

EBS/82/84

CONFIDENTIAL

May 11, 1982

To: Members of the Executive Board

From: The Acting Secretary

Subject: Kenya - Use of Fund Resources - Compensatory Financing
Facility - Fluctuations in the Cost of Cereal Imports

Attached for consideration by the Executive Directors is a paper on a request expected to be received from Kenya for a purchase equivalent to SDR 60.4 million under the decision on compensatory financing of fluctuations in the cost of cereal imports. A draft decision appears on pages 16 and 17.

The subject, together with the review of stand-by arrangement with Kenya (EBS/82/91, 5/11/82), is proposed to be scheduled for discussion on Wednesday, June 9, 1982.

Att: (1)

Issued in Helsinki and Washington, D.C.

INTERNATIONAL MONETARY FUND

KENYA

Use of Fund Resources--Compensatory Financing Facility--
Fluctuations in the Cost of Cereal Imports

Prepared by the Research and African Departments

(In consultation with the Exchange and Trade Relations,
Legal, and Treasurer's Departments)

Approved by Wm. C. Hood and J. B. Zulu

May 11, 1982

The Managing Director has been informed that the authorities of Kenya will shortly request a purchase equivalent to SDR 60.4 million (58.3 per cent of quota) under the decision on compensatory financing of fluctuations in the cost of cereal imports (Decision No. 6860-(81/81), adopted May 13, 1981). 1/ The expected request relates to a net shortfall estimated for the calendar year 1981 as the sum of an excess in cereal import costs and a shortfall in merchandise exports. Accordingly, the proposed purchase consists of a cereal component of SDR 31.6 million (equivalent to 30.5 per cent of quota) and an export component of SDR 28.8 million (equivalent to 27.8 per cent of quota). Kenya's purchases outstanding under the 1979 compensatory financing decision (Decision No. 6224-(79/135)) amount to SDR 69 million (66.7 per cent of quota). The proposed purchase, if approved, would raise outstanding purchases relating to the export shortfall component to 95 per cent of quota and total purchases outstanding under Decisions No. 6224 and No. 6860 together to 125 per cent of quota. 2/ It would also raise Fund holdings of Kenyan shillings from 323.2 to 381.5 per cent of quota; a waiver of the limitation in Article V, Section 3(b)(iii) of the Fund's Articles of Agreement will therefore be required and is being proposed.

This paper, which is being circulated in advance of the formal request from Kenya, is presented in five sections and an annex. The sections deal with: (1) balance of payments position and cooperation with the Fund; (2) determination of the amount of compensation; (3) causes of the excess in cereal imports and of the shortfall in merchandise exports; (4) repurchase; and (5) staff appraisal and proposed decision. The Annex summarizes Fund relations with Kenya.

1/ Paragraph 2 of Decision No. 6860 provides that for a period of three years from a member's first purchase under the decision, any request for a compensatory financing purchase shall be made under Decision No. 6860 rather than under Decision No. 6224.

2/ The joint limit on purchases outstanding under Decision No. 6224 and Decision No. 6860 together is 125 per cent of quota.

1. Balance of payments position and cooperation with the Fund

a. Balance of payments

Kenya's overall balance of payments position deteriorated sharply from a surplus of SDR 152 million in 1979 to a deficit of SDR 150 million in 1980 (Table 1). An increase in import demand, which followed the relaxation of the import deposit scheme, coupled with a continued deterioration in the terms of trade in 1980 resulted in a twofold rise in the current account deficit to SDR 712 million (equivalent to 13 per cent of GDP) which could be only partially offset by net capital inflows. Reflecting a 7 per cent reduction in exports and in imports, the trade account deficit decreased from SDR 1,049 million in 1980 to SDR 972 million in 1981. This, together with an increase in the inflow of invisibles, resulted in a reduction of the current account deficit to SDR 612 million (equivalent to 11 per cent of GDP). The inflow of capital, however, declined in 1981 because of the lower disbursement of public long-term capital and a sharp drop in import credits. Consequently, the deficit in the overall balance of payments widened to SDR 198 million, of which SDR 23 million was financed by net purchases from the Fund. Gross international reserves declined from SDR 392 million at the end of 1980 to SDR 215 million at the end of 1981, equivalent to about 6 weeks of merchandise imports.

In 1982, the current account deficit is projected to decline further to about SDR 470 million (equivalent to 8 per cent of GDP) following an expected improvement in exports. Imports are expected to remain constant in SDR terms as a result of cautious government expenditure policies, import tariff increases and exchange rate adjustments. Net capital inflows are projected to decline further reflecting lower inflows of public capital and higher debt repayments. The projected overall balance of payments deficit for 1982 is SDR 169 million.

b. Cooperation with the Fund

Since the amount outstanding under the compensatory financing facility is already above 50 per cent of Kenya's quota, the proposed purchase may be approved only if the Fund is satisfied that Kenya has been cooperating with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties. For reasons outlined below, the staff is of the opinion that this requirement is met in the case of Kenya.

