Report No. 201-KE

The Second Decade: A Basic Economic Report on Kenya

Annex 4: Domestic Savings and Financial Intermediation
Annex 5: Priorities for Planning and Project Design
Annex 6: Priorities for External Assistance

(Vol. V of Five Volumes)

January 15, 1974

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Eastern Africa Regional Office

Document of the International Bank for Reconstruction and Development
International Development Association

UNITS OF VALUATION

The official unit of currency in Kenya is the Kenya Shilling (Sh.) However, in accordance with the practice of the Kenya Government, most large values in the report are expressed in Kenya Pounds (£)

£ 1 = Sh. 20
Sh 1 = 100 cents

Some values have been expressed in terms of constant US dollars for purposes of international comparison.

CURRENCY EQUIVALENTS

From Independence at the end of 1963 until March, 1973, the exchange rate between the Kenya Shilling and the US dollar was retained at \$1 = Sh.7.143. This is the exchange rate used throughout the report. Since June 30, 1973, the Kenya Shilling, together with those of Tanzania and Uganda, has been set at a central rate of \$1 = Sh.6.9, and all three countries have availed themselves of the wide margins of up to 2¼ per cent.

		Exchange Rate Used in the Report	Present Rate of Exchange
US dollar	=	Sh. 7.143	Sh. 6.9
Kenya Pound	=	\$ 2.80	\$2.8985

THE MISSION

This report is based on the findings of an IBRD mission which visited Kenya in March/April, 1973. The main mission consisted of the following Bank staff:

John Burrows	-	Chief of Mission
Ramgopal Agarwala	-	Macro-Economist
George Beier	-	General Economist (Project Planning and External Assistance)
Ved Gandhi	-	Fiscal Economist
Randolph Harris	-	General Economist (Public Services)
Martin Wolf	-	General Economist (Private Sector)

Sven Burmester (Education), Andrew Hayman (Tourism) and Frank Stubenitsky (Health) also participated in the work of the Mission and have contributed to the report. Lyle Hansen was adviser to the Mission.

A preliminary report was prepared in August and discussed with the Government of Kenya during October 1973. The present report incorporates the comments of Government, and where possible, includes more recent material.

PREFACE

1. During the course of 1972, the World Bank decided to embark upon a series of "basic" economic reports on its major member countries. The nature of country economic work has been under review for some time in the Bank, and the decision to undertake these major reviews on a regular basis reflects the general desire to improve both the quality and the usefulness of this work. The basic economic report is intended to provide a periodic overview of the operations of an economy. From the Bank's point of view, these reports are intended to provide a new perspective of the longer term structural developments in an economy, to assess the extent to which they can be shaped by policy changes, and to identify the country's external assistance requirements. But more than this, a basic economic report is expected to provide a synoptic view of the many facets of the economy, and thus to bring into focus other work being undertaken by the Bank and elsewhere at a sectoral or project level. From the country's point of view, it is hoped that these policy-oriented reports will be valuable in giving objective and possibly new insights into the dynamics of the economy and the options which may be open to the Government in the future management of the economy.

2. This is the first basic economic report on Kenya. The timing is particularly appropriate as Kenya prepares to enter the second decade of Independence and is about to publish the Third National Development Plan. We feel that it is therefore a suitable time to assess how far Kenya has come during the past ten years, to review her major successes and failures, to assess what prospects lie ahead, and to identify major policy issues. This is the main purpose of the report. Of course, this is not the first Bank report to undertake this task, but the latest in a series. For example, the Bank published a report on the Kenya economy in 1963 which reviewed the development prospects of the country as it moved towards Independence. In 1967, a major Bank mission reviewed the revised development plan (1966-70) and again in 1969 another mission reviewed the second (1970-74) plan. Each of these missions and the subsequent reports differed in composition and scope, but all served to make a critical review of Kenya's national plans and to offer constructive comments. At the request of the Government, both the 1969 mission and the recent 1973 mission visited Kenya while the new plan was still in draft form, so that the comments of the mission could be taken into account before the plans were published.

3. A report of this nature must essentially be the result of a compromise between comprehensiveness and brevity. The Kenya economy is much too broad and its operations much too complex to allow for complete coverage, even in a "basic" report. We have therefore deliberately circumscribed the scope of the report in a number of ways which it is important to make clear at the outset. First of all, the report is intended to be a review of the operations of the Kenya economy only, and makes no attempt to review progress or prospects of the wider region to which the Kenyan economy belongs, or even to assess in any comprehensive way how Kenya's development prospects are affected by her membership of the East African Community. Some of these relationships are referred to when they are of particular relevance, but the report has not tried to view the Kenyan economy from an integrated regional perspective. This limitation does not in any sense mean that either the Mission or the Bank feels that regional economic considerations are unimportant. On the contrary, it is clear from its major financial commitment to the EAC

corporations and the development bank that the Bank fully supports this unique development in regional cooperation which Kenya, Tanzania and Uganda have pioneered. The report focuses on Kenya and ignores the wider Community simply to keep the scope of the report within manageable bounds. This narrow focus becomes seriously myopic only in those sections of the report (on trade policies for instance) where Kenya must clearly act in concert with her partners in the Community. Again, while we try to suggest what options might be best for Kenya, viewed in isolation, we are very conscious that these options will have to be reviewed by all three Partner States, and that the decisions will ultimately be taken with the interests of the whole region in mind.

4. The scope of the mission was circumscribed in a second major respect. Even in its focus on Kenya, the report will not undertake a detailed review of all sectors of the economy and of all economic problems. The economic literature on Kenya is prolific, and we have drawn heavily on this. In particular, the recent ILO/UNDP Report on Employment, Incomes and Equality in Kenya has presented a very comprehensive and innovative analysis of unemployment and poverty, and we make no attempt to go over this ground again. Rather, we see this report, with its broader macro-economic focus, as being essentially complementary to the ILO/UNDP Report. We have not attempted to add in any significant way to the existing knowledge on the various sectors; instead, we have tried to consolidate and integrate this knowledge into our overall understanding of the operation of the economy. Similarly, we have not placed great emphasis on reviewing progress under the Second Plan or on describing the objectives of the Third Plan, because these tasks have been done very well by the Government itself.

5. Our report does not therefore try to deal with everything in great depth. On the contrary, it draws heavily from the wide range of studies already available and tries to use this information to provide a synoptic view of the way in which the economy as a whole functions and perhaps some new insights into important relationships between variables. Thus, while the report tries to be as informative as possible and to present sufficient background data on most aspects of the economy for the general reader, the detailed analysis is highly selective and focuses mainly on a number of key issues which we see as critical to the future development of Kenya and the well-being of its people.

6. The report is divided into five volumes. The main report traces the major developments in Kenya's first decade of independence, identifies the emerging issues, and examines the major options open to the Government in the future, as the Mission sees them. The remaining four volumes contain the analytical annexes, which discuss the major issues in detail and extend the technical arguments.

7. An outline of the complete report is shown on the opposite page, and a select bibliography of some of the major sources of information on Kenya is given at the end of Volume I.

THE SECOND DECADE

A BASIC ECONOMIC REPORT ON KENYA

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DOMESTIC SAVINGS AND FINANCIAL INTERMEDIATION

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CONTENTS

CHAPTER 1: THE ROLE OF SAVING PROPENSITY IN GROWTH

1.01 The process of economic growth is often viewed as one of saving, investing and growing. Actually the historical evidence on the process of economic growth suggests that the causality may often have been the exact opposite. As Kuznets has demonstrated 1/ for the United States, the periods of high growth preceded and not followed increases in saving-income and investment-income ratios. Even in the less developed countries in the post war period, the countries that have attained high rates of growth are probably distinguished more by their efficiency of resource use (indicated, say, by incremental capital output ratios) than by the rate of accumulation. For example, Iran and South Korea which have attained annual GDP growth rates significantly higher than Kenya's (11.3 percent and 11.8 percent, 2/ respectively) were characterized by lower ICORs (2.0 and 2.46) and not by higher domestic saving-income ratios (17.3 percent and 17.8 percent).

1.02 Even to the extent that investment increases are important, it seems doubtful whether they are always stimulated by higher saving propensities; quite often investment increases bring about *ex post* increases in saving by changes in income or prices. 3/ In this process, saving behavior and savings mobilization are important not because they determine present investment, but because they increase the efficiency of capital formation and determine the process by which *ex post* equalization of saving and investment is brought about. This in turn has implications for future investment possibilities. The financial institutions which mobilize savings help in allocating funds to productive users, thus raising overall efficiency of investment.

