so decide for one of them. May we discuss please?

S.A.
Thanks -
lets discuss

Attachment

cc: Mrs. Junz
Mr. Kanesa-Thasan
Mr. Pujol
Mr. Sheehy
Mr. Feldman
Mr. Leeahtam

Ghana, Kenya, and Pakistan: ESAF

Rank 1 = most favorable to higher ESAF access
Rank 3 = least favorable to higher ESAF access

I. GDP per capita

(1)	Ghana	$318
(2)	Kenya	$328
(3)	Pakistan	$350

II. GDP real growth rate

(1)	Ghana	5.0 %
(2)	Kenya	5.1%
(3)	Pakistan	6.6%

III. Manufactured output/GDP

(1)	Ghana	9.4%
(2)	Kenya	11.4%
(3)	Pakistan	18.1%

IV. Share of IDA in World Bank group loans (figures not strictly comparable)

(1)	Ghana	100.0%
(2)	Pakistan	60.0%
(3)	Kenya	52.0%

V. Reserves to imports (latest year)

(1)	Kenya	14%
(2)	Pakistan	15%
(3)	Ghana	25%

VI. Debt/GDP (latest year)

(1)	Ghana	63%
(2)	Kenya	51%
(3)	Pakistan	41%

Probably does not include military

VII. FCO as percentage of quota

(1)	Ghana	288.3%
(2)	Kenya	189.1%
(3)	Pakistan	129.5%

VIII. Fund quota to imports

(1)	Kenya	9.9%
(2)	Pakistan	11.6%
(3)	Ghana	36.2%

IX. Debt service ratio (including Fund)

(1)	Ghana	62.6%
(2)	Kenya	32.8%
(3)	Pakistan	28.3%

Same

Office Memorandum

TO: Mr. Boorman February 25, 1988

FROM: S. Kanesa-Thasan

SUBJECT: <u>Ghana, Kenya, and Pakistan - Access under ESAF</u>

I have difficulty with Mr, Anjaria's attempt at "fine tuning" of some "indicators" to determine the blend of Fund support between SAF/ESAF and GRA resources.

The criteria which should apply are simply:

(1) Whether the member is eligible to use SAF/ESAF.

(2) Members capacity to make timely repayments of Fund resources (and the expected time horizon for reaching balance of payments viability).

(3) Balance of payments need based on a "reasonable growth target" and "equitable" sharing of the financing burden between the Fund and other sources.

There would be a clear presumption that every SAF-eligible country would <u>first</u> use SAF/ESAF resources within the norms specified for access limits, if there is a satisfactory program which would ensure timely repayments. If after taking into account concessional financing from other sources, there is still an unfinanced gap, use of GRA resources could be considered, if the member is judged to be capable of meeting the relevant repayment requirements.

Agreed

On this basis, with the right programs, I would have no difficulty with a proposal to use only SAF/ESAF in Ghana and Kenya, <u>subject to prescribed access limits</u>. However, balance of payments needs <u>and a better medium term balance of</u> payments outlook may warrant supplementary use of GRA resources, in the case of Kenya, but probably not Ghana given the latters heavy debt service burden and larger outstanding debt to the Fund.

Yes as the problem

The Pakistan case should be treated as unique because of its large potential share of SAF/ESAF resources, if normal access limits were applied and its status vis-à-vis China and India in the SAF.

cc: Ms. Junz
Mr. Pujol
Mr. Sheehy

Office Memorandum

TO: Mr. Hino
Mr. Pujol

March 8, 1988

FROM: S.J. Anjaria SJA

SUBJECT: Kenya--ESAF

At my request, Mr. Feldman has prepared the attached policy matrix for Kenya, which attempts to set forth the areas in which structural reforms could be made more ambitious or accelerated in order to provide a basis for support under an ESAF program. I would like to get together with you later this week, or early next week, to discuss whether this is what we have in mind when we seek a "more ambitious" structural adjustment program under ESAF. Please let me know when you are ready to discuss this.

Attachment

cc: Mr. Boorman
Mr. Feldman

(CGK/KEN)tblken01
DRAFT/R. Feldman/3/4/88

Table . Kenya: Summary of Possible Strengthened Policy Measures Under an ESAF Arrangement, 1988-90 1/

	Measures	Timing	Remarks
1. Pricing Policy			
a. Exchange rate	Flexible exchange rate policy. Commitment to depreciate annually in real terms in anticipation of balance of payments developments.	June 1988	Present commitment to depreciate by a specified percentage in real terms during July 1987-December 1988 may have to be accelerated or made larger.
	Adjust exchange rate with the aim of increasing the competitiveness of the tradeable goods sector and in keeping with the major import and other liberalization steps scheduled in 1988 and 1989 (see 2 below).	Dec. 1988, Dec. 1989	
b. Domestic prices			
(i) Price controls	Decontrol all prices under the General Order as follows:		Accelerates timing compared with SAF.
	Decontrol 15 prices. Decontrol additional 15 prices. Decontrol prices of remaining items.	June 1988 Dec. 1988 June 1989	PFP under SAF seems to exclude decontrolling prices on about 10 of the items under the Special Order, mainly food and beverage items for which the Government wants to protect the purchasing power of low-income groups. Price controls on these items should also be removed.
(ii) Subsidies	Work out and commit to specific timetable for the elimination of subvention to public enterprises. See 3b below for more details.	June 1988	

Table (continued) . Kenya: Summary of Possible Strengthened Policy Measures Under an ESAF Arrangement, 1988-90

	Measures	Timing	Remarks
c. Interest rates	Begin freeing long-term rates and allow them to be determined by borrowers and lenders.	Dec. 1988	Accelerates what was called for under SAF. Abolish or adjust maximum lending rates as appropriate, so that rates can reflect risk and other market conditions.
	Maintain minimum savings interest rate at a specified level (say 2 percentage points) above inflation rate.	June 1988	
2. Trade Policy	Lift controls on items for which quantitative restrictions not binding.	Prior action	
a. Import liberalization	Abolish all quantitative restrictions for BOP reasons and establish an open general license policy. These measures to be completed by end-1990 and accomplished in three stages.		
	(i) Implement the new import licensing system, significantly expanding the automatic licensing list. Eliminate quantitative restrictions on one-third of the import items subject to quantitative restrictions.	Dec. 1988	Continue work on "equivalent" tariffs. reportedly initiated in 1984 Convert quotas to tariffs that are equivalent or less restrictive.
	(ii) Eliminate quantitative restrictions on most (three-fourths?) of the restricted import items that remain.	Dec. 1989	
	(iii) Eliminate any remaining quantitative restrictions.	Dec. 1990	Except those for well-defined items for health, public safety, social reasons.