Kenya was granted a one-year stand-by arrangement from the Fund on January 8, 1982 in the amount of SDR 151.5 million, or 146.4 per cent of quota. This arrangement replaced a two-year arrangement approved on October 15, 1980 in the amount of SDR 241.5 million. The equivalent of SDR 90 million had been drawn under the two-year arrangement prior to

Table 1. Kenya: Balance of Payments, 1979-82

(In millions of SDRs)

	1979	1980	1981 Estimate	1982 Projection
A. Current account	-369	-712	-612	-470
Trade balance	-589	-1,049	-972	-878
Exports	(788)	(958)	(891)	(992)
Imports	(-1,377)	(-2,007)	(-1,863)	(-1,870)
Services (net)	143	230	240	274
Transfers (net)	77	107	120	134
B. Capital account	514	555	407	301
Public long-term capital (net)	139	160	122	95
Private long-term capital (net) 1/	167	147	118	124
Other capital (net) 2/	132	125	77	--
Exceptional financing	76	123	90	82
SAL loans	(--)	(56)	(--)	(70)
Eurocurrency loan	(76)	(68)	(65)	(-22)
Other concessionary loans	(--)	(--)	(25)	(34)
C. SDR allocation	7	7	7	--
D. Overall balance (A+B+C)	152	-150	-198	-169
E. Financing	-152	150	198	169
Change in gross reserves	-211	111	176	-26
Use of Fund credit	56	44	23	195
Other liabilities	3	-5	-1	--
Memorandum items:				
Gross reserves end of period				
In millions of SDRs	493.6	391.7	215.4	241.4
In months of imports	4.3	2.3	1.4	1.5
Current account/GDP	7.8	13.2	10.8	8.0
Conversion rates (KSh per SDR)				
Period average	9.66	9.66	10.55	11.95
End of period	9.66	9.66	11.95	11.95

Sources: Data provided by the Kenyan authorities; and staff estimates.

1/ Includes parastatals.

2/ Includes errors and omissions and valuation adjustments.

cancellation in January 1982 after deviations from the program targets. ^{1/} The measures already adopted by the authorities to contain the balance of payments deficit include two devaluations of the Kenyan shilling in 1981 by a combined 20 per cent in terms of the SDR, and the implementation of a new import policy under which quantitative restrictions are replaced by a system of higher tariffs that are to be eventually reduced. Developments during the current stand-by program are reviewed in Kenya--Review of the Stand-By Arrangement (EBS/82/91, 5/11/82)--which is scheduled to be considered by the Board concurrently with the CF request. The review confirms that the performance criteria for January 1982 were observed, and that understandings were reached on fiscal, import, exchange rate and interest rate policies.

2. Determination of the amount of compensation

The calculations are based on the actual cost of cereal imports for the whole of calendar year 1981 but on partly estimated data for merchandise exports; actual data on exports are available through June 1981, and exports for the period July-December 1981 have been estimated at a monthly rate of SDR 78 million compared with the monthly rate of about SDR 80 million in the preceding twelve months (July 1980-June 1981). ^{2/}

Executive Board Decision No. 6860 provides that the amount of compensation be calculated as the sum of the excess in cereal import costs and the shortfall in merchandise exports, subject to quota limits. In this case, the amount of compensation for which the member is eligible is determined at SDR 60.4 million, which, if purchased, would raise the total outstanding purchases under the facility to SDR 129.4 million, equivalent to the maximum permissible amount of 125 per cent of quota. In accordance with paragraph 10 of the decision, the authorities are expected to indicate the cereal component of the purchase to be SDR 31.6 million, and the export component to be SDR 28.8 million (Table 2).

a. Cereal import excess

In calendar year 1981, the cost of Kenya's cereal imports on commercial terms amounted to SDR 64.5 million, which, though lower than the all-time peak reached in 1980, was 74 per cent above the average cost of SDR 37 million in the two pre-excess years. The value of cereal imports is projected to decline to an average of SDR 13 million in the following two years. On the basis of these movements, the excess in cereal imports in calendar year 1981 is estimated at SDR 31.6 million.

^{1/} Policies and progress under the 1980 stand-by arrangement are described in: Kenya--Request for Stand-By Arrangement (EBS/80/215, 9/30/81), and Kenya--Request for Stand-By Arrangement, (EBS/81/241, 12/10/81).