1.03 Similarly, even though an *ex post* increase in the saving-income ratio can be brought about by an increased investment financed by credit creation, the *ex ante* propensity to save determines whether the equalization is brought about by inflation or not. If the consumption propensity is high, the equalization is brought about by an increase in consumer prices as well as increase the demand for consumer goods imports which may reduce resources for investment in future. A high saving propensity, on the other hand, will make any given increase in investment more easily sustainable. Without the stimulus of investment, higher saving propensity may merely result in lower income, as is well known from Keynesian economics.

1/ S. Kuznets, "Long-Term Changes in the National Income of the United States of America since 1870," in *Income and Wealth of the U.S.* (ed. S. Kuznets), Bowes and Bowes, Cambridge, 1952.

2/ For the five-year period ending in 1970.

3/ The effect of inflation on savings is of course complex. In general, a *ceteris paribus* increase in *expected* inflation reduces saving *propensity*, although an actual increase in inflation may bring about an increase in *ex post* "forced" savings.

1.04 In the light of the above observations, we shall study the saving propensity and savings mobilization in Kenya not simply as ex post ratios but in terms of the processes associated with them. We shall conclude that the ex post saving-income ratio in Kenya over the period under study, namely, 1964-71 was generally very high. Moreover, the relatively low rate of inflation which prevailed until recently might be an indication that the ex ante propensity to save was also high. The efficiency of investment as indicated by ICORS, was also quite good until recently compared with most other less developed countries.

1.05 In recent years, however, there are indications that saving propensity may be declining and that the ex post high rate of investment can only be maintained by inflation, balance of payments deficits and foreign borrowing -- all of which could create problems in the future. 1/ Even though it is difficult to be definitive, it seems to us that in spite of the good performance of the past, the time has probably come to increases efforts in the direction of checking the incipient fall in saving propensity. We shall also argue that, from an allocational point of view, it may be necessary to allocate finance to new directions -- agriculture and small business -- for both efficiency and distributional reasons. The present system of financial institutions is primarily geared to the "formal" sector and needs some retuning for meeting the newly emerging needs.

1/ In this connection, it is sometimes argued that foreign capital inflows reduce ex ante domestic savings. In our judgment, the causality is often the other way around; when for extraneous reasons, saving propensity declines, part of the gap may have to be filled by foreign capital inflow. For a more detailed discussion, see Appendix.

CHAPTER 2: DOMESTIC SAVINGS IN KENYA

Movements in Aggregate Saving-Income Ratio

2.01 The movements in gross domestic savings and the savings-income ratio in Kenya are presented in Table 1. The *ex post* saving-income ratio was, except for 1965, around 19-20 percent. This should be regarded as an excellent performance in comparison with most other less developed countries. This looks all the more remarkable when viewed in the light of the slow rate of price inflation in general and in the consumer price index in particular (Table 2). This implies that *ex post* saving was by and large a reflection of genuine *ex ante* saving propensity and not in the nature of forced saving through credit creation.

2.02 In Tables 1 and 2, the saving-income ratios do not take into account the effect of international terms of trade. However, to measure the real purchasing power of the goods and services produced in a country, one should adjust the GDP at constant prices by the change in terms of trade. This provides a series of "gross domestic income" 1/ from which, after deducting consumption, we obtain a series of gross domestic savings at import prices. This measurement of savings is helpful in computing resource requirements at constant prices.

2.03 The estimates of GDS and gross national savings (GNS) 2/ as percentage of gross domestic income for Kenya and a number of other countries are presented in Table 3. In order to take out fluctuations, these are presented as three year centered moving averages. In the light of these more refined estimates, Kenya's performance again appears to be excellent.

1/ Gross domestic income (GDY), adjusted for changes in terms of trade, is defined as follows:

$$GDY = GDP - \left(\frac{X}{PX} - \frac{X}{PM}\right)$$

where: GDY = gross domestic income at constant prices
GDP = gross domestic product at constant prices

$\frac{X}{PX}$ = exports deflated by export price index

$\frac{X}{PM}$ = exports deflated by import price index

2/ (GNS) defined as: GNS = GDS + FSY + NCT
where : GNS = gross national savings
GDS = gross domestic savings
FSY = net factor service income
NCT = net current transfer received

Even South Korea, whose success in economic growth is generally regarded as spectacular, did not have a higher saving propensity than Kenya. In Africa, Ivory Coast, which has sustained a remarkable rate of growth (7.5% per annum over 1960-70), achieved a savings rate significantly higher than Kenya's. But the expatriate community is even more important in the Ivory Coast than in Kenya and, when allowance is made for factor incomes and transfers, we find that as far as national savings are concerned, Kenya's performance was marginally better than Ivory Coast's. In recent years, Brazil has come to be regarded as the latest miracle in economic growth. But even there, we find that Brazil's saving-income ratio was lower than Kenya's.

2.04 However, while Kenya's long-run performance in savings has been very good, there are, in recent years, some causes for concern. As shown in Table 4, GDS actually declined in 1971 compared with that in 1970. The decline in GNS was even larger because of increase in net factor service payments and a decline in net current transfers received.

Factors Behind the Savings Behavior

2.05 It will be interesting to examine the causes behind the good saving performance in Kenya compared with other developing countries. One possible reason could be the high growth rates of income. 1/ Regression of domestic saving-income ratio on growth rate of GDP in Kenya over the period under study does show some association. 2/ In particular, it "explains" the

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1/ For a detailed discussion, see S.K. Singh, "The Determinants of Aggregate Savings", IBRD Economic Staff Working Paper No. 127, March, 1972.

2/ $S/Y = .1706 + .22 \frac{Y}{Y}$

(19.8) (2.1) (t-statistics)

$\bar{R}^2 = .36$; D.W. = 2.08' SEE = 0.11

	1965	1966	1967	1968	1969	1970	1971
Saving-Income Ratio							
Actual	.166	.202	.182	.173	.194	.202	.185
Estimated	.174	.204	.179	.189	.188	.188	.185

dips in the saving-income ratio in 1965 and 1971. However, for a cross-country analysis, it is difficult to be sure if high growth rate causes high saving-income ratio, or the other way round. 1/ In order to understand the behavioral relationships better, it is desirable to make an analysis of the disaggregated figures on savings.

2.06 In particular, it is desirable to analyze the saving behavior of households, government and businesses separately. Within business savings again, depreciation allowances accounting for a major part of business savings are determined by past investment pattern and tax laws, and should not be regarded as a function of income. No disaggregated figures on savings are available from published sources of data in Kenya. However, the macro-unit in the Ministry of Finance and Planning has prepared some provisional and as yet unpublished estimates of the components of savings. These figures are presented in Table 5, from which it can be seen that the major source of savings has been the household sector, whose contribution increased very considerably until 1969 (when it was about 54%). Since then, however, it has declined rapidly to only 25 percent in 1971. There has been a steady increase in the relative importance of depreciation allowances (in proportion to total capital stock), while the relative share of Government savings has increased substantially, especially since 1969.

2.07 Does the structure of savings in Kenya throw any light on the factors behind Kenya's good performance compared with other developing countries? Table 6 presents some figures on the structure of savings in a number of other countries, for comparative purposes. In general, it is difficult to conclude anything definite from these figures because of extreme variations in the structure of savings from country to country, from year to year in the same country and even from one estimate to another in the same country and in the same year. We therefore have to rely on an analysis of the unpublished esti mates of savings referred to above.

1/ Since growth rate of GDP is, by definition,

(1) $G_y = k(\frac{I}{y}) = k\,\frac{S}{y} + k\,\frac{F}{y}$

where G_y is GDP growth rate

k inverse of ICOR

$\frac{I}{y}$ investment-income ratio

$\frac{S}{y}$ saving income ratio

$\frac{F}{y}$ foreign capital inflows as a ratio of income

we have

(2) $\frac{S}{y} \equiv \frac{1}{k} \cdot G_y - \frac{F}{y}$

Therefore, causal interpretation on regressions of type (2) could be misleading.