Table (continued) . Kenya: Summary of Possible Strengthened Policy Measures Under an ESAF Arrangement, 1988-90

	Measures	Timing	Remarks
b. Tariffs	Protection to be provided solely by tariffs. Reduce the number of tariff levels substantially as outlined below, mainly at the top of the range, taking into account 2a above, as well as the goal of moving toward a uniform tariff structure.		Any quantitative restrictions on individual items to be removed before tariffs on those items are reduced.
	Commitment to reduce the number of tariff levels from 26 to 5.	June 1988	
	Reduce the number of tariff levels to 10, by eliminating tariffs at the high end.	June 1989	
	Reduce the number of tariff levels to 5, reducing further the average height of tariffs.	June 1990	We could indicate a target for the average tariff.
c. Export incentives	Dismantle export compensation scheme and begin to replace it with a simplified duty drawback/ duty exemption scheme.	June 1988	Instead of strengthening the administration of the compensation scheme as called for under the SAF.
	Expand manufacturing-in-bond or establish free trade zones.	Dec. 1988	
Fiscal Policy			
a. Tax Reform	Undertake a comprehensive study of tax system aimed at raising revenue, including increasing user charges.	Complete ongoing study by April 1988	
	Formulate revenue/GDP targets and implement recommendations of study, consistent with achieving these targets and the fiscal deficit targets.	Begin in FY 1988/89 budget and complete in FY 1989/90 budget.	Targets to be formulated along the lines suggested in the Government's "Memorandum of Economic and Financial Policies."
b. Public enterprises	Determine enterprises to be restructured and divested, and define procedures for restructuring and divesture.	June 1988	

Table (concluded) . Kenya: Summary of Possible Strengthened Policy Measures Under an ESAF Arrangement, 1988-90

	Measures	Timing	Remarks
	Complete process of restructuring and divesture.	Begin Sept. 1988 and complete by Dec. 1989	
	For industrial enterprises remaining in public sector, formulate procedures for streamlining the monitoring of performance. Decide which public enterprises should operate without subvention, and which may need subvention for social reasons.	June 1988	
	Establish annual targets for the reduction of subvention paid to public enterprises, consistent with eliminating such subvention in the (after?) FY 1989/90 budget.	Sept. 1988	

1/ To be read in conjunction with "Summary and Timeframe for Macroeconomic and Structural Adjustment Policies, 1987-90" in Kenya-Policy Framework Paper, EBD/88/5 (1/7/88), pp. 17-22.

Office Memorandum

MEMORANDUM FOR FILES

February 12, 1988

SUBJECT: Kenya - Mr. E. Kotut, Governor, Central Bank of Kenya--Meeting with Mr. Ouattara

At their request, Mr. E. Kotut met with Mr. Ouattara on Tuesday, February 9, 1988 at 2:30 p.m. The Governor was accompanied by Mr. W. Kinyua of the Central Bank of Kenya and Mr. A. Faria, Advisor to the Executive Director for Kenya. The discussion centered on the timing of the next mission to Kenya, the authorities' enquiry into the possibility of converting the current SAF arrangement into an ESAF, and technical assistance for a proposed reorganization of the financial sector.

Mr. Kotut expressed the Kenyan authorities' interest in advancing the timetable of the review mission to Kenya so that it takes place as soon after the March performance as possible, preferably beginning the first week of April 1988. He stated that the Kenyan authorities were interested in converting the current SAF arrangement into an ESAF and wanted to learn more about the new facility. He wondered whether it would be possible for the April mission to look into the matter and, if so, whether they could be informed of the nature of conditionality and other requirements related to the ESAF before the mission arrives in Nairobi to enable the authorities to lay the necessary groundwork.

Mr. Ouattara indicated that the review mission had been envisaged for late April, but no firm date had been set. He said that the Department would be in touch with the authorities to agree on a mutually convenient date. With regard to the ESAF, Mr. Ouattara responded that the possibility of an ESAF for Kenya had been examined closely before the Managing Director's visit in November, 1987. However, given the fact that Kenya was in need of an arrangement quickly to help ease a tight liquidity situation, it was decided to proceed with an arrangement under the SAF. Mr. Ouattara pointed out that the staff would not be in a position to provide in detail the requirements under an ESAF because the modalities of the new arrangement were still being worked out and Executive Board final consideration was not expected until sometime in late February. By expressing interest so early, Kenya risked becoming a first ESAF case. Mr. Ouattara wondered whether the authorities would really be interested in being a first case, with all the scrutiny and thoroughness in programming that a first test case would elicit.

!

Mr. Ouattara also briefed the Governor on some of the main highlights of the Executive Board discussion of Kenya's current stand-by and SAF arrangements on February 1, 1988. He said that Directors were generally complimentary of Kenya's adjustment efforts, which were undertaken under difficult circumstances, but were emphatic in pointing out that much more needed to be done on the budget and made a strong plea to the authorities to take measures to tighten the budgetary situation in the course of the program. The Governor stated that there were already indications of improvements in the budgetary posture as the buildup in expenditure on education and health levels off and that he expected that some measures would be taken once the elections were out of the way.

Mr. Kotut reported that a World Bank financial sector mission was currently in Kenya to discuss the first draft report on the proposal to reorganize the financial sector. Implementation of the final recommendation could involve a financial sector loan from the Bank. However, the Governor expressed uneasiness because the Fund was not involved, especially in areas which, in his view, appeared to be within the competence of the Fund. Mr. Ouattara responded that many of the proposals in the reorganization appeared sectoral and procedural in nature and within the sphere of the Bank's competence. Moreover, the Bank planned to provide substantial financial and technical assistance. However, Mr. Ouattara cautioned against the extensive use of outside consultants because of the need for subsequent follow-up and the specialized knowledge of local conditions generally available to the Bank staff. Mr. Ouattara indicated that the Fund should not be involved except in providing limited technical assistance through the CBD, perhaps in the form of a coordinator who would have an overall view of the impact of the suggested changes. In this regard, Mr. Kotut indicated that he would raise the matter with Mr. Zulu.

dB

D.T.S. Ballali
Assistant Division Chief
East African Division

cc: Mr. Ouattara
Mr. Gondwe
Mr. Artus
Mr. Jiménez (on return)

INTERNATIONAL MONETARY FUND

February 25, 1988

Mr. Anjaria:

Attached is a draft note for discussion on an ESAF for Kenya. I would note that I have not yet been able to talk to the African department or World Bank people about their views on which reforms would be viewed more favorably. Any comments?

RF

Robert Feldman

Attachment

SAF-Related Measures That Might Be Strengthened Under an ESAF Arrangement

Export Incentives

1. Abolish export compensation scheme. It is ineffective (payments for import duties represent less than 10 percent of the value of eligible exports; approximately one third of these payments go to two firms). There are considerable delays in payment. Low priority seems to be afforded to the scheme within the bureaucracy.

2. If the scheme were administered as intended it would seem to cover duties at maximum import intensity. Assuming average ad valorem tariffs of 25 percent on imported inputs and the maximum import intensity allowed of 70 percent would imply duties of 18 percent of the export price while the scheme compensates for duties at a rate of 20 percent. Improving the scheme may lead Kenya's exports at some stage to face countervailing duties since export compensation could exceed actual duty payments.

3. Instead of strengthening the administration of the compensation scheme (which is called for under the SAF arrangement), begin to replace it with a simplified duty drawback/duty exemption scheme. Such a scheme could possibly be administered by making imported inputs duty free in proportion to a firm's exports over total production. Remove domestic content requirement.

4. Alternatively, or in addition, begin establishing manufacturing-in-bond schemes or free trade zones.

Import Liberalization

1. Announcement of new import licensing schedules (results of World Bank mission?). Should result in an expansion of import items subject to automatic licensing as a prior action to an ESAF arrangement.

2. Abolish all quantitative restrictions for balance of payments reasons and establish an open general license policy. The easing of quantitative restrictions might proceed in three annual stages with all restrictions eliminated in the last year of the ESAF arrangement. To be more ambitious, the first stage could be accelerated and begin before the first year of the ESAF arrangement.