^{2/} Exports during the first six months of 1981 were equal to exports in the last six months of 1980.

Table 2. Kenya: Determination of the Amount of Compensation

(In millions of SDRs)

	Calendar Years				
	1979	1980	1981	Judgmental Forecast	
				1982	1983
<u>Trade values</u>					
1. Cereal imports <u>1/</u> : (commercial) (1.1)-(1.2)	2.9	71.2	64.5	17	9
1.1 Total imports <u>2/</u>	4.7	84.8	89.0	35	22
1.2 Concessional imports	1.7	13.5	24.5	18	12
2. Merchandise exports	798.4	1,009.9	953.8	1,065	1,200
<u>Excesses and shortfalls</u>					
3. Net amount (net shortfall) <u>3/</u> (3.1)+(3.3)			65.8		
3.1 Excess in cereal imports			31.6		
3.2 Export shortfall			34.2		
4. Proposed purchase			60.4		
4.1 Cereal component			31.6		
4.2 Export component			28.8		

1/ Gross imports, c.i.f. on commercial terms; the data include the nonconcessional element of food aid, which consists of freight and insurance charges, and in the case of PL-480 loans, 5 per cent of the f.o.b. value of food aid.

2/ Sum of concessional and nonconcessional imports.

3/ The net shortfall is the sum of the excess in cereal imports (SDR 31.6 million) and the shortfall in merchandise exports (SDR 34.2 million).

b. Export shortfall

Total export earnings for calendar year 1981, estimated at SDR 954 million, were 6 per cent above their average in the two pre-shortfall years (1979-80), but 6 per cent lower than the export earnings of SDR 1,010 million in 1980. Earnings are projected to average SDR 1,106 million during 1982-83, which implies an annual growth rate of 10 per cent. On the basis of these movements, an export shortfall of SDR 34.2 million is estimated for exports in 1981. ^{1/}

3. Causes of the excess in cereal imports and the shortfall in merchandise exports

The excess in Kenya's cereal imports (SDR 31.6 million) is accounted for by larger imports of maize (causing an excess of SDR 24.3 million) and wheat (excess of SDR 7.7 million); a small shortfall of SDR 0.4 million is estimated for rice (Table 3). Maize is the country's staple food, and in normal years Kenya exports small quantities in excess of domestic needs. Mainly because of droughts in two consecutive years, domestic production was low in both 1979 and 1980; this necessitated an increase in imports of maize in 1980 and 1981, on both commercial and concessional terms. Imports are expected to decline sharply in the next two years, because the 1981 crop has already recovered due to better weather, and the 1982 crop is assumed to return to normal levels. In normal years, Kenya imports small amounts of wheat, but because of a poor crop, its imports rose temporarily in 1981.

The shortfall in merchandise exports (SDR 34.2 million) is largely attributable to declines in coffee and tea exports in 1981 for which shortfalls of SDR 31.4 million and SDR 13.6 million, respectively, are estimated (Table 4); the coffee shortfall is mostly due to lower international prices, while the tea shortfall is mostly due to lower volume caused by reduced output as the result of insufficient rainfall. A small shortfall of SDR 0.1 million for cement exports, and a larger one of SDR 17.8 million for miscellaneous products are estimated for calendar year 1981. Excesses are estimated for petroleum products (SDR 33.7 million), and fruit and vegetables (SDR 2.6 million).

a. Cereal import costs

Kenya's policies regarding food crops have been characterized by government intervention in pricing and marketing since before independence. Producer and consumer prices are controlled for most domestic food commodities. Producer prices are set in an annual price review which, in general, establishes a single price for each crop for an entire year at all purchasing points throughout the country. Criteria for setting prices

^{1/} Kenya made its last CF purchase of SDR 69 million (100 per cent of quota at the time), in August 1979 with respect to a shortfall of SDR 100 million estimated for the year ended March 1979. Calculations based on actual data for the post-shortfall period (and slightly revised data for the previous three years) indicate a larger shortfall of SDR 124 million.

Table 3. Kenya: Estimation of the Excess in the Cost of Cereal Imports by Major Categories and by Volume and Unit Value