2.08 Household Savings. Since it has been the major source of savings, the decline in household savings in recent years must be the cause for some concern. The saving-income ratio of household has fluctuated around 10 percent. The lowest ratio was in 1965, when the growth in personal disposable income was virtually nil. Apart from this drop, the ratio was rising steadily until it reached the level of 14.5 percent in 1969. Since then, however, it has dropped sharply and was only 7 percent in 1971. As before, a part of the changes in household saving-income ratio could be explained with reference to changes in growth rates of personal disposable income. 1/

2.09 The above analysis does not indicate any definite conclusions as to why Kenya's household saving performance was good and why it has deteriorated recently. In fact, it is quite possible that the recent decline is only a random fluctuation and the saving-income ratio will improve in the future as it did after 1965 and 1967. 1/ However, it is also possible that there is some structural change going on in the economy and some tentative judgment may be made on the basis of what is known of the Kenyan economy.

(a) The expatriate business community has been playing an important role in Kenya's economic life. Thriftiness of this community may well have been an element in good saving performance of Kenya. It is also possible that in recent years, their confidence in the future was badly shaken. One type of reaction was probably to consume more goods and services because of the uncertainties of the future. The same kind of reaction might have led to an apparent increase in consumer expenditure, due to over-invoicing of imports, as a method of repatriation of capital. In other words, even when real consumption was

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1/ The regression equation is:

$$S = \underset{(4.17)}{8.33} + \underset{(1.1)}{.26Y}$$

where S = saving income ratio (%)
Y = percentage change in personal disposable income

	1965	1966	1967	1968	1969	1970	1971
Actual	6.5	10.3	10.5	11.1	14.5	11.4	7.0
Estimated	8.4	12.3	9.6	11.3	10.0	10.5	9.6

1/ Recent information does suggest, in fact, that savings performance in 1972 returned to its level of 1970.

not increased, over-invoicing resulted in higher recorded consumption in Kenya even though part of it was actually saved and repatriated abroad. 1/

(b) A second contributing factor to decline in household savings could have been the increased rate of inflation in recent years and static interest rate structure. For the first time since Independence, the real interest rates in Kenya are becoming negative. In 1972, for example, the rate of inflation was about 6 percent, or well above any rate offered by commercial banks (see Table 11).

(c) Apart from the above two factors of recent origin, Kenyanization and urbanization in general may have been contributing to a reduction in the propensity to save. Because of the obligations of the extended family system, Kenyans who took over expatriate jobs may not have been able to save as much as their predecessors. This system did have desirable income distribution effects but its effects on savings could well have been adverse. Similarly, urban migrants generally tend to save less than their rural counterparts in agriculture. The reasons are various: demonstration effects are stronger in urban areas, agriculturists tend to have a higher saving-income ratio because of greater degree of transient element in their incomes; agriculturist can put their savings into farm improvement and therefore have better investment opportunities than urban workers who can only put their money in banks; 2/ to a farmer

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1/ In order to reduce the impact of uncertainty, it may be desirable to consider some scheme for smooth transfer of business from expatriate to Kenyan hands. See Annex 3.

2/ In urban areas, savings for house purchase is an important encouragement to saving. Kenya's past housing policy has offered little opportunity to the lower income groups in the urban areas to own their own houses, and home ownership has been further discouraged by the subsidies injected into public housing. It is hoped that the increasing emphasis on self-help low-cost urban housing schemes in Kenya will unlock a new source of savings among the wage-earners.

a tractor may be as much a status symbol as an automobile is to a city man. 1/

2.10 Government Savings. Even though Kenya is a predominantly private sector economy, the role of public sector is significant and increasing. The contribution of public sector to saving in the economy is noted in Table 5. In order to analyze further the sources of receipts and the types of expenditure, we present the detailed figures in Table 7. In 1964, the tax receipts did not even cover government consumption expenditure. However, there were large international transfer receipts (£ 20.7 million) which offset this deficit, and gave rise to positive savings. Over the period 1964 to 1969 there was a decline in government saving, partly because of the decline in international transfers and partly because of the rapid rise in government consumption, which increased by about 17 percent in both 1968 and 1969. In 1970 and 1971 however, there was a significant recovery in government saving, a very welcome offset to the decline in private household savings over this period.

2.11 Corporate Savings. With economic growth, corporate savings, especially depreciation allowances, normally account for an increasing part of total gross savings. 2/ In Kenya, depreciation allowances increased by about 140 percent between 1964 and 1971, an average annual rate of about 14 percent. However, the growth in undistributed profits was disappointing. They actually declined from £ 13.5 million in 1964 to £ 3.6 million in 1968. Since then, they have recovered to £ 13.1 million in 1971, but are still marginally below the 1964 level. Thus even though the recent recovery in this component of saving is encouraging, the overall stagnation over the period is a cause for some concern.

1/ Using the data collected by Central Province Survey (1963), M. Scott obtained the following regression:

$S = -299 + 0.198Y \qquad (R^2 = .96)$

where S = savings as indicated by cash surplus

Y = income

In spite of problems of data and interpretation of cross section equations, the marginal propensity to save of 20% indicated by the above equation is impressive. For details, see M.FG. Scott, "Estimates of Shadow Wages in Kenya," February 1973 (mimeo).

2/ For example in the U.S. in 1971, capital consumption allowances were \$93.8 billion which was about 9% of GNP (\$1,050.4 billion). Corporate sector capital consumption allowances (\$60.3 billion) and undistributed profits (\$20.5 billion) together accounted for 53% of total private gross investment (\$152.0 billion).

Prospects of Savings: Projections in the Macro-Model

2.12 Household Savings. The detailed projections on prospects of savings over the Third Plan period and beyond are given in Annex 1, in the context of the overall macro-economic scenario. Some relevant figures on savings are reproduced in Table 8. From this table, we note that if the past good performance could be continued the ex ante saving income ratio would be about 20-22 percent. This is a respectable rate although the investment program of the Third Plan which implies a GDP growth rate of 7 1/2 percent will require investment income ratio of about 25 percent. If, however, the average saving propensity of household sector cannot be maintained at 10 percent, the average over the sample, but remains at 7 percent reached in 1971, the overall saving income ratio will be about 19-20 percent, which would be insufficient to finance the investment levels required for Plan targets. This would mean inflationary pressure and/or balance of payments deficits, over the Plan period and beyond. However, the assumption about the saving-income ratio of households is critical and on the basis of statistical evidence available so far, the 1971 behavior could well be random. All that one could say is that there is a need for vigilance in this respect and it may be useful to think out the policy alternatives before the problem becomes serious.

2.13 Government Savings. In the projections, government savings account for about 24 percent of total savings in 1978, which is the proportion reached in 1971. Thus, if the Government visualizes an increasing relative role for the public sector, it may be necessary to improve Government's saving performance. 1/

2.14 Business Savings. The contribution of depreciation allowances to total savings continues to increase and would amount to 41 percent by 1978 in the projections. The annual growth rate in depreciation allowances of about 14.5 percent (in real terms) is quite reasonable. 2/ However, the contribution of undistributed profits registers a decline from 11.8 percent in 1971 to 6 percent in 1978. As mentioned before, the slow growth in undistributed profits over the past and expected future is worrisome and may deserve more intensive study for discussion of possible reasons and remedial measures.

1/ For more detailed discussion, see Annex 2.

2/ This, however, presupposes that target growth rates and investment rates over the Plan period are feasible which may be doubtful. See Annex 1.

CHAPTER 3: DEVELOPMENT IN FINANCIAL INTERMEDIATION

3.01 As discussed in Chapter 1, we believe that institutions for effective mobilization and allocation are important for achieving efficiency of resource use. However, in spite of the importance of the financial institutions, we do not propose to discuss these in this annex because they have been adequately discussed elsewhere. The Bank Economic Report of 1972 1/ presented a broad survey of the developments in this respect. More recently, the Central Bank of Kenya has published a booklet, Money and Banking in Kenya, which gives a historical review of development of financial institutions and their present position. Lastly, the Agricultural Sector Survey report 2/ of the Bank has discussed the rural credit institutions in a comprehensive manner. We therefore confine ourselves to a brief reference to the main highlights in the financial sector in recent years.

3.02 The banking system in Kenya is fairly advanced in comparison with other developing countries at a similar stage of development. There are eleven commercial banks in Kenya, three of which dominate the banking system and account for 80 percent of total bank deposits. The rate of growth of money supply has shown some wide fluctuations in recent years. As shown in Table 9 the rate of growth of money supply accelerated to 23 percent per annum in 1970. This was due to the rise in deposits, particularly the term deposits, which was due partly to the increase in blocked accounts of emigrants and other non-residents, and partly to a genuine increase in savings. However, in 1971, there was a decline in the rate of growth of deposits and money supply. In 1972 the money supply expanded by about 14.7 percent.