In stage 1: The list of items on schedule 1B (667 in 1987) should be shortened substantially. Hopefully, this may not be too difficult as the quantitative controls according to some reports have not appeared to be binding in recent years. [Outcome of World Bank negotiations important]. Base granting of import licenses under Schedule 1B (or its new equivalent) on annual foreign exchange allotments for this schedule instead of on decisions made for this purpose at the weekly Import Management Committee meeting. Possibly begin work associated with liberalizing imports on Schedule 2B (e.g., equivalent tariffs, exchange rate adjustment).

In stage 2: Eliminate all quantitative restrictions on items on schedule 1B. Begin liberalizing Schedule 2B imports (or its new equivalent), cutting the list of 863 restricted items (in 1987) by half say. Eliminate non-binding quotas. Perhaps convert quotas for items cut to tariffs that are equivalent or less restrictive, or use temporary surcharges. [Check status of work on equivalent tariffs that was initiated in 1984, according to the World Bank report on Policies and Prospects for Restoring Growth and Per Capita Income in Kenya].

In stage 3: Eliminate all remaining quantitative restrictions for balance of payments reasons. Protection to be provided solely by tariffs.

3. Reduce the number of tariff classifications and move toward a uniform tariff.

<u>Exchange Rate Policy</u>

1. Commit to depreciate in real terms in anticipation of balance of payments performance. If authorities believe that import liberalization will result in rising imports then exchange rate should be depreciated in advance of such liberalization. If authorities do not believe that rising imports will result then opposition to liberalization is weakened.

2. Front load real depreciation.

<u>Pricing Policy</u>

1. Abolish all controls on prices and interest rates, eliminating subsidies to public enterprises. Tariffs of public enterprises should be set at levels for enterprises to be self-sufficient.

Office Memorandum

TO: Mr. Boorman

February 12, 1988

FROM: S.J. Anjaria SJA

SUBJECT: Kenya--ESAF

In the course of discussions with Mr. Hino on Kenya's access to ESAF, the question arose whether we should expect Kenya to use a "blend" of SBA and ESAF resources, rather than ESAF resources alone. The main arguments in favor of blending are that Kenya's external debt profile seems manageable (1987 debt to GDP, 51 percent; debt service ratio, 33 percent), and that Kenya will be able to service the relatively expensive debt to the Fund without significant difficulty. Also, Kenya is an "IDA blend" country, for which the draft ESAF guidelines envisage blending ESAF and regular Fund resources. Accordingly, Mr. Hino would propose maintenance of the SBA, and substitution of SAF by an ESAF program with access under the latter of about 100 percent of quota. This would provide Kenya with additional access of about 60 percent of quota over the period of the ESAF arrangement, during which Kenya would be expected to undertake substantial reforms in the area of exchange rate and pricing policies, import liberalization, and tax reform.

I agree, of course, that Kenya must give priority to the above policy reforms under an ESAF arrangement. However, I would suggest, as an alternative, cancellation of the current SBA and replacement of both SBA and SAF with an ESAF of about 150 or 200 percent of quota. This would provide Kenya additional access of almost 70 or 120 percent of quota over the life of the ESAF arrangement.

I prefer an ESAF-only option for a variety of reasons:

1. Although Fund credit outstanding to Kenya is relatively low (189 percent of quota, or 4.5 percent of GDP), the authorities will need to be confident over the three-year period of a strong structural adjustment effort that they have adequate access to regular Fund resources, as a necessary second line of reserves. Therefore, if a bold ESAF program is launched now, there would be good reason to "save" SBA resources for later use, if needed to back up a further macroadjustment effort.

2. The authorities have pressed for an ESAF arrangement mainly because it is a cheaper source of finance than an SBA (Mr. Abdallah's request for an ESAF was based on estimated savings in charges of $26 million). I feel that it will be tactically difficult to convince Kenya both to beef up its structural adjustment effort and to accept higher cost SBA resources. If we were to insist on retaining the SBA while providing an ESAF arrangement of 100 percent of quota, I question if we are likely to

get the ambitious structural adjustment we want. (Of course we have to ensure that cancellation of the SBA does not lead to relaxation of the macroeffort.)

3. Given the relative size of Kenya's quota, raising the level of gross reserves by 2 weeks' imports would be equivalent to about 40 percent of quota. If substantial trade liberalization is to be undertaken, a more comfortable cushion of reserves than the current 2.2 months' imports might be considered desirable. On these grounds, even access under ESAF of, say, 200 percent of quota would not, a priori, seem "excessive."

4. For the integrity of the ESAF as a whole, particularly in the early stages of its operation, we should be bringing forward strong cases to the Board. An ESAF arrangement of 100 percent of quota could well be seen as a "weak" program almost by definition. In contrast, an ESAF of, say, 150 or 200 percent of quota with strong structural reform is more likely to be perceived as a "model" ESAF arrangement. In this connection, at the recent Board meeting on Kenya, at least one Director (Mr. de Groote) expressed the view that the 60 percent access under the current 18-month SBA is on the low side: upon reflecting I feel that Mr. de Groote may have a point, and that the strength of Kenya's existing adjustment effort (assuming the program remains on track) could be recognized in the context of a not-too-"frugal" (Mr. de Groote's word) access under the ESAF.

5. I see no good reason to attach ourselves irrevocably to the IDA blend criterion. With management's recent decision with regard to Pakistan, this "category" of only two remaining countries (Sri Lanka and Kenya) seems hardly meaningful as such.

In brief, I feel we should avoid putting ourselves in the position of having to convince the authorities that the Board's decision to grant access of up to 250 percent of quota under the ESAF did not really apply to Kenya. Of course, this limit is not an entitlement, but the fact remains that the main criteria for access under the ESAF--strength of adjustment and balance of payments need--would indicate that Kenya should qualify for higher access than that suggested by Mr. Hino. Assuming that the structural reforms are reinforced, the program should be rather strong by any standard (balance of payments viability is envisaged by the end of the program period!). With regard to balance of payments need as well, a larger ESAF access seems justified, particularly if in addition to ESAF, we are prepared to grant access under an SBA.

Could we please discuss?

cc: Mr. Pujol, Mr. Hino, Mr. Sheehy, Mr. Feldman, Mr. Huh

Office Memorandum

Kenya file

February 10, 1988

To: Mr. Anjaria

From: L. Van Houtven

Subject: Kenya - Summing Up

I refer to your memorandum of February 5. In the Board discussion there was clearly widespread support for the conversion of the present arrangements into an enhanced structural adjustment facility arrangement. However, of the 18 speakers, only a few expressed the view that structural adjustment should be stronger and more timely if Kenya is to qualify for an enhanced structural adjustment facility arrangement. Although these few included some of the major countries, the thrust of the discussion did not espouse that position. Consequently, the summing up accurately reflects the sense of the meeting.

cc: Mr. Boorman

TO: Mr. Ouattara February 8, 1988

FROM: Julio M. Jiménez

SUBJECT: KENYA

I met with the Governor of the Central Bank of Kenya, Mr. Eric Kotut, on Sunday afternoon. He has requested a meeting with you for Wednesday morning (2.10.88) following the conference on the PFP.