	Calendar Years							Arithmetic Excess		
	1976	1977	1978	1979	1980	1981	1982		1983	
----- (In millions of SDRs) -----										
Cereal imports										
Commercial:										
(1)-(2)	2.5	4.1	12.2	2.9	71.2	64.5	17	9	31.6	
Maize	--	--	--	--	64.1	48.9	9	1	24.3	
Wheat	--	4.1	12.2	2.9	6.4	15.4	7	7	7.7	
Rice	2.5	--	--	--	0.7	0.2	1	1	-0.4	
1. Total	2.5	4.1	12.2	4.7	84.8	89.0	35	22	41.9	
Maize	--	--	--	--	65.8	61.7	11	4	33.2	
Wheat	--	4.1	12.2	4.7	15.1	26.0	14	10	12.0	
Rice	2.5	--	--	--	3.9	1.3	10	8	-3.3	
2. Concessional (Food aid)	--	--	--	1.7	13.5	24.5	18	12	10.6	
Maize	--	--	--	--	1.7	12.8	2	2	9.1	
Wheat	--	--	--	1.7	8.6	10.6	7	4	4.2	
Rice	--	--	--	--	3.2	1.1	9	6	-2.8	
Commercial Cereal Imports 1/	(Per cent Share in 1981)	(1981 = 100)							(As Per Cent of 1981 Value)	
Value	100.0	--	7	22	4	118	100	31	10	47.4
Maize	75.5	--	--	--	--	151	100	29	--	44.0
Wheat	24.5	--	30	90	18	19	100	39	41	56.6
Volume	--	--	9	26	4	128	100	30	9	45.8
Maize	--	--	--	--	--	164	100	28	--	41.0
Wheat	--	--	38	104	18	28	100	38	38	57.6
Unit Value	--	--	80	87	99	93	100	103	108	0.6
Maize	--	--	--	--	--	92	100	104	--	40.8
Wheat	--	--	80	87	99	106	100	102	108	-3.0

1/ Excluding payments for the nonconcessional part of food aid (see footnote 1 of Table 2).

Table 4. Kenya: Export Earnings and Shortfalls by Major Commodities

	Calendar Years						Judgmental Forecasts		Shortfall	
	1976	1977	1978	1979	1980	1981	1982	1983	Geometric	Arithmetic
----- (In millions of SDRs) -----										
Total exports	659.8	994.1	765.0	798.4	1,009.9	953.8	1,048	1,168	34.2	41.8
Coffee	192.5	423.8	257.9	229.0	223.9	206.3	248	289	31.4	32.9
Tea	65.8	148.6	131.7	130.1	120.1	115.8	131	153	13.6	14.2
Petroleum products	103.0	132.2	124.4	140.9	314.4	288.1	282	296	-33.7	-23.8
Fruit and vegetables	32.2	47.2	41.0	44.6	52.3	64.1	73	80	-2.6	-1.2
Cement	16.7	17.7	18.6	17.3	21.0	22.4	25	28	0.1	0.4
Others	249.6	224.6	191.4	236.5	278.2	257.1	288	322	17.8	19.3
----- (Percentage change) -----										
Total exports	51	-23	4	26	-6	10	11			
Coffee	120	-39	-11	-2	-8	20	17			
Tea	126	-11	-1	-8	-4	13	17			
Petroleum products	28	-6	13	123	-8	-2	5			
Fruit and vegetables	47	-13	9	17	23	14	10			
Cement	6	5	-7	21	7	13	11			
Others	-10	-15	24	18	-8	12	12			

include consideration of border prices, production costs, supply trends, the effects on consumers and promotion of specific crops. 1/ Prices of farm inputs are controlled by the government, with ceilings on margins to importers and distributors. Fertilizer, the major import, has not been subsidized by the government in recent years.

Kenya has been a small exporter of maize since the early 1970's, and by the end of 1978 the National Cereals and Produce Board (NCPB) was holding a volume of stocks that was considered excessive. The 20 per cent reduction in producer prices was intended to lower the excessive level of stocks; a smaller acreage was consequently planted to the main crop, which is harvested in September-October, but output in 1979 declined more sharply than intended, because adverse weather reduced yields substantially. NCPB stocks became virtually depleted, and by the end of the year, maize stocks were at an all-time low level of 44 thousand tons. 2/ In order to provide adequate supplies for consumers until the harvest from the 1980 crop became available, emergency imports of cereals were started in early 1980. Imports had to be stepped up later in the year when it became apparent that no substantial relief could be expected from the September-October harvest, again because of adverse weather. This occurred even though acreage had been restored to pre-1979 levels in response to the sharp increase in producer prices--to a level 12 per cent higher than in 1978. 3/ Total

1/ The producer price of maize was reduced from Ksh 889/ton in 1978 to Ksh 720 at the beginning of 1979, which led to reduced acreage for maize in that year. At the beginning of 1980, the producer price was raised to Ksh 1,000/ton, and although there was a substantial acreage increase in response, production only increased from 1.35 million tons to 1.60 million tons because of drought. The producer price was raised again to Ksh 1,050/ton at the beginning of 1981, and improved weather resulted in a crop of 2.2 million tons, similar to the pre-1979 levels. High levels of imports were still necessary in 1981, however, since the 1981 crop is largely for consumption in 1982. The producer price of maize was raised by 37 per cent at the beginning of 1982.