3.03 The loans and advances to the private sector expanded at an accelerating rate up to 1971 when the rate of expansion was 36 percent. This was associated with a serious deficit in balance of payments and the Central Bank used for the first time its power of variation in minimum cash balances. It announced that from December 16, 1971, commercial banks were to maintain with it minimum cash balances equivalent to 5 percent of their net deposit liabilities, in addition to the required liquidity ratio of 12-1/2 percent imposed in December 1969 under the Banking Act. However, due to the abruptness of the change, some banks found it difficult to meet the requirement, and the measure had to be withdrawn after six weeks. In 1972, there was a significant slowdown of demand for credit mainly due to the tightening of import controls and the disruption of trade with Uganda. Commercial banks in general seemed to have excess liquidity and the monetary authorities were urging them to expand their lending.

1/ The Mobilization of Private Savings, Annex B, Vol. II, Economic Program and Prospects in Kenya, IBRD, Report No. AE-22, March 1972. See also B. Dillon, Financial Institutions in Kenya, 1964-71: A Preliminary Analysis, Working Paper No. 61, IDS, Nairobi, September 1972.

2/ Agriculture Sector Survey Kenya, IBRD Report No. 254-KE.

3.04 As regards allocation of loans, the main problem is to find ways of expanding commercial bank lending to agriculture. As shown in Table 10, the proportion of loans and advances made to agriculture have not been expanding at all -- in fact, they have declined from 12.3 percent in 1969 to 10.2 percent in 1971. This is in spite of attempts by the Central Bank and the Government to persuade the banks to expand their loans to agriculture. It seems that unless some way is found by which public institutions can act as intermediaries for channeling funds to agriculture, the share of loans to agriculture is likely to remain inadequate.

3.05 Apart from the commercial banks, Kenya has eleven non-banking financial institutions in the private sector, under the category of "specified financial institutions". In the last two years their role relative to commercial banks has been increasing. At the end of June 1970, their assets amounted to only 8 percent of those of the commercial banks, by the end of September 1972, this ratio has risen to 15 percent. This was due partly to the differential impact of credit controls on banking and non-banking financial institutions; but it was also influenced by the more flexible and aggressive interest rate policy followed by these institutions in attracting deposits in the face of a rising rate of inflation, in contrast to the static interest rates of commercial banks.

3.06 Apart from the above, there are a number of specialized lending institutions in the public sector providing development finance for industry and commerce, agriculture, housing and tourism. In general, these public sector institutions depend on government loans and grants or on foreign capital. They do not mobilize their own resources and are generally undercapitalized. Nor have they succeeded in attracting the long-term funds available in other financial institutions such as life insurance companies. If the public financial institutions are to play their proper role in savings mobilization for growth, it is desirable to think of the ways of broadening their capital base. In particular, some of the institutions (such as the AFC) might be able to accept deposits from the households they serve. The growth of the cooperative savings movement is especially promising in this respect.

CHAPTER 4: SOME POLICY IMPLICATIONS

4.01 As suggested in the preceding chapters, the performance of the Kenyan economy in generating and mobilizing domestic savings has been very good and if these trends were likely to continue in the future, policy instruments for improving saving performance would not be of high priority. There are, however, certain indicators which suggest that, left to itself, saving performance might deteriorate in the future, and it is therefore necessary to think of policy measures to prevent this deterioration. In fact, as is often found in real life, once the situation starts to deteriorate, destabilizing forces are strengthened and corrective measures become more painful and less effective. It is, therefore, advisable to anticipate the problems and discuss and adopt preventive policy measures before the problems get out of hand.

Interest Rate Policy

4.02 The first area in which some review of policy is necessary is interest rate policy. As shown in Table 11, the interest rate level and structure have been almost static in Kenya for as long as systematic data are available, which is since 1967. The rate of interest on savings deposits in commercial banks and post offices has been 3 percent per annum. The deposit rates in hire purchase companies and building societies are somewhat higher, but these are restricted in coverage. The minimum rate on loans and advances has been static at 7 percent, but actual rates may have gone up to a certain extent. The Central Bank rates on advances against Kenya Government securities and under crop finance schemes have also been static at 6.5 and 6.0 percent, respectively. The redemption yield rates on locally registered Kenya Government stocks based on government support prices have actually declined since 1965 particularly in the case of long term (over 10 years) and medium-term (5-10 years) stocks. The yield on long-term stocks declined from around 8.5 percent in 1965 to around 7 percent in 1972, and that on medium-term stocks from around 7.7 percent to around 6.5 percent. The structure and level of interest rates was not a serious problem as long as the rate of inflation was low and the balance of payments strong. However, in 1972, when the rate of inflation reached about 6 percent, the real rate of interest became negative for the first time since Independence. Similarly, the balance of payments position in 1972, though better than in 1971, was still under strain, and it is likely to come under further pressure as the Third Plan programs create new demands for foreign resources.

4.03 The rate of inflation is, of course, a worldwide phenomenon at present. However, in many countries, the old orthodoxy about low interest rate policy has been given up and interest rates have moved up along with inflation. For example, as shown in Table 12, in Britain and in Euro-dollar markets (the two most important markets for Kenya) the interest rates have gone up dramatically and are now much higher than those in Kenya. For an open economy like Kenya this could cause serious problems. For example, foreign companies and banks which might under better conditions have borrowed abroad (and thus increased the availability of resources for the economy) are now tempted to borrow domestically. There are, of course, restrictions on domestic borrowing by foreign companies, but the interest differential can still create pressures on domestic resources by tempting the foreign companies to borrow to the limit, and even to find ways of bypassing the legal provisions. 1/ Similarly, it creates an incentive for foreign companies to repatriate their profits (on which there is no restriction) which could otherwise have been used domestically. It is true that the rate of inflation in Britain is even higher than in Kenya. However, for international financial movement, the relevant consideration is not the domestic inflation rate but the interest rate difference and exchange risk. On both these counts, the dice are loaded against Kenya.

4.04 In this connection, it is important to emphasize the mutually destabilizing effects of inflation and balance of payments deficits under a regime of static interest rates and exchange rates. As inflation gathers momentum, it stimulates demand for investment and by increasing expected rate of inflation, reduces savings propensity. This is associated with and it further stimulates the rise in imports and discourages exports; the consequent strain on balance of payments and risk of exchange rate depreciation further reduces foreign capital inflow, thus further reducing the total resources available and increasing the rate of inflation. Once this set of forces gets going it is possible to end up either with a Latin American type of situation, with open inflation and exchange crises, or the Indian type of situation, with repressed inflation and exchange controls. The time for action is before destabilizing expectations get entrenched, and in Kenya's case that time is now.

4.05 It is of course desirable to make some quantitative estimates of the effects of interest rate variation on saving propensity, financialization of savings, on efficiency of investment (through better allocation and through capital-labor substitution), and on balance of payments (through demand for imported capital goods). In Annex I, we do try to work out the implications of variation in interest on macro projections to 1985, on the basis of some assumptions about elasticity of substitution between capital and labor. However, it has not been possible to make any systematic statistical analysis in Kenya because interest rates have varied so little in the past. In the absence of relevant empirical material in Kenya, it may be of some value to study the experience of other developing countries which have adopted different interest rate policies. It is, of course, possible that the experience of one country does not apply to another. The problem is further complicated by the fact that, even in those countries where interest rates have changed, it is difficult to identify the specific influence of changes in interest rates because of the other associated changes going on. All that one can get is a broad feel of the possible association of interest rate policies and the other relevant economic magnitudes.

1/ See Annex 3.

4.06 Among the countries that have made dramatic experiments in interest rate and other financial policies in recent years, the three that are well known are: South Korea (since mid-sixties), and Indonesia and Brazil (since 1967-1968). The initial characteristics of these three were all different. In South Korea the domestic saving rate (three-year centered moving average) was 5 percent in 1963 and the foreign resource balance was two and a half times the level of exports. But the efficiency of investment as indicated by ICOR was quite good (see Table 13). In Indonesia, both domestic savings and ICOR were in bad shape (domestic saving income ratio about 6 percent and ICOR about 5), although the resource balance was only about 25 percent of exports. In Brazil's case, the domestic saving ratio was quite good (about 17%) and the resource balance varied between deficit and surplus, but the efficiency of investment was low (ICOR was about 4). The financial policies adopted by these three countries also differed markedly.