The Governor informed me that he had discussed with Mr. Abdallah the results of the recent Board meeting on Kenya. He had been impressed by the large number of Directors that participated and the strong support which Kenya had received. I mentioned to the Governor that one needed to be very careful in interpreting the support. In my view, Directors welcomed Kenya's recognition of its current problems and had voiced approval at the wide ranging program of action which had been initiated. Continued support will, of course, be largely based on how well Kenya performs under the program. In this regard, it must be highlighted that several Directors felt that not enough commitments had been made with respect to structural policy reform and that the Kenyan Government would be well advised to strengthen the program at the time of the review, if it wanted to convert the arrangements into an enhanced SAF. In this regard, Directors were critical of the staff because the program did not include sufficient backup policy options to be utilized in case the program falls off track for exogenous or other factors.

The Governor explained that parliamentary elections are now scheduled for March 21. Although it was important to get this event out of the way as quickly as possible, he felt that it would have a negative impact on the end of March performance criteria. In addition, he highlighted that the reform of the National Cereals Produce Board (NCPB) to be financed by the EEC, is also likely to have a negative impact on the evolution of the program in the first part of the year, because the EEC will not be transferring resources directly to the NCPB, but will only reimburse the Government after it has made the transfers. In his view, this is likely to influence the end of March ceiling, although by the end of June it will have been corrected.

I mentioned to the Governor that I was quite heartened that the authorities were following developments of the program closely and were becoming aware before the fact of the difficulties which were emerging. This would of course allow them to take some offsetting actions in order that the program does not go very much off track. The Governor said that the amount of time left before the end of March performance criteria was limited and would probably not allow for many meaningful measures to be taken.

The Governor may want to raise with you the feasibility of a short mission to evaluate recent developments and their impact on the ceilings and to investigate a possible waiver.

In contrast to previous agreements with the World Bank that the financial sector should be an area of primary responsibility for the Fund, the Bank has began negotiating a financial sector loan which could touch on institutional and legal issues and on monetary policy implementation. While the authorities recognize the need for reform, they are somewhat hesitant to agree that the preliminary studies be funded by the World Bank. The Governor would like to raise with Mr. Zulu the possibility that the Fund provide technical assistance in bank supervision. An appointment with Mr. Zulu is scheduled at 10:00 a.m. Wednesday, February 10.

cc: Mr. Bornemann (o/r)
Mr. Artus

Office Memorandum

To: Mr. Anjaria February 8, 1988

From: J. Fajgenbaum and P. M. Thomsen JF PT

Subject: Kenya--Access under stand-by arrangement

The following are some comments on the third paragraph of Mr. de Groote's statement at the Board.

The level of access under the stand-by arrangement (43 percent of quota) compares with an average of 43 percent in 1986, and 40 percent in 1987. It could also be noted that 65 percent of the stand-by programs approved in 1986 and 69 percent of those approved in 1987 contemplated access levels equal to or lower than that of Kenya. However, the strength of the program and the likelihood that Kenya would not be a prolonged user would appear to have justified a larger access under the stand-by arrangement. This, in turn, could have allowed for higher imports or reserve accumulation. On this basis, if agreement on an ESAF were reached, a larger access than the mere substitution of the SBA/SAF could be envisaged.

As noted by Mr. de Groote, the catalytic role of the program is expected to facilitate the mobilization of financial resources necessary to close any ex ante gaps. Although the Fund and World Bank staffs are assisting the Kenyan authorities in the formulation of a medium-term structural adjustment program that could be supported by ESAF resources, the stand-by program, and the level of access thereunder, is presumably not linked to such possibility. Furthermore, if this were the case, it would have been tantamount to committing the Fund prior to Board approval of such structural adjustment program and to creating the expectation that Kenya is "entitled" to ESAF resources independently of the quality of such a program.

With respect to the comparisons with other countries, it should be noted that the fact that other countries have made higher and prolonged use of Fund credit does not necessarily entitle other countries to attain the same level of Fund credit.

5 - 100

Mr. B[illegible]

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MR. ABDALLAH
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MR.H.SIMPSON

INTERNATIONAL MONETARY FUND,
WASHINGTON D.C.

2.6.88

[redacted]

1. AS FISCAL AGENCY FOR THE GOVERNMENT OF KENYA WE DESIRE TO PURCHASE FROM THE INTERNATIONAL MONETARY FUND SDR 3,230,000 AND THE EQUIVALENTS OF SDR 2,000,000 IN BELGIAN FRANCS, SDR 2,420,000 IN GREEK DRACHMAS AND SDR 8,000,000 IN JAPANESE YEN TOTALING THE EQUIVALENT OF SDR 15,650,000 IN ACCORDANCE WITH TERMS OF ARTICLE V, SECTIONS 3 AND 4, AND WITH STAND-BY ARRANGEMENT EFFECTIVE FEBRUARY 1, 1988.

2. WE DO HEREBY REPRESENT THAT THIS PURCHASE IS NEEDED IN ACCODANCE WITH THE PROVISIONS OF FUND AGREEMENT.

3. PLEASE CREDIT KENYA'S SDR ACCOUNT WITH SDR 3,230,000 ON VALUE DATE OF PURCHASE.

4. PLEASE PLACE CURRENCIES AT OUR DISPOSAL AT BANQUE NATIONALE DE BELGIQUE, BRUSSELS, BANK OF GREECE, ATHENS, AND THE BANK OF JAPAN, TOKYO AND REQUEST THOSE INSTITUTIONS TO ARRANGE EXCHANGE OF CURRENCIES INTO U.S. DOLLARS AND PAYMENT OF PROCEEDS TO ACCOUNT OF CENTRAL BANK OF KENYA, NAIROBI WITH FEDERAL RESERVE BANK OF NEW YORK, NEW YORK ON VALUE DATE OF PURCHASE.

5. THE EQUIVALENT OF DESIRED PURCHASE, NAMELY KENYA SHILLINGS 369,442,719.85 WILL BE CREDITED TO FUND'S NO. 1 ACCOUNT ON VALUE DATE OF PURCHASE.

6. REGARDING SERVICE CHARGE, PLEASE DEBIT KENYA'S SDR ACCOUNT WITH SDR 78,250 ON VALUE DATE OF PURCHASE .

TESTED FOR A TOTAL AMOUNT OF [redacted]

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Mr. Boorman

Office Memorandum

TO: Mr. Hino

FROM: S.J. Anjaria SJA

SUBJECT: Kenya--ESAF

February 4, 1988

As you know, the Kenyan authorities have expressed interest in an ESAF arrangement. If we believe that it would be desirable to have an early ESAF program with Kenya, it will be necessary to resolve a number of issues. The issues, and the attitude we might take, are summarized below. Could we discuss at an early opportunity?

1. Timing

I presume there is no difficulty with starting an ESAF program with the new budget year from July 1, as mentioned in the recent memorandum to Mr. Abdallah. The SAF arrangement will need to be canceled at the same time, but of course the 20 percent of quota will have been drawn.

2. Access

Last Monday the Board authorized an 18-month SBA equivalent to 60 percent of quota, and a SAF equivalent to 63.5 percent of quota. Assuming that in the 3-year period another SBA of roughly the same magnitude would have been authorized, an "equivalent" ESAF arrangement would be of the order of 180 percent of quota.

Given the historically good track record, we might think in terms of an ESAF of 200 percent of quota.

3. Conditionality

As a first approximation, we might take the position that the macroeconomic framework on which the SBA and the SAF arrangement are based is broadly appropriate. If so, the main result of the switch from SBA/SAF to ESAF should be a more ambitious approach on the structural side.