2/ Reliable statistics on Kenya's acreage, production and consumption of cereals are not available; the annual consumption rate for maize is estimated at about 2 million tons in recent years, with more than three quarters of the total being consumed on-farm in the subsistence agriculture sector. Less than half a million tons of maize are normally marketed each year through the NCPB which supplies the urban areas and exports any residual amounts of maize.

3/ Because of the reduction in the producer price of maize in 1979, it is believed that a part of the acreage was switched to sugar production. The producer price of sugar remained unchanged during the period 1978-80, so that the increase in maize prices in 1980 restored relative prices in favor of maize. A secular increase in sugar acreage has been under way, however; sugar cane output increased by 34 per cent in 1979 and by a further 27 per cent in 1980; Kenya began to export sugar in 1979 (see Section 3.b (6)).

imports in 1980 reached 430 thousand tons (of which 20 thousand tons were on concessional terms), at a total cost to Kenya of SDR 64.1 million. Imports continued in 1981 as the spring maize crop (accounting for 15-20 per cent of the total), which is harvested in February-March, was also adversely affected by weather, and famine conditions were reported in parts of the country; imports in 1981 amounted to 364 thousand tons (of which 124 thousand tons were on concessional terms), at a total cost to Kenya of SDR 48.9 million.

Supply prospects for 1982 have improved markedly following the harvesting of the 1981 maize crop. The bulk of maize output in 1981, which is estimated to be 40 per cent higher than in 1980, will be available for consumption in 1982. In addition, the 37 per cent increase in December 1981 of producer prices for the 1982 crop should have a beneficial impact on the supply prospects for 1983. Consequently, maize imports are projected to decline sharply in 1982 to about 70 thousand tons and to be negligible in 1983. On the basis of these movements, an excess of SDR 24.3 million is estimated for maize imports in 1981.

Wheat production has not been able to keep up with expanding consumption in Kenya in recent years and has to be imported regularly to meet domestic demand. Due to a production shortfall caused by adverse weather, imports had to be stepped up from about 58 thousand tons annually during 1979-80 to 150 thousand tons in 1981, out of which 43 thousand tons on average during 1979-80 and 70 thousand tons in 1981 were received on concessional terms. The total cost to Kenya of these imports increased from SDR 4.6 million in 1979-80 to SDR 15.4 million in 1981. The producer price of wheat has recently been increased by 22 per cent, and with normal weather conditions production is expected to increase in 1982 and 1983, with the result that import needs are projected to decline although some concessional imports may continue. Total wheat imports are projected at 73 thousand tons with the cost to Kenya being estimated at SDR 7 million in each of the post-excess years, 1982 and 1983. An import excess of SDR 7.7 million is estimated in 1981.

For rice, an import shortfall of SDR 0.4 million is estimated for 1981. Kenya did not import rice in the period 1977-79, but since 1980 it has received some concessional imports. ^{1/} Since Kenya has not and is not expected to import rice from commercial sources, the calculations are based on that portion of the cost of concessional imports that Kenya is required to meet.

^{1/} These consist of rice provided as grants from Japan and of rice under PL 480 from the United States. The cost to Kenya consists of freight and insurance and, in the case of PL 480 imports, of 5 per cent of the f.o.b. value of the rice.

b. Merchandise exports

(1) Coffee

The shortfall in coffee exports in 1981, estimated at SDR 31.4 million, accounts for 92 per cent of the overall shortfall. The value of these exports, which accounted for roughly 22 per cent of total export earnings in 1981, amounted to SDR 206 million, 9 per cent below the pre-shortfall average (Table 4). Lower earnings were entirely due to a 15 per cent decline in export unit values, reflecting a corresponding decline in international coffee prices. The volume of exports, at about 84 thousand tons, was 7 per cent above the 1979-80 average (Table 5). Kenya is a member of the International Coffee Agreement and its export quota during calendar 1981 amounted to 69 thousand tons. Kenya was, however, able to export an unusually large amount of 15 thousand tons of coffee outside the quota markets to nonmember countries.