4.07 However, all three countries, although different in circumstance, adopted measures to increase the real rate of interest and, although the mechanism differed in the three cases, they all accelerated their growth rates by improving the elements in which performance had been weakest. Thus, South Korea improved its domestic saving ratio (which was poor), though not its ICOR (which was good). Brazil accelerated its growth through an improvement in ICOR, but not in its saving-income ratio (which was good). Indonesia had poor performance in both savings and ICORs and it improved its performance in both respects, though its savings performance still has a long way to go. In all these cases, the financial policies were associated with improvement in the degree of financial intermediation, as indicated by the figures of time and savings deposits shown in Table 14. These show that the proportion of money supply held in time and savings deposits increased substantially particularly in Korea and Indonesia. Obviously, one cannot conclude anything definite about the effects of interest rate policy from the above. All one can say that the three countries which have in recent years followed active financial reform policies have accelerated growth. Their experience may not apply to Kenya, but it certainly does not contradict the hypothesis that higher real interest rates may help growth -- through stimulating savings, better allocation, or the more intensive use of capital. If Kenya decides to reexamine its interest rate policy, as the Mission recommends it should, it will be useful for the Government to examine the experience of these countries more closely to see what lessons could be learned for Kenya.

4.08 In the context of a brief review of this kind, it is not possible to suggest any detailed policy reforms. However, in the light of the above discussion, we would like to make some tentative recommendations about the direction in which interest rate policy in Kenya might move.

(a) From the point of view of savings mobilization, as well as the allocative efficiency, there is a case for higher interest rates for both deposits and loans.

(b) The increase in rates should be particularly high at the long-term end of the interest rate structure. This seems desirable because short-term loans are necessary for working capital which is complementary with employment. It is the longer term rate of interest that may be important for reducing the capital intensity, for example, in building and construction, which is particularly high in Kenya. The longer term interest rate may also be a significant instrument for changing the import intensity of investment goods, because the imported investment goods generally tend to be of longer life than similar domestic investment goods. It could be argued that, with fungibility of capital, it is difficult to change the structure of rates by government policy. Actually, both the level and structure of interest rates are now largely determined by administrative fiats and not by market forces. In particular, the low rates that often prevail on long-term lending by official institutions can be changed by government policy. Moreover, even though some amount of fungibility is possible, long-term capital investment cannot be generally financed by short-term loans, due to the costs of roll-overs and the risk of illiquidity.

(c) High interest rate policy should not exclude the agricultural sector. It seems to us that the real problem is one of access not cost; in other words, it is much better to get credit to small-scale farmers at the market rate, than not to get it to them at subsidized rates. In fact, the cost of credit is not a major item in farm budgets, and we would not expect a moderate increase in lending rates to have any significant adverse effects on farmers. Quite the reverse, the productivity of credit -- particularly on such inputs as fertilizer, improved seed or grade cattle -- should be high enough to make even high cost credit attractive to the progressive farmer.

(d) It is true that many agriculturists in Kenya are at present saddled with heavy debts, partly as a result of the terms of settlement schemes. However, the way to tackle the debt problem on old loans as well as the new is to be liberal in amortization schedule and not in lower interest rates. 1/

1/ For example, a settlement farmer with a development loan of £1,000 over 10 years at 6-1/2%, pays £165 a year (£100 redemption + £65 interest). If the interest rate were halved (to 3-1/4%) he would save £33 in annual costs. But the same result would be achieved by extending the maturity of the loan from 10 to 15 years. If the maturity were extended to as much as 21 years, the farmer could afford to pay 8-1/2% on his loan, and still save £33 a year, or 20 percent of his present settlement costs.

Financial Intermediaries

4.09 Our second set of suggestions relates to financial intermediaries. In general, our feeling is that the financial institutions are well developed in Kenya and a more active interest rate policy should further stimulate the system and enable it to perform its functions on savings mobilization and allocation more effectively. The main areas in which there is, we feel, a need for strengthening institutions are: (a) institutions for channeling financial resources to small African businessmen and farmers, and (b) institutions for mobilizing savings from low income groups in both rural and urban areas. In terms of priority, it seems to us that the agencies for channeling of resources are more important than for saving mobilization. At present it seems that financial institutions are net transferers of funds from rural areas to urban areas. Thus any further development of institutions for mobilization of savings, without a prior (or at least concurrent) development of lending functions, will only accelerate the drainage of fund from rural areas to urban areas.

4.10 The development of lending institutions for agriculturists becomes extremely important if the strategy of agriculture-oriented growth is accepted. The problems and possibilities in this field have been examined at length in the Agricultural Sector Survey 1/. Similarly, the institutions for channeling resources to small African businessmen are inadequate and as discussed in Annex 5 special measures are needed for this purpose, possibly in conjunction with a special Kenyanization Fund. Mobilization of savings from small savers will however become more important in the future as policies are adopted for income redistribution. For this purpose, we recommend the following policy measures:

(a) The strengthening of the Post Office Savings Bank as a savings institution. In many respects the network of post offices seem very suited as a mobilizer of small savings but over the period 1963 to 1971, the net balances due to depositors have actually slightly declined. The Government has recently taken some steps to improve the administration of post office savings, which may help to increase its popularity. It may be necessary to introduce more reforms later.

(b) The Mission feels that the rural cooperatives provide an excellent instrument for savings mobilization as well as for channeling credits to farms. It is hoped that priority will be given to this aspect of cooperative development, rather than unproductive forms, such as consumer cooperatives.

(c) It would be useful to explore ways in which the commercial banks could be encouraged to lower their minimum deposit requirements (as the KCB has already done). More practicable ways than mooal suasion will also have to be found to increase commercial bank lending to small farmers and entrepreneurs.

1/ IBRD Report No. 254-KE, op. cit., Annex 7.

Impact of Restructured Growth Strategy

4.11 Apart from the above suggestions regarding financial policies, it is important to emphasize that the general policy packages discussed in Volume I and in Annex I have relevance for savings mobilization also. In particular, it seems worth emphasizing that an agriculture-oriented growth strategy, which should help in the matter of balance of payments gap, unemployment and poverty, may also help to stimulate savings. As discussed above, for the same level of income agriculturists tend to save more than urban workers, and the effects of income redistribution on savings will be less serious for growth if the redistribution is from urban rich to rural poor, than from urban rich to urban poor. Because of lack of data on savings in different sectors, it is difficult to be more precise about the effects of restructuring growth or redistribution through growth. One point worth noting is that, with restructured growth, investment requirements are brought down to a manageable level, and this reduces the savings due to depreciation allowances in the future. This however is not a demerit point for restructured growth, because by reducing investment requirements, it is actually reducing the gap between investment and saving, which is what matters from the point of view of internal and external imbalance.

EFFECT OF FOREIGN CAPITAL INFLOW ON DOMESTIC SAVINGS: A CASE STUDY FOR KENYA

1. In recent years it has been argued that foreign capital inflows reduce domestic savings; it is further argued that because of this substitution effect, the net benefits of foreign capital may be significantly less than the inflows suggest. In this appendix, we examine this thesis in the light of the Kenya experience. We begin with a brief review of the stages of development in this thesis and examine its validity from general analytical and statistical points of view. We shall then examine the Kenyan data to test the hypothesis and present some results of our analysis of the problem from a different point of view.

A Brief Survey of the Literature

2. The literature on this subject has been recently reviewed by Mikesell and Zinser. 1/ Without going over the same ground, we would like to summarize the main stages of the debate very briefly:

(i) T. Haavelmo pointed out the general principle that to the extent that foreign capital inflows increase the permanent income of a country, it would be expected to lead to increase in consumption as well as savings.

(ii) Rahman 2/ emphasized the importance of "psychological" factors in inducing the government to relax its saving efforts, when foreign funds are available. Rahman and Enos and Griffin, 3/ tried to test the hypothesis by

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1/ Raymond F. Mikesell and James E. Zinser, "The Nature of the Savings Function in Developing Countries: A Survey of the Theoretical and Empirical Literature," The Journal of Economic Literature, March 1973.