At my request, Mr. Huh has prepared the attached summary of "additional" structural measures which might form the basis of an ESAF arrangement. I would appreciate your advice on the content of the structural policies--is this enough?--as well as on the best way of encouraging AFR to think along these lines. How should we approach the IBRD with these additional measures?

Is there not an argument that since ESAF resources are concessional and longer term -- therefore carry less burden on the Bod in the medium term -- the access to ESAF could be less than the combined SAF and SBA?

JB

The next mission will probably leave for Kenya end-April/early May. We would need to agree within the building and with the IBRD before then.

Attachment

cc: Mr. Boorman
Mr. Pujol
Mr. Huh
Mr. Feldman

ETR2--CGK/KEN--tbkenkmhl

DRAFT
K. M. Huh
February 4, 1988

Table . Kenya: Summary of Possible Additional Structural Policy Elements for ESAF, 1988-90 1/

	Measures	Timing (Target Dates)	Remarks
1. Exchange rate policy	Flexible exchange rate policy		Present commitment to depreciate by a specified percentage in real terms during July 1987-December 1988 may have to be accelerated if BOP/import liberalization objectives are not realized.
	(1) Commitment to depreciate discretely in real terms by specified magnitude annually.	December 1988	
	(2) Magnitude of real depreciation be assessed with reference to balance of payments performance, e.g., rate of expansion of nontraditional exports, pace of import liberalization.	1989-90	
2. Import policy			
a. Import liberalization	Announcement of new licensing system under negotiation in the context of the World Bank's Industrial Sector Credit.	April 1988	A firm target date for introduction of new licensing system; clearly defined timetable for full liberalization of quantitative restrictions; understanding regarding annual progress toward this objective.
	(1) New import licensing system which is more liberal than existing system to be established by expanding automatic licensing list. Specific commitments regarding number of items/value of imports to be subject to automatic licensing.	June 1988	
	(2) Commitment to further expand automatic licensing list in terms of total imports (by item or by import value).	June 1989	

DRAFT
K. M. Huh
February 4, 1988

Table (continued). Kenya: Summary of Possible Additional Structural Policy Elements for ESAF, 1988-90 1/

	Measures	Timing (Target Dates)	Remarks
	(3) Commitment to abolish quantitative restrictions for balance of payments reasons; quantitative restrictions to be retained only for well-defined items for health, public safety, social reasons.	June 1990	
	(4) Protection of domestic industries to be provided soley by tariffs.	June 1990	
b. Tariffs	Define more precisely the number of tariff classifications to be reduced and specify the rate for each classification in the new system; establish annual objectives for tariff rate dispersion, harmonization.	May 1988	To keep classification initially to minimum (e.g., not more than 10 duty rate levels); ultimate objective to reduce classifications to 5 levels, depending on degree of protection required, with specified maximum rate level.
c. Export incentives	(1) Formulate comprehensive export promotion program, with no subsidy elements.	May 1988	To estimate extent of overcompensation under present export compensation scheme; ultimate objective, to abolish export compensation scheme, and replace it with general scheme having neutral production cost offsetting impact.
	(2) Begin implementing program Complete implementation of program	June 1988 June 1989	
	(3) Begin simplifying export compensation scheme	June 1988	
	(4) Replace export compensation scheme by a simplified duty drawback/duty exemption system.	December 1988	

ETR2--CGK/KEN--tbkenkmhl

DRAFT
K. M. Huh
February 4, 1988

Table (continued). Kenya: Summary of Possible Additional Structural Policy Elements for ESAF, 1988-90 1/

	Measures	Timing (Target Dates)	Remarks
3. Fiscal policy	(1) Undertake a comprehensive study of tax system aimed at raising revenue, including increase of user charges.	Complete ongoing study by April 1988	
	(2) Begin to implement recommendations of study, with a view to achieving revenue/GDP targets.	Begin in FY 1988/89 budget and complete in FY 1989/90 budget	Consider temporary import surcharges, if implementation of recommendations of study not feasible to achieve targets and tariff reform delayed.
	(3) Observe annual budgetary/deficit targets specified under SAF program.	FY 1988/89 FY 1989/90 FY 1990/91	Depending on progress on revenue raising, expenditure cutting, and availability of external aid, ratios of domestically financed deficit/GDP to be reduced further.
4. Public enterprises	(1) Determine enterprises to be restructured and divested, and define procedures for restructuring and divesture.	June 1988	Establish annual targets in the reduction of subvention paid to public enterprises; decide which public enterprises should operate without subvention, and which may need subvention for social reasons.
	(2) Begin process of restructuring and divesture.	September 1988	
	(3) Complete above process.	December 1989	
	(4) Formulate procedures for streamlining the monitoring of performance of industrial enterprises remaining in public sector.	June 1988	

Table (continued). Kenya: Summary of Possible Additional Structural Policy Elements for ESAF, 1988-90 1/

	Measures	Timing (Target Dates)	Remarks
5. Monetary policy	(1) Increase the band between maximum lending rate and minimum savings rate, and allow interest rates to be determined by market forces; allow spread between short-, medium- and long-term interest rates to reflect market conditions.	April 1988	Specify desirable band; define extent of Central Bank's intervention role in determination of particular rates; specify types of new financial instruments banks and nonbanks are allowed to issue; specify frequency and minimum amount of treasury bill auctions and modality for secondary market for treasury bills.
	(2) Begin freeing long-term rates and allow them to be set between lenders and borrowers.	December 1988	
	(3) Maintain minimum savings interest rate at a specified level (say 2 percentage points) above inflation rate.	April 1988	
	(4) Implement all the provisions of amendments to the Banking Law.	December 1988	
	(5) Amend regulations that differentiate between banks and nonbank financial institutions toward more even treatment.	December 1988	
	(6) Amend existing legislation to permit banks and nonbanks to issue new financial instruments.	December 1988	
6. Pricing policy	(1) Abolish all price controls.	December 1988	

DRAFT
K. M. Huh
February 4, 1988

Table (concluded). Kenya: Summary of Possible Additional Structural Policy Elements for ESAF, 1988-90 1/

	Measures	Timing (Target Dates)	Remarks
7. Employment policy	(1) Formulate employment policy consistent with high population growth	June 1988	
	(2) Begin implementing policy.	December 1988	

1/ To be read in conjunction with "Summary and Timeframe for Macroeconomic and Structural Adjustment Policies, 1987-90" in "Kenya-Policy Framework Paper," EBD/88/5, 1/7/88, pp. 17-22. This table summarizes "additional" policy measures which could form part of ESAF program, either in terms of shortened timeframe or being more specific in policy actions to be undertaken.

Office Memorandum

February 2, 1988

MEMORANDUM FOR FILES

SUBJECT: Executive Board Meeting on Kenya

The Executive Board met on February 1, 1988 at 10 a.m. to conclude the 1987 Article IV consultation with Kenya and its requests for use of resources under Stand-by and SAF arrangements. This memorandum briefly summarizes Directors' views on a potential ESAF program for Kenya.

Most Directors indicated that Kenya would be a good candidate for an arrangement under the ESAF. Some of these Directors, in commenting on the SAF program, expressed the view that more specific details on the structural adjustment measures to be implemented and/or their timing would have been desirable. At least one of these Directors, the U.S. Director, seemed to link such specificity to supporting an ESAF request for Kenya. Some of these Directors, e.g., those representing the United States, Germany, and Canada, also indicated that they would, broadly speaking, be willing to favorably consider an ESAF request once the operational modalities are worked out, but that the strength of the structural adjustment effort under the proposed SAF should at least be sustained in the interim; the U.S. Director mentioned the possibility of strengthening the structural adjustment effort when appropriate.