The value of coffee exports during 1982-83 is projected to average SDR 268 million, which is 30 per cent above 1981 but still 37 per cent below the peak of 1977. Kenya's quota for the 1981/82 (October/September) coffee year has been increased to 85 thousand tons compared with its revised quota of 67 thousand tons for 1980/81. This represents an increase of 25 per cent compared with an increase of about 9 per cent in the global quota. Kenya was granted a larger increase in view of the hardships caused by the relatively high level of stocks it was forced to carry over from the 1979/80 and 1980/81 crops. The projected volume increases for the two post-shortfall years (1982-83) of approximately 8 per cent per annum may, therefore, be conservative but the projections assume a sharp decline in Kenya's exports to nonmember countries. After declining from \$1.78 per pound for the first half of 1980 to \$1.30 per pound for the second half of that year, coffee (other mild) prices remained depressed during the first nine months of 1981 at about \$1.25 per pound, but recovered in the last quarter of the year to average \$1.41 per pound, and advanced further in the first quarter of 1982. The price recovery is expected to continue in 1982 and 1983 as world supplies are worked down. Kenya's export unit values are accordingly projected to average 16 per cent above their level in 1981, or at nearly their 1979-80 average.

(2) Tea

After reaching a peak in 1977, Kenya's export earnings from tea have also declined. In 1981, at an estimated SDR 116 million, they were 7 per cent below the 1979-80 average as the result of lower volume; the price was slightly above the average for 1979-80, though it had declined by 5 per cent from 1980. The production and export of tea, which had increased rapidly in the 1970s, has since dropped sharply owing to adverse weather during the 1980 and 1981 growing seasons in all the major tea-producing districts. The annual volume of exports, which had reached 94 thousand tons in 1979, was down to 75 thousand in 1980 and 1981.

Table 5. Kenya: Export Value, Volume and Unit Value by Major Commodities

(1981 = 100: In terms of SDRs)

	Value Share in Total Exports in 1981 (In Per Cent)	Calendar Years								Shortfall in Per Cent of Level in Shortfall Year
		1976	1977	1978	1979	1980	1981	1982	1983	
Value	72.9	59	110	82	81	105	100	109	122	2.5
Coffee	21.6	93	205	125	111	109	100	120	140	15.2
Tea	12.1	57	128	114	112	104	100	113	132	11.7
Petroleum										
products	30.2	36	46	43	49	109	100	98	103	-11.6
Fruits and										
vegetables	6.7	50	74	64	70	82	100	114	125	-3.9
Cement	2.3	75	79	83	77	94	100	113	125	0.4
Volume		100	106	99	95	111	100	105	110	4.0
Coffee		93	112	102	92	95	100	107	116	1.6
Tea		78	92	112	124	99	100	110	120	10.1
Petroleum										
products		116	108	95	85	131	100	100	100	2.2
Fruits and										
vegetables		86	103	88	98	100	100	108	112	3.5
Cement		101	109	102	85	89	100	108	114	-1.4
Unit value		59	104	83	85	95	100	104	111	-1.4
Coffee		101	183	123	121	114	100	112	121	13.3
Tea		72	139	102	91	105	100	103	110	1.6
Petroleum										
products		31	43	45	56	83	100	98	103	-13.4
Fruits and										
vegetables		58	72	73	71	82	100	106	112	-7.1
Cement		74	72	81	90	106	100	105	110	2.0

In 1982-83 production is expected to recover as the weather returns to normal, and the higher prices received by producers after the September 1981 devaluation should stimulate production and more intensive picking. Export volumes are projected to increase by 10 per cent annually to reach 91 thousand tons by 1983. Export unit values are projected to increase by 3 per cent in 1982 and by a further 7 per cent in 1983 as international prices improve in response to a better balance between supply and demand. On the basis of the foregoing, earnings from tea exports are projected to average SDR 142 million in 1982-83, nearly 14 per cent above the 1979-80 average. An export shortfall of SDR 13.6 million is estimated for 1981.

(3) Petroleum products

Imported crude petroleum is refined into petroleum products at the Mombasa refinery for domestic use and for export. Export earnings are estimated at SDR 288 million in 1981 (accounting for 30 per cent of total merchandise exports), 8 per cent lower than in 1980, though 37 per cent above the average for 1979-80. The unusually large increase (123 per cent) in 1980 was due to a 43 per cent rise in the unit value of exports, reflecting the increase in international prices, and to a 54 per cent increase in the volume of exports. The volume increase was partly due to more exports of refinery residues and heavy fuel oil for bunkering. In 1981 the volume declined by 24 per cent owing to a corresponding decline in the volume of imported crude petroleum. Export unit values increased in 1981 (by 20 per cent in SDR terms or by 9 per cent in U.S. dollars), roughly in line with the increase in the international crude prices, which partly offset the effect of the volume decline on the value of exports.

Earnings from petroleum products are projected to decline by 2 per cent in 1982 and to increase by 5 per cent in 1983, reflecting similar changes in unit values; export volumes are projected to remain at the 1981 level. On the basis of these projections, an export excess of SDR 33.7 million is estimated for petroleum product exports in 1981.