2/ M. A. Rahman, "Foreign Capital and Domestic Savings: A Test of Haarelmo's Hypothesis with Cross-Country Data," Review of Economics and Statistics, February 1968.

3/ K. B. Griffin and J. L. Enos, "Foreign Assistance: Objectives and Consequences," Economic Development and Cultural Change, April 1970.

estimating cross country regressions of the following type:

$$\frac{S}{Y} = \alpha + \beta \frac{F}{Y}$$

Where S = domestic savings
Y = gross national product
F = foreign capital inflow defined as imports minus exports

They found β to be significantly negative.

(iii) Weisskopf 1/ argued that Rahman, Griffin-Enos results were unsatisfactory because of the econometric problem of identification and are misleading in a trade-constrained situation. He developed a technique for identifying savings contraint cases and tested the hypothesis for the cases where savings constraint was binding and found evidence in support of the hypothesis that foreign capital inflow reduced domestic savings.

(iv) Papanek in an interesting article 2/ has attacked this thesis from three angles. He argues, first, that the statistical relationship is in part the result of an accounting convention, not of a behavioral relationship. Second, estimates of savings contain wide margin of errors. Lumping of different types of capital inflow together is wrong. Strikingly different results obtained by different authors cast doubt on their reliability. Third, he contends that these authors mistake association for causality. Exogenous factors may casue both high capital inflow and low saving rates.

(v) Chenery and Carter 3/ have shown that even if the substitution hypotheses were correct, the implication drawn about the effects of foreign capital are wrong, because the analysis ignores the interdependence between different variables and their dynamic effects.

1/ T. E. Weisskopf, "An Econometric Test of Alternative Constraints on the Growth of Underdeveloped Countries," The Review of Economics and Statistics, February 1972. For a critique of Weisskopf's methodology, see The Review, February 1973.

2/ G. F. Papanek, "The Effect of Aid and other Resources Transfers on Savings and Growth in Less Developed Countries," The Economic Journal, September 1972.

3/ H. Chenery and N. G. Carter, "Internal and External Aspects of Development Plans and Performance, 1960-1970," IBRD Working Paper No. 141, February 1973.

Some General Criticisms

3. The "substitution hypothesis" and the usual statistical analysis to support it seems to us to be defective for a number of reasons. In the first place, it is difficult to imagine a behavioral saving function for the economy as a whole. The saving behavior of business sector as far as depreciation allowances (which generally account for more than 50 percent of business savings) are concerned depends mainly on tax laws and past invesmtnet pattern. Similarly, the government saving behavior is influenced by different type of factors, political processes, current expenditure requirements of past capital expenditure, etc. and should be analyzed separately. Thus, it seems difficult to imagine for purposes of economic analysis, a behavioral entity for the economy as a whole whose "income" is increased as a result of foreign capital inflow and which reacts in such a way as to reduce its domestic savings.

4. Even if one can imagine a behavioral entity for the economy as a whole, should capital inflow lead, a priori, to lower savings? Possibly, but not necessarily. To the extent that foreign aid increases "permanent income" it can be expected to lead to some increase in "permanent consumption." However, to the extent that the availability of foreign techniques increases the productivity of capital, foreign capital inflow improves the rate at which the present goods can be transformed into the future goods and thus may increase the rate of savings. It is difficult to be sure which way the balance will lie.

5. Even if the a priori thesis had some theoretical validity, its statistical implementation is faulty and fails to test the hypothesis. First of all, the statistical equations use "trade balance" (imports minus exports) as the indicator of foreign aid. Actually the thesis if correctly tested statistically, would require estimates of grant element of foreign capital by examining the terms of lending and sources of finance for the gap; it cannot be approximated by trade balance which might have been financed by drawing down of foreign reserves, workers' remittances, profits from foreign investment, suppliers' credits at exorbitant interest rates, or IDA credits on virtual grant terms. Similarly, if the influence of foreign capital inflows on savings is to be estimated, both should be measured independently. Actually, savings are generally estimated by deducting trade balance from investment so that if there is any error in measurement of trade balance it is transmitted, one to one, to savings estimates, which are then being regressed on trade balance (thus violating the statistical assumptions underlying regression theory). Moreover, the statistical regressions assume that current income and foreign capital inflows are independent, whereas, in practice, in the absence of foreign capital inflows, current domestic income would have been lower due to lack of raw materials and lacking complementary elements for domestic investment.

6. Even if the statistical result of negative association between savings and trade balance were correct, the inference of causal relation will be wrong. This is not the usual caveat applicable to statistical relation. In the first place, the usual growth rate equation gives definitionally an equation where saving-income ratio is negatively associated with foreign capital <u>if</u>, in regression, growth can be assumed to be independent of foreign capital inflow. Thus

$$\frac{S}{Y} = k(G_y) - \frac{F}{Y}$$

$\frac{S}{Y}$ = saving income ratio G_y = growth rate of GDP

k = ICOR $\frac{F}{Y}$ = capital inflow as a ration of GDP

In this case, the causality is from foreign and domestic savings to growth, not from foreign capital to domestic savings. Secondly, quite often due to extraneous reasons (for example, a transient decline in income due to bad weather), saving may decline leading to emergency imports and balance of trade deficit. However, here both low savings and high trade deficit are caused by other factors, not one by the other. Some such cases have been pointed out by Papanek. As we would notice below, Kenya's case fits in this category rather well.

7. Lastly, even if the causal inference were correct for <u>ex post</u> relation between saving and foreign capital inflow, the inference about the efficiency of foreign capital will be wrong. As Chenery and Carter argue, "The proper test of the effectiveness of aid, however, is its effect on growth or other social objectives rather than on savings as conventionally measured ... In cases where there is constraint other than savings, or where the constraints are mixed over time period, the negative association can be expected as a result of <u>ex post</u> savings falling below <u>ex ante</u> as the system is constrained elsewhere. The association between aid and savings in these cases (the vast majority) is not direct and, in fact, were we to reduce F (current trade balance), savings would rise, but <u>output</u>, <u>investment</u> and <u>consumption</u> would fall." 1/ To take a simple example, suppose that food is imported to pay the workers on a public works project and workers consume the food instantly. In terms of national accounts, output is increased by the value of public works (investment), consumption and investment are also increased by the same amount and saving income ratio is reduced. However, if this food aid has not come in, output, investment and consumption would have been lower and the inference from the regression where output is independent of "food aid" is misleading. The correct way to asses the effects of foreign capital is to work out the alternative scenarios of output, investment, consumption,

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1/ Chenery and Carter, op, cit., pp. 27-28.

and so on under alternative assumptions about the levels of capital inflow and examine the difference made by changes in capital inflow to the overall picture. This is what we try in our model as presented in Annex I and the basic results are reported below.

Statistical Analysis with the Kenyan Data

8. In the light of our comments on the usual statistical analysis of the problem, it is clear that this type of analysis has very limited power of discrimination for testing the hypothesis under discussion, and widely different results could be obtained for different countries and different times and different approximations for "foreign capital inflow". Our analysis of Kenyan data confirms our suspicions. Testing the form used by Rahman and Enos and Griffin, we got

$$\frac{S}{Y} = \underset{(15.2)}{0.1707} - \underset{(-.57)}{.1852}\,\frac{F}{Y}$$

$$\bar{R}^2 = -.11; \quad DW = 1.2; \quad SEE = .026$$

where S = gross national savings

Y = gross domestic income

F = resource gap

(All figures in constant prices)