I do not recall any Director at the meeting directly calling for a requirement of stronger adjustment under the ESAF than the SAF, although it was my impression that a number of them would like to see an ESAF program package that is stronger than the current SAF program package. The Japanese Director seemed to come the closest in at least raising the issue of whether conditionality under the ESAF would be higher.

Robert A. Feld

R. Feldman, Economist
Exchange and Trade Relations Department

cc: Mr. Anjaria

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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ETR file

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

DISPATCHED IMF
1988 FEB -2 AM 10: 47

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CC: SEC
MD
DMD
MR. ABDALLAH
AFR
ETR
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MR. H.SIMPSON

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Executive Board took following decisions February 1: quote

A. 1987 Consultation

1. The Fund takes this decision relating to Kenya's exchange measures subject to Article VIII, Section 2(a), and in concluding the 1987 Article XIV consultation with Kenya, in the light of the 1987 Article IV consultation with Kenya conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (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(a), arising from limitations on foreign exchange for imports and rental income remittances as described in EBS/88/2. In the circumstances of Kenya, the Fund grants approval for their retention until December 31, 1988, or the conclusion of the next Article IV consultation with Kenya, whichever is earlier.

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FEB - 4 1988
EXCHANGE & TRADE RELATIONS

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AUTHORIZED BY NAME (TYPE): Leo Van Houtven — AUTHORIZED BY NAME (TYPE):

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B. Stand-By Arrangement

1. The Government of Kenya has requested a stand-by arrangement for a period of 18 months from February 1, 1988 for an amount equivalent to SDR 85 million.

2. The Fund approves the arrangement set forth in EBS/88/2, Supplement 2.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

C. Structural Adjustment Arrangement

1. The Government of Kenya has requested a three-year structural adjustment arrangement, and the first annual arrangement thereunder, under the structural adjustment facility.

2. The Fund notes the Policy Framework Paper for Kenya set forth in EBD/88/5.

3. The Fund approves the arrangement set forth in EBS/88/2, Supplement 3. Unquote

Van Houtven, Secretary, Interfund

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EXT.: DEPT.: DATE:

AUTHORIZED BY NAME (TYPE): Leo Van Houtven

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

EFN
FM

DATE: January 28, 1988

TO: Mr. Michel Camdessus, Managing Director, IMF

FROM: Barber B. Conable

EXTENSION: 73665

SUBJECT: KENYA - Policy Framework Paper, 1988-90

The Committee of the Whole of the Executive Directors of the Bank and IDA discussed the paper entitled "Kenya: Policy Framework Paper, 1988-1990" on January 26, 1988. Attached, for your information, is a summary of the main points.

Barber B. Conable

Attachment

cc: Members of the Committee of the Whole
Mr. Erb

KENYA - Policy Framework Paper, 1988-90

Summary of Discussions by Committee of the Whole

The Executive Directors commended the Kenya Government for its good past performance and generally sound economic management within a difficult global environment, but noted the decline in the rate of growth since 1980 and the scope for further strengthening of economic performance. They concluded therefore that the Policy Framework Paper under review provided an appropriate basis for further adjustment efforts, based on the formulation and implementation of specific policy measures aimed at improved growth performance and development of the Kenya economy.

The Executive Directors suggested that, in carrying out this program of adjustment, the Government should pay particular attention to the following:

- A strong private sector will be necessary to achieve good economic performance and to provide an adequate increase in employment opportunities for Kenya's growing population; therefore, steps should be taken to reduce constraints on the private sector, including relaxation of import and price controls, reduced direct state intervention in the agricultural sector, and reduction in the Government budget deficit.

- Measures should be taken to strengthen programs of family planning to encourage reduced population growth.

- Improvements in the effectiveness of Government operations will need to be made through civil service reform, in order that essential public sector services will be available as required. A review of the functioning of parastatals, and implementation of the existing plans for their restructuring and divestiture, should be given priority.

- An appropriate exchange rate policy should be maintained, and greater interest rate flexibility should be allowed.

- Attention should be given to export diversification.

- Measures should be adopted which mitigate the adverse effects of adjustment on the more vulnerable segments of the population.

- Concrete measures should be prepared to address environmental issues.

- The need for land reform, and revisions of land taxes with the objective of discouraging underutilization of land, should be considered.

- In view of the increase in the external debt burden, the Government's intention to minimize nonconcessional borrowing was welcome.

- Finally, determined implementation of a specific program to implement these policies would be critical to the success of the overall adjustment effort and to the achievement of an adequate rate of economic growth.

The Executive Directors noted the substantial external financing requirements that were projected for the period 1988-90. It will require concerted donor action to meet these requirements, and the hope was expressed that the PFP might be used to strengthen donor coordination in the implementation of the program.

1/28/88

Office Memorandum

ETR 7/69

TO: Mr. Anjaria

FROM: A. Leipold AL

SUBJECT: Draft Information Notice on Kenya

January 26, 1988

Attached for your comments and approval is a draft information notice for Kenya, prepared in collaboration with Mr. Huh. The chart is in preparation.

Attachment

Cleared orally w/ Leipold 1/26/88

SJA

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

KENYA

Real Effective Exchange Rate - Information Notice

Prepared by the African Department and the
Exchange and Trade Relations Department

(In consultation with the Legal Department and
the Research Department)

Approved by A. D. Ouattara and S. J. Anjaria

January , 1988

The recent evolution of Kenya's real effective exchange rate, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. Based on this index, as of November 1987, the Kenya shilling had depreciated in real effective terms by more than 10 percent since the last occasion on which developments in Kenya's exchange rate were brought to the attention of the Executive Board. 1/ The depreciation is estimated to have amounted to 11.9 percent.

Exchange rate developments and policy in Kenya during the past few years are described in the recently issued staff report for the 1987 Article IV consultation and request for stand-by arrangement and for arrangements under the Structural Adjustment Facility (EBS/88/2, 1/7/88) and the report on recent economic developments (SM/88/24, 1/20/88). The Kenya shilling is pegged to a basket of currencies. The staff report notes that the Kenyan authorities have been pursuing a flexible exchange

1/ The 1986 Article IV consultation on January 16, 1987. The Acting Chairman's Summing Up was circulated as SUR/87/5 (1/21/87).

rate policy for a number of years by broadly maintaining the real effective exchange rate, and that the flexibility has increased since the end of 1985. During January 1986-November 1987, the real effective exchange rate declined by 20.6 percent. The staff has encouraged the authorities to continue with this policy, and to keep the exchange rate under review in light of changing circumstances and of the need to further liberalize imports and to strengthen the export performance over the medium term. ~~In their memorandum of economic and financial policies (EBS/88/2, Appendix II), setting out the policies and objectives that the Government will implement in the first year of a three-year adjustment program based on a policy framework paper (PFP) discussed with the World Bank and the Fund, the authorities state that the Government has targeted a depreciation of the real effective exchange rate during the program to support their import liberalization program.~~

The Executive Board is scheduled to conclude the 1987 Article IV consultation and consider the request for stand-by arrangement and for arrangements under the Structural Adjustment Facility on February 1, 1988.

keninstbl (1.25.88)