(4) Fruit and vegetables

The export value of fruit and vegetables (including beans, peas, mangoes, melons, okra, pineapples, avocado pears) in 1981 is estimated at SDR 64 million, which represents a 23 per cent increase over 1980. As the volume of exports remained virtually unchanged from the average in 1979-80, the increase in value reflected a higher export unit value for the group as a whole, which was partly determined by changes in the commodity composition of exports. Most of this fresh produce is exported by air cargo to European and some Middle Eastern countries, and the availability of air cargo space at the proper time is a crucial determinant of these exports, apart from the size of each crop.

As the competitiveness of these exports is expected to be enhanced by the 1981 devaluations, the volume of exports is projected to increase by 8 per cent in 1982 and by a further 4 per cent in 1983; export unit values are projected to increase by 6 per cent per year in 1982-83. On the basis of these movements, an excess of SDR 2.6 million is estimated for these exports in 1981.

(5) Cement

Cement exports in 1981, estimated at SDR 22.4 million, are 17 per cent above their 1979-80 average, largely because of an increase in volume. Export prices averaged 6 per cent lower than in 1980 (14 per cent in U.S. dollar terms), which helped improve overseas demand for Kenya's cement. Projections for 1982-83 assume that prices will increase by about 5 per cent per year and volumes by 7 per cent per year. Consequently, export earnings are projected to grow at an annual rate of 12 per cent; a small shortfall of SDR 0.1 million is estimated for 1981.

(6) Other exports

This group covers a variety of agriculture-based products (hides and skins, meat, pyrethrum extract, cut flowers, sisal, wattle extract, cashew nuts, cotton, wool, butter and ghee, and until recently, some cereals), minerals (soda ash, fluorspar), and some manufactured products (transport equipment, and machinery); beginning in 1979 sugar began to be exported. These exports had been adversely affected in 1977 and 1978 by the loss of protected markets in the former East African Community, the closure of the Tanzanian border, and the disruption of normal trade with Uganda. Impressive growth was then achieved in 1979 (+24 per cent) and 1980 (+18 per cent) as markets were diversified and trade with Uganda recovered. Export earnings in 1981, estimated at SDR 257 million, are 8 per cent lower than in 1980, largely due to the effects of the 1980 drought on many of the agricultural products. The depletion of herds resulted in lower availabilities of meat and hides and skins, and lower production of wool, butter and ghee. In addition, external factors adversely affected some exports: the decline in international sisal prices led to lower unit values and also discouraged sisal cutting which resulted in a decline in the volume of exports; the development of synthetic pyrethrins seriously eroded the international market for pyrethrum.

A return to normal rainfall is expected to lead to a recovery in output for most of the agricultural exports and the 1981 devaluation is expected to enhance the competitiveness of these miscellaneous exports. Earnings from the group as a whole are projected to rise by an average of 12 per cent from 1981. Based on these movements, an export shortfall of SDR 17.8 million is estimated for 1981.

4. Repurchase

In accordance with paragraph 12 of the decision on compensatory financing of cereal import costs, the Kenyan authorities are expected to represent that they will make a repurchase in respect of any outstanding

part of this purchase if the amount purchased on the basis of partly estimated data (i.e., estimates for merchandise exports during the six-month period July-December 1981) exceeds the amount that could have been purchased on the basis of actual data for the entire shortfall year. The amount to be repurchased would be equivalent to the excess amount purchased by using partly estimated rather than actual data for the entire shortfall year.

5. Staff appraisal and proposed decision

The Kenya authorities are expected to request a purchase equivalent to SDR 60.4 million under Decision No. 6860-(81/81) in respect of an excess in cereal import costs and a shortfall in merchandise exports for the calendar year 1981. Exports for the last six months of the shortfall year have been estimated by the staff in cooperation with the authorities and, consequently, the request for the purchase is expected to include a representation by the authorities that they will make a prompt repurchase of the amount of any overcompensation calculated on the basis of actual data for the whole shortfall year rather than of partly estimated data for the year. The proposed purchase is equivalent to 58.3 per cent of quota and, if approved, would raise the member's aggregate purchases outstanding under Decision No. 6860-(81/81) and the 1979 CF decision (No. 6224-(79/135)), to 125 per cent of quota; the proposed purchase is the sum of the export component, determined at SDR 28.8 million, and the cereal component, determined at SDR 31.6 million. For a period of three years from the date of the proposed purchase, any future request by Kenya for a CF purchase would have to be based on Decision No. 6860.