However, if the same hypothesis is tested in a different form, we get

$$S = \underset{(-.37)}{-230.5} + \underset{(7.1)}{.36Y} - \underset{(-3.08)}{.77F}$$

$$\bar{R}^2 = .89; \quad DW = .89; \quad SEE = 20.0$$

It is interesting to note that the coefficient of F is not significantly different from unity which may well be the result of defining S as I - F. If this were a genuine behavioral response one would expect some lag in response of saving to movements in F. However, if we introduce a lag of one period to F we get

$$S = -114.5 + 0.25Y + 0.422F_{-1}$$
$$\quad (-1.2) \quad (3.3) \quad (.86)$$

$\bar{R}^2 = .72$; DW = 2.2; SEE = 32.8

Similarly if we move away from definitional relationship and use long-term capital inflows (FC) as the indicator of the foreign capital inflow instead of trade balance, we get

$$S = -139.87 + .28Y - .24FC$$
$$\quad (1.3) \quad (3.1) \quad (-.49)$$

$\bar{R}^2 = .70$; DW = 2.74; SEE = 33.3

9. In order to further examine the hypothesis we also made a disaggregative analysis. In most cases, foreign capital inflows are not used to finance imports of non-capital goods directly. Therefore, the hypothesis of negative association between F and S implies that due to the fungibility of foreign exchange, the availability of foreign capital either increases imports of consumer goods (MC) or raw materials (MR) or reduces exports (X). In order to test this hypothesis we ran the following regressions:

$$MR = 5.57 + .055\ FC + .1399\ CDP$$
$$\quad (.1) \quad (.20) \quad (2.9)$$

$\bar{R}^2 = .73$; DW = 1.2; SEE = 19.0

$$MC = 19.50 - .089\ FC + .046\ GDP$$
$$\quad (.63) \quad (-.57) \quad (1.75)$$

$\bar{R}^2 = .25$; DW = 1.54; SEE = 10.4

Government imports (MG)

$$MG = 8.76 + .067\ FC + .0031\ GDP$$
$$\quad (.83) \quad (1.256) \quad (.34)$$

$\bar{R}^2 = .32$; DW = 2.0; SEE = 3.6

$$X = 103.09 + .144\ FC + .207\ GDP$$
$$\quad (1.40) \quad (.39) \quad (3.26)$$

$\bar{R}^2 = .79$; DW = 3.54; SEE = 25.1

Except in the case of government imports (which include import of capital goods), none of the above equations show any significant evidence in support of the hypothesis under consideration.

10. Apart from regressions, if we examine the figures, we note that only in the last two years, namely, 1970 and 1971 has the current balance (imports minus exports) has been significantly positive. As discussed in the text, these were the years when due to extraneous factors, savings propensity probably did decline leading to balance of payments deficit. Thus, the Kenyan experience will fit, rather well, Papanek's examples where causality does not run from trade balance to savings but the other way round. Moreover, the balance of payments deficits were financed largely by drawing down of foreign reserves and this also illustrates the fallacy of equating trade balance with foreign aid.

11. On the basis of the above results, we conclude that regression equations of ex post aggregate savings on trade balance do not measure the effect of foreign capital inflow on domestic savings propensity. Because of the various conceptual and statistical problems involved, these simple minded regressions given completely misleading (and unstable) results. For more meaningful results, we have to analyze the problem in the framework of a complete model where the saving functions are treated in a disaggregated fashion and the dynamic effects are studied. This is what we did in our macro-model (Annex I) and some of the main results are reported below.

Result of Analysis with the Macro-Model

12. The details of the macro-model are presented in Annex 1. The model uses slightly modified gap analysis, when the ex post equalization of ex ante and ex post consumption is brought about by changes in relative prices of consumer goods. We note in Annex 1 that if the target growth rates are to be attained, there is a gap in foreign exchange resources, over and above the past and expected future commitments. If this gap could be filled by commercial borrowing, the macro economic scenario is as presented in Table 15. If the extra resources are not obtained to fill this gap, and structural and other policy changes are not adopted, the feasible growth rate would be about half of the plan targets. On the other hand, if the additional foreign capital required to fill the gap is provided, domestic savings are in fact higher by a substantial amount. However, if we run regressions of savings on income and foreign capital, it does not capture this effect, but shows the usual negative association between savings and trade balance. (See Table 15)

13. Our arguments and results should not be interpreted to mean that foreign capital inflow can do no harm. In fact we argue in Annex I that foreign capital inflows, indiscriminately used, could create debt servicing problems in the future, and we point out at other places that in the past foreign private investment and external aid have not always been in Kenya's interest. We also find that when faced with the foreign exchange problem, it is advisable to examine structural and policy changes which may reduce the foreign exchange gap. It is quite possible that when apparently easy foreign capital inflows are available, policy makers may ignore the harder alternatives of structural and policy changes and thus harm the long run objectives of a country. All that we argue here is these types of effects cannot be assessed by simple minded regressions, but have to be based on case by case country studies. These studies may have to take into account political and institutional factors for analysis of saving behavior in the economy, particularly that of the government.

STATISTICAL TABLES

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TABLE 1 GROSS DOMESTIC SAVINGS

(£ million)

	GROSS DOMESTIC SAVING	GDP	SAVING INCOME RATIO (%)
1964	63.92	355.00	18.0
1965	53.57	356.39	15.0
1966	82.49	415.89	19.8
1967	86.66	437.54	19.8
1968	87.08	479.73	18.2
1969	106.55	519.15	20.5
1970	116.40	577.79	20.1
1971	121.13	630.46	19.2
1972	143.51	711.21	20.2

Source: Ministry of Finance and Planning, Kenya.

TABLE 2 CONSUMER PRICE INDICES IN VARIOUS COUNTRIES (1963 = 100)

	BRAZIL	COLOMBIA	KOREA	PHILIPPINES	IVORY COAST	ETHIOPIA	TANZANIA	KENYA
1960	27	6[illegible].0	72.4	88.1	-	-	102.5	93.6
61	38	74.0	78.3	89.6	101.2	-	103.4	95.4
62	5[illegible]	75.6	83.6	94.7	99.8	-	103.4	98.2
63	100	100.0	100.0	100.0	100.0	100.0	100.0	100.0
64	187	117.6	127.9	108.2	101.3	-	101.7	99.9
65	303	121.8	145.3	111.0	102.7	-	108.4	103.5
66	444	146.0	162.8	117.0	108.4	126.8	113.4	108.4
67	575	157.9	180.4	124.3	110.9	127.8	116.0	111.1
68	714	167.1	200.6	127.3	116.7	128.0	120.2	111.9
69	880	184.0	220.8	129.7	122.0	129.6	121.8	110.6
70	1048	196.6	248.9	148.4	133.5	143.0	125.2	113.2
71	1269	214.4	279.7	170.0	131.4	143.7	130.3	117.5

Source: *International Financial Statistics*, 1972 Supplement, IMF, 1973.

Annex I

Table 3: Gross Domestic Savings (GDS) and Gross National Savings (GNS) as a Percentage of Gross Domestic Income (GDY)

(Three-year centered moving average)

	Kenya		Tanzania		Ethiopia		Ivory Coast		Colombia		Philippines		Brazil		Indonesia		South Korea	
Per Capita Income (1970) in US$	150		100		80		310		340		210		420		80		250	
Population (000) (mid-1970)	11,250		13.270		24,625		4,941		21,632		36,850		92,764		115,567		31,793	
Annual Growth Rate of GNP (%) (1960-70)	6.7		6.1		5.0		7.5		4.9		5.9		5.1		3.0		9.4	
	GDS	GNS	GDS	GNS	GDS	GNS	GDS	GNS	GDS	GNS	GDS	GNS	GDS	GNS	GDS	GNS	GDS	GNS
1964					10.2	10.5			19.3	17.8	22.4	23.3	18.6	18.0	5.4	4.0	7.6	13.4
1965	18.6	17.8	17.1	15.6	10.1	10.6			19.4	18.0	22.3	23.3	18.4	17.8	6.5	5.4	10.1	15.1
1966	18.3	16.3	17.4	16.0	10.7	11.1	20.8	16.3	19.3	17.8	21.6	22.7	17.3	16.6	5.8	5.0	12.1	16.8
1967	18.5	16.4	17.6	16.7	11.6	11.8	21.1	16.2	19.2	17.7	20.1	21.0	16.1	15.3	6.3	5.6	14.4	18.7
1968	18.4	17.0	17.5	17.6	12.2	12.3	22.2	17.7	19.6	18.1	18.3	19.2	16.6	15.7	5.9	5.0	16.4	20.4
1969	19.1	18.5	17.3	17.9	12.1	12.2	22.7	18.7	20.0	18.4	18.3	18.7	17.4	16.4	7.5	6.4	17.8	20.9
1970	19.5	19.0	18.7	19.2	12.0	12.0			20.0	18.2	18.9	19.3	17.2	16.3	8.5	6.7	17.8	19.9

Source: World Bank Atlas and other IBRD Estimates.