Table 1. Kenya: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

	Real Effective Exchange Rate 1/ 2/	Nominal Effective Exchange Rate 1/	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. Dollars 1/	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
Quarterly						
1982						
I	96.5	91.3	105.7	70.9	127.5	127.9
II	99.9	92.8	107.6	69.6	132.6	133.1
III	103.3	94.4	109.4	67.6	137.6	137.3
IV	102.6	93.3	109.9	64.9	140.8	140.3
1983						
I	93.0	83.8	110.9	57.8	144.4	144.8
II	95.0	85.3	111.3	57.1	147.8	148.3
III	95.9	85.5	112.1	54.6	152.7	152.3
IV	97.4	87.2	111.7	54.4	155.7	155.2
1984						
I	100.5	89.8	111.8	54.7	158.9	159.3
II	100.0	88.8	112.6	53.0	163.1	163.6
III	102.8	90.9	113.1	50.5	167.5	167.1
IV	105.3	92.7	113.6	48.9	172.3	171.8
1985						
I	107.6	92.8	116.0	45.7	179.9	180.3
II	105.8	90.3	117.2	46.2	186.4	187.0
III	96.6	82.5	117.2	44.2	189.8	189.5
IV	93.8	80.8	116.2	45.2	191.9	191.4
1986						
I	91.0	79.9	113.8	45.9	192.0	192.2
II	87.0	76.8	113.3	45.5	192.4	193.0
III	86.1	75.9	113.3	46.3	194.4	194.1
IV	86.0	75.6	113.7	45.8	198.8	198.4
1987						
I	81.9	72.6	112.8	46.1	200.8	201.0
II	80.0	72.4	110.5	46.0	202.4	203.0
III	80.0	73.1	109.4	44.9	205.5	205.0
Monthly						
1987						
Jan. 3/	83.2	73.6	113.0	46.5	199.9	199.3
Feb.	81.6	72.2	113.0	45.8	201.1	200.8
March	81.0	72.1	112.4	46.0	201.3	202.8
April	79.4	71.5	111.1	46.3	201.2	202.4
May	80.0	72.5	110.3	46.2	202.4	202.6
June	80.6	73.2	110.1	45.6	203.7	204.0
July	80.8	73.5	110.0	45.0	204.9	204.3
Aug.	80.6	73.6	109.5	44.8	205.4	204.4
Sep.	78.6	72.2	108.9	44.8	206.1	206.4
Oct.	76.8	70.6	108.7	43.9	207.2	207.5
Nov.	73.3	67.6	108.4	43.8	208.3	
Percentage change						
Jan. 1987 - Nov. 1987	-11.9	-8.2	-4.1	-5.6	4.2	

Source: Information Notice System.

1/ Increases mean appreciation.
2/ Using seasonally adjusted price indices.
3/ Date of latest consideration by Executive Board.

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Mr. Anjaria

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THE PRESIDENT
INTERNATIONAL MONETARY FUND
WASHINGTON DC

Kenya

ORIG: AFR
CC: MD
DMD
MR. ABDALLAH
ETR
FAD
SEC MR. BOUTER
STA MRS. SHATILA
TRE MR. H. SIMPSON

JANUARY 12, 1988

UPON THE RETIREMENT OF MR. PHILIP NDEGWA, THE PRESIDENT OF THE REPUBLIC OF KENYA, H.E. THE HON. DANIEL TOROITICH ARAP MOI HAS EFFECTIVE TODAY JANUARY 12, 1988 APPOINTED MR ERIC CHERUIYOT KOTUT AS THE GOVERNOR OF THE CENTRAL BANK OF KENYA. MR. KOTUT HAS BEEN DEPUTY GOVERNOR SINCE 1984. H.E. THE PRESIDENT HAS ALSO APPOINTED MR. WANJOHI MUREITHI AS THE DEPUTY GOVERNOR.

J.K. WAIGURU
SECRETARY
CENTRAL BANK OF KENYA
NAIROBI.
JN+
NNNN

22324 KENYABANK
440385 FUND UI

...
REPLY VIA WORLDCOM

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Time: 10:45 01/12/88 ???
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JAN 12 1988

INCOMING CABLE/TELEX

Mr. Ouattara

bcc: Blue Folder
Mr. Hino
Mr. Hut.

ETR
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Office Memorandum

TO: Mr. Abdallah

January 12, 1988

FROM: The Managing Director

SUBJECT: Kenya

Following your recent discussions with Mr. Erb, the staff report on Kenya was issued on January 7, 1988. As you know, we are in the process of developing the operational guidelines for the use of resources under the ESAF and finalizing our discussions with contributors so as to make the facility operational at an early date. As Mr. Erb explained to you, if we had waited for these elements to be fully in place, disbursements to Kenya under an ESAF would probably not have been possible until late March or early April. With the issuance of these papers, I expect Board discussion of the Kenya program to take place on February 1, with the initial disbursement being made three business days following the Board meeting.

In the weeks ahead, we will of course be looking closely at the question of whether SAF programs such as Kenya's could be effectively converted to ESAF programs and under what circumstances such conversion would be appropriate. I have asked the staff to do everything possible to expedite consideration of the ESAF for Kenya. My view is that a convenient time to move from the current arrangements to an ESAF might be at the time of the mid-term review, which would allow the ESAF program to coincide with the beginnning of Kenya's new fiscal year on July 1. Also, in a substantive sense this timing would provide the authorities with the opportunity to implement the several structural policy measures which are currently in the development stage. This will be an important factor in considering the access of Kenya to ESAF resources. Needless to say, successful performance under the current program and formulation of the new budget consistent with program objectives would only strengthen the case for moving Kenya into an ESAF at that time.

Copy to The DMD
Mr. Whittome ✓

Office Memorandum

To : The Managing Director

From : A. Abdallah

Subject : Kenya

Date: December 10, 1987

No. 5738

I would like to acknowledge your kind personal note of December 7, 1987 and to express once again my personal gratitude for the interest you have taken in my country and its problems.

The recent conclusion of program negotiations on a three-year SAF program and an 18-month stand-by program, has been warmly welcomed by everybody in the country. My tentative understanding is that the resources that will be committed under the program after Board approval before end January 1988 are likely to be as follows:

	1988	1989	1990	Total	Percent of quota
	(In millions of SDRs)				
SBA	62.6	22.4	--	85.0	(59.86)
SAF	28.4	42.6	19.2	90.2	(63.50)
Total	91.0	65.0	19.2	175.2	(123.36)
(as percent of quota)	(64.08)	(45.77)	(13.52)	(123.37)	
Prospective repayments	67.4	98.0	76.2	241.6	
Net flows	23.6	-33.0	-57.0	-66.4	

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These data clearly show that, with Kenya's outstanding obligations to the General Department amounting to SDR 287.3 million (202.32 percent of quota) at end October, 1987, there will already be a substantial net repayment to the Fund by early in the second half of 1989.

Against this background, I would appreciate any clarification that can be provided on the following matters:

(a) would it be possible to have simultaneous drawings under the existing SAF (SAF) and enhanced SAF (ESAF) on the basis of present understandings?

DEC 1 1 1987

(b) if such is the case, could the more expensive SBA resources be substituted by at least an equivalent amount of concessional ESAF resources, based on the agreed condition and a formal request by the Kenyan authorities, in the program presented for Board approval?