Kenya's balance of payments deteriorated further in 1981, and the overall deficit increased to SDR 198 million from SDR 150 million in 1980. In 1982, a lower but substantial overall deficit of SDR 169 million is projected. Gross official reserves at the end of 1981 declined to SDR 215 million, equivalent to about six weeks of imports. The staff is of the opinion that Kenya's balance of payments need justifies the proposed purchase under the compensatory financing facility. The staff also believes that the level of cooperation required for CF purchases beyond 50 per cent of quota is met in this case by the adoption by Kenya of a financial program in support of which a one-year stand-by arrangement was approved by the Fund on January 8, 1982 and by Kenya's successful performance under the stand-by arrangement which is reviewed in the concurrent Staff Report (EBS/82/91).

For calendar year 1981, an excess of SDR 31.6 million is estimated for Kenya's total cost of cereal imports. Kenya had to import unusually high volumes of cereals in both 1980 and 1981 because of sharply reduced domestic crops of maize and wheat as the result of drought during two consecutive seasons. In addition to commercial imports of cereals Kenya received substantial quantities of cereals in the form of aid, and in accordance with the terms of Decision No. 6860, the concessional element of these imports is excluded from the calculation of the amount of compensation for which the member is eligible. Maize imports are estimated to

account for SDR 24.3 million, or 77 per cent of the total excess in the cost of cereal imports; the remaining 23 per cent is accounted for by an excess in wheat of SDR 7.7 million and a shortfall in rice (SDR 0.4 million). The staff considers that the excess estimated for 1981 is of a short-term character and, since it was mainly due to adverse weather conditions, it further considers that the excess is attributable to circumstances largely beyond the control of the member.

A shortfall of SDR 34.2 million is estimated for total merchandise exports in 1981. Shortfalls estimated for exports of coffee (SDR 31 million), tea (SDR 14 million), cement (SDR 0.1 million) and the group "other exports" (SDR 18 million) are partly offset by export excesses estimated for petroleum products (SDR 34 million) and fruits and vegetables (SDR 3 million). The shortfall in coffee exports was primarily due to lower international prices, whereas the shortfall in tea exports was chiefly due to lower volume caused by adverse weather. The decline in miscellaneous exports was partly a consequence of the adverse affects of the droughts on agricultural products; external demand conditions were unfavorable for other products like sisal and pyrethrum. Export excesses in petroleum products and fruits and vegetables are attributable to higher prices.

Total exports are projected to increase by 10 per cent per year during 1982-83. The recovery for coffee exports is based on both a higher volume due to enlarged quotas under the ICA and an improvement in international prices as a better balance is achieved in the world supply-demand position. The recovery for tea exports is also based on both higher prices and volumes, the latter assuming a return to normal weather conditions. No growth is projected for petroleum exports as imports of crude oil are expected to be restrained and export unit values to be roughly stagnant. The growth projected for the rest of Kenya's exports is based on the recent devaluation and, for the agriculture-based products, on an improvement in weather conditions. The staff believes that the shortfall in Kenya's export earnings is attributable to circumstances largely beyond the member's control and that, in light of the projected recovery, it is temporary in character.

The request for a compensatory financing purchase under Decision No. 6860-(81/81) is expected to include a statement that Kenya will cooperate with the Fund in efforts to find, where required, appropriate solutions for the member's balance of payments difficulties. The staff therefore considers that the expected request will meet all the requirements set forth in that decision. Accordingly, the following draft decision is proposed for adoption by the Executive Board after a duly authenticated request has been received:

1. The Fund has received a request from the Government of Kenya for a purchase equivalent to SDR 60.375 million under the decisions on Compensatory Financing of Fluctuations in the Cost of

Cereal Imports (Executive Board Decision No. 6860-(81/81), adopted May 13, 1981) and on Compensatory Financing of Export Fluctuations (Decision No. 6224-(79/135), adopted August 2, 1979).

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

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

Relations with the Fund

(As of April 30, 1982)

Status:	Article XIV
Date of membership:	February 3, 1964
Quota:	SDR 103.5 million
Fund holdings of currency:	SDR 334.49 million (323.18 per cent of quota)
Of which: Oil facility	SDR 3.87 million (3.749 per cent of quota)
Compensatory financing facility	SDR 69.0 million (66.7 per cent of quota)
Supplementary financing facility	SDR 78.46 million (75.81 per cent of quota)
Holdings of SDRs:	SDR 8.19 million, or 22.15 per cent of net cumulative allocations (SDR 36.99 million)
Trust Fund loan disbursements (first and second periods):	SDR 46.91 million
Direct distribution of profits from gold sales (July 1, 1976- July 31, 1980):	US\$7.61 million
Gold distribution:	41,079.961 fine ounces (four distributions)
Exchange arrangements:	Pegged to the SDR at K Sh 11.95 = SDR 1 (since September 21, 1981)
Intervention currency and rate for the U.S. dollar:	U.S. dollar; K Sh 10.74 = US\$1