TABLE 4 DOMESTIC SAVINGS ADJUSTED FOR TERMS OF TRADE

(Figures in millions of US$ at average 1967-69 prices and exchange rates)

	GROSS DOMESTIC PRODUCT (GDP)	GROSS DOMESTIC INCOME (GDY)	DOMESTIC SAVINGS	NATIONAL SAVINGS
1964	1,024.8	1,033.7	196.3	204.1
1965	1,039.2	1,041.6	172.7	163.6
1966	1,194.6	1,204.3	241.1	214.6
1967	1,241.9	1,246.4	226.4	190.2
1968	1,345.9	1,346.0	233.2	218.7
1969	1,434.1	1,429.3	278.6	274.7
1970	1,544.4	1,536.0	311.8	305.6
1971	1,644.1	1,611.8	304.2	290.7

Source: IBRD estimates.

TABLE 5 SOURCES OF SAVINGS IN KENYA

	HOUSEHOLDS	GOVERNMENT[a/]	BUSINESS: UNDISTRIBUTED PROFITS	BUSINESS: DEPRECIATION ALLOWANCES
		£ Million		
1964	24.8	12.8	13.5	16.8
1965	17.0	9.8	6.7	17.4
1966	31.7	10.3	12.0	19.2
1967	33.8	10.6	6.9	22.6
1968	39.8	10.7	3.6	26.3
1969	55.4	7.4	10.6	30.1
1970	47.3	20.4	12.0	33.4
1971	30.5	26.2	13.1	41.0
		Percentages		
1964	36.5	18.9	19.9	24.8
1965	33.5	19.2	13.2	34.2
1966	43.2	14.1	16.4	26.3
1967	45.7	14.4	9.3	30.5
1968	49.5	13.3	4.5	32.7
1969	53.5	7.1	10.2	29.1
1970	41.8	18.0	10.6	29.5
1971	27.5	23.7	11.8	37.0

a/ Figures on Government Saving given here do not agree with those in Annex 2, due to differences in definition.

Source: Ministry of Finance and Planning, Kenya.

TABLE 6 STRUCTURE OF SAVINGS IN VARIOUS COUNTRIES

COUNTRY	YEARS	PERCENTAGE OF TOTAL SAVINGS GENERATED BY		
		GOVERNMENT	CORPORATIONS	HOUSEHOLDS
Taiwan	1955-59[a]	43.2	56.8	
	1960-64[a]	20.2	79.8	
	1965-68[a]	15.5	84.5	
	1958-59[b]	37.1	6.2	56.7
Philippines	1955-59[a]	24.0	34.2	41.8
	1960-64[a]	13.0	24.0	63.0
	1965-68[a]	8.2	20.7	71.2
	1955-59[a]	12.3	30.9	56.8
Venezuela	1960-64[a]	56.0	10.2	33.6
	1965-68[a]	59.2	13.7	27.0
Brazil	1955-59[a]	24.2	75.8	
	1960-64[a]	10.2	89.8	
	1965-67[a]	22.6	77.3	
Korea, South	1955-59[a]	61.0	8.8	30.2
	1960-64[a]	75.2	32.4	-7.6
	1965-67[a]	63.2	23.0	13.5
	1958-59[b]	-51.6	30.6	121.0
Colombia	1955-59[a]	49.6	20.4	29.8
	1960-64[a]	38.2	35.6	26.2
	1965-68[a]	55.2	30.7	14.2

Sources: [a] U Tun Wai, Financial Intermediaries and National Savings in Developing Countries, Praeger Publishers, 1972. Based on UN Yearbook of National Income Accounts.

[b] U.N. ECAFE, Economic Bulletin for Asia and the Far East, December, 1962. Based on "direct" saving estimates.

TABLE 7 GOVERNMENT RECEIPTS AND EXPENDITURES, 1964-1971

(£ Million)

	1964	1965	1966	1967	1968	1969	1970	1971	PERCENTAGE INCREASE 1964-1971
Government Interest Paid	4.23	4.57	4.99	5.33	5.69	6.30	7.00	7.70	82
Transfer Payments Made									
International	5.10	6.20	7.60	6.70	4.40	4.00	3.70	3.90	-24
Households	11.74	9.19	8.12	7.85	9.52	8.49	8.29	8.17	-30
Government Consumption	49.35	52.32	57.09	62.23	73.52	85.55	94.25	105.03	113
Business Subsidies	.35	.53	.70	1.55	2.64	2.10	1.16	0.97	177
Government Saving	12.81	9.75	10.31	10.61	10.65	7.36	20.41	26.24	105
Total Expenditure	83.58	82.56	88.81	94.27	106.42	113.8	134.81	152.01	82
Tax Receipts of which	48.01	52.17	58.89	66.47	72.78	82.17	95.67	111.17	132
Direct Income Taxes	(10.47)	(10.70)	(9.23)	(14.60)	(11.96)	(14.68)	(16.65)	(19.90)	90
Indirect Business Taxes	(26.91)	(29.44)	(35.48)	(35.97)	(43.06)	(46.62)	(56.55)	(62.94)	136
Personal Taxes	(10.63)	(12.03)	(14.18)	(15.90)	(17.76)	(20.87)	(24.47)	(28.33)	167
Profits of Government Corporations and Sales of Services	14.37	16.89	19.12	19.40	20.34	20.43	26.74	29.54	99
International Transfer Receipts	20.70	13.50	10.80	8.40	13.30	11.20	12.40	11.30	-45
Total Receipts	83.58	82.56	88.81	94.27	106.42	113.8	134.81	152.01	82

Source: Ministry of Finance and Planning, Kenya

Annex

TABLE 8 PROJECTIONS OF EX ANTE SAVINGS: 1974 -1985
(£ Million, at Constant 1970 Prices)

	1974	1975	1976	1977	1978	PERCENTAGE INCREASE 1974-78	1980	1985
Basic Projections								
GDP at Market Prices	767.2	827.1	892.1	962.9	1039.9	36	1215.2	1812.7
Gross Investment	194.0	210.9	228.5	247.7	268.6	38	316.2	478.2
Investment/Income Ratio (%)	25.3	25.5	25.6	25.7	25.8		26.0	26.4
Gross Savings of which	161.6	177.1	194.	212.5	232.3	44	274.1	425.4
Households	51.9(32.1)	55.5(31.3)	59.4(30.6)	63.6(29.9)	68.2(29.4)	31	79.0(28.8)	114.9(27.0)
Corporations								
Undistributed Profit	9.3(5.8)	10.2(5.8)	11.2(5.8)	12.3(5.8)	14.0(6.0)	51	21.4(7.8)	43.9(10.3)
Depreciation Allowances	61.8(38.2)	69.3(39.1)	77.3(39.8)	86.0(40.5)	94.3(40.6)	53	104.2(38.1)	147.3(34.6)
Government	38.6(23.9)	42.2(23.8)	46.2(23.8)	50.6(23.8)	55.9(24.1)	45	69.5(25.4)	119.3(28.0)
Saving/Income Ratio (%)	21.0	21.4	21.7	22.0	22.4		22.5	23.5
Projected Level of Savings (assuming household savings income ratio remains at 7%)								
Gross Savings	146.1	160.5	176.3	193.5	211.8	45	250.5	391.0
Household	36.3	38.9	41.6	44.5	47.7	31	55.3	80.4
Saving/Income Ratio (%)	19.0	19.4	19.8	20.1	20.4		20.6	21.5
Projected Level of Savings (assuming restructured growth)								
GDP at Market Prices	766.4	827.1	893.1	964.8	1042.8	36	1219.9	1820.3
Gross Investment	176.3	191.3	206.9	223.8	242.1	47	283.8	424.4
Gross Savings	159.0	173.6	189.6	207.1	226.0	42	265.7	409.1
Households	52.1(32.8)	55.9(32.2)	60.0(31.6)	64.4(31.1)	69.2(30.6)	33	80.5(30.3)	117.5(28.7)
Corporations								
Undistributed Profit	10.0(6.3)	11.4(6.6)	12.9(6.8)	14.5(7.0)	16.6(7.3)	66	24.8(9.3)	48.5(11.9)
Depreciation Allowances	59.9(37.7)	65.9(38.0)	72.4(38.2)	79.6(38.4)	86.6(38.3)	45	94.1(35.4)	130.6(31.9)
Government	37.0(23.3)	40.4([illegible])	44.3(23.4)	48.6(23.5)	53.6(23.7)	45	66.4(25.0)	112.6(27.5)

Source: Mission estimates

Note: Figures in parentheses indicate the percentage distribution of total savings by source.

TABLE 9 CHANGES IN MONEY SUPPLY AND RELATED VARIABLES