(c) As the amount of conditional SBA resources proposed to be allocated to Kenya constitutes only about 60 percent of quota compared with the maximum access limit under the proposed ESAF of 250 percent of quota, and given the serious net repayment situation with the Fund that is likely to develop after 1988, could an understanding be established at this stage that additional resources under the ESAF would be made available up to this limit in the second and third years of the program, depending on the evolution of balance of payments need?

(d) could an assurance be given that the possible substitution of SBA resources by ESAF resources would not in principle deny Kenya prospective access to SBA resources, again if this was warranted by balance of payments need?

In conclusion, I would note that the case of Kenya raises a number of substantive issues about the relationship between SAF and ESAF, between them and the SBA, as well as matters of transitional importance. These have been raised in a preliminary fashion in my buff and will no doubt be more fully explored by other Executive Directors during today's meeting. Inasmuch as my own country's case appears to illustrate some questions needing answers and to facilitate further reflection on them by Fund Management, I have decided to send you this personal memorandum. I hope it will not cause you unnecessary inconvenience.

cc:
Mr. A.D. Ouattara

INTERNATIONAL MONETARY FUND

1/6/88

TO : Mr. Gondwe
Mr. Whittome

FROM: R. D. Erb

Kenya

I explained to Mr. Abdallah that in order to proceed with the Kenya program, we preferred to begin with the SAF and stand-by. I indicated that we are in the process of developing our approach to the ESAF and that we are not automatically converting existing SAFs (and/or stand-by's) into ESAFs. I held open the possibility of a conversion later in the winter or spring, following policy discussions with the authorities.

We should also respond in writing, and I have made a suggestion on the draft note for the MD to send to Mr. Abdallah.

Mr. Whittome
P.T.O.

Mr. Erb

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

December 22, 1987

FROM: L.A. Whittome /LAW

SUBJECT: Mr. Abdallah's Note of December 10, 1987

In response to Mr. Abdallah's note of December 10, on the relationship of the SAF, the enhanced SAF, and stand-by arrangements, we have prepared the attached draft reply, which has been reviewed by the African Department. A copy of Mr. Abdallah's December 10 note also is attached.

Attachments

cc: Mr. Ouattara
Mr. H. Simpson

→ Mr Whittome
→ Mr. Coondue
I think this memo could be redone in the light of our discussions with Abdallah and also to make the responses more specific to the Kenya case since his questions are Kenya specific. We could add that we are following the same approach to other similar cases.
RDE
Jan 6, 1987

1987 DEC 22 PM 6 32
OFFICE OF THE DEPUTY MANAGING DIRECTOR

Chron

Office Memorandum

TO: The Managing Director
The Deputy Managing Director

December 22, 1987

FROM: L.A. Whittome /LAW

SUBJECT: Mr. Abdallah's Note of December 10, 1987

In response to Mr. Abdallah's note of December 10, on the relationship of the SAF, the enhanced SAF, and stand-by arrangements, we have prepared the attached draft reply, which has been reviewed by the African Department. A copy of Mr. Abdallah's December 10 note also is attached.

Attachments

cc: Mr. Ouattara
Mr. H. Simpson

bcc: Brian Stuart
DFD

TO: Mr. Abdallah December 18, 1987

FROM: The Managing Director

SUBJECT: Kenya - Use of Fund Resources

Thank you very much for your note of December 10, 1987. It raises a number of substantive issues about the relationship of the SAF, the enhanced SAF, and stand-by arrangements. Specific policies in these areas understandably are still evolving, but I would like to give you my preliminary responses to your questions. In these responses, I am guided by the interesting discussions we have had in the Executive Board over the past several months.

As regards the possibility of simultaneous drawings under the existing and enhanced Structural Adjustment Facilities (point (a) of your note), I would note that the enhanced SAF will incorporate SAF funding. Countries will have the option of using one or the other of the facilities, but not both at the same time.

Your point (b) raises the question of whether a program that could be supported by a regular SAF arrangement and a stand-by arrangement might instead qualify for the enhanced SAF. This issue would need to be addressed on a case-by-case basis; however, I believe it would not be appropriate to presume that, as a matter of course, resources provided under a stand-by arrangement could be readily substituted by those available under the enhanced SAF even if, as in the case of Kenya, structural adjustment policies were being implemented as part of an existing SAF. Programs to be supported by the enhanced SAF are to be guided by the same general objectives as those supported by the existing SAF. However, given the considerably larger resources available under the enhanced SAF, Executive Directors have, as you know, endorsed the idea that it would be advisable for programs supported by the enhanced SAF to embody a more ambitious approach in both the magnitude of the structural adjustment and the timing of its adoption, than would be the case under the regular SAF.

As regards your point (c), the system that is being developed would in no way preclude a country from entering into a regular SAF arrangement and canceling that arrangement at the end of the first or second annual arrangements (or earlier under certain exceptional circumstances) and requesting a full three-year enhanced SAF arrangement. The decision as to whether the member's program would qualify for the enhanced SAF, and in what amount would need to be made at the time of the request on the basis of an assessment of the strength of the program and the balance of payments need. No assurances could be given at this time that additional resources up to the limits established under the enhanced SAF would be made available.

Similarly, on your point (d), a decision not to request a stand-by arrangement at a particular point in time does not preclude a member from seeking access to General Resources at some future date. Consideration of such a request would be examined on a case-by-case basis in accordance with existing guidelines.

Generally speaking, countries should be encouraged to adopt as soon as it is practical policies that would qualify for support under the enhanced SAF. In the specific case of Kenya, negotiations recently have been completed on a structural reform program that could be supported by the regular SAF. As a general point, a program under the enhanced SAF would be expected to include more ambitious measures on the structural side that would ensure that any additional resources are used to encourage longer run adjustment and development. If the authorities were to decide to proceed with a request under the enhanced SAF, the program would need to be reevaluated to determine if it meets this requirement. As indicated above, use of the regular SAF at this time would not prevent Kenya from shifting to a three-year enhanced SAF arrangement in early 1989.

cc: The Deputy Managing Director
Mr. Ouattara
Mr. Whittome
Mr. Simpson

ETR

INTERNATIONAL MONETARY FUND

January 4, 1988

Mr. Anjaria
Mr. Stuart

Kenya

Attached is a list indicating the deviations of policies in the PFP which was negotiated with the Kenyan authorities from the draft which was approved by management prior to the mission.

KF
K. Flug

Attachment

cokenkaf
1/4/88

Kenya--Policy Framework Paper--Comments

In several policy areas, particularly with respect to structural reforms, the PFP which was negotiated with the authorities reflects a slower schedule of policy implementation than was included in the draft PFP which was approved by management. This in the case with respect to the following:

1. Import liberalization (para 19). The current draft ties the liberalization schedule to the determination that the financing gap is filled, while the previous draft suggested complete schedule.

2. Tariff reform (para 19). The earlier draft envisaged the reform in the June 1988 budget, while the revised draft expects the reform in the 1988-89 - 1990-91 budgets.

3. Revision of the export compensation and duty drawback schemes (para 20) was to take place no later than April 1988 according to the previous draft, and no later than June 1988 according to the revised draft.

4. A design of a comprehensive medium-term export promotion scheme was to be ready for implementation by June 1988 according to the previous draft, and by June 1989 according to the revised PFP.

5. Banks and nonbanks that meet certain criteria were to be permitted to issue bearer negotiable certificates of deposit beginning in 1988 according to the previous draft (para 28). This reform was modified in the revised PFP to say that "regulations that presently differentiate banks and nonbank financial institutions will be amended toward a more even treatment by December 1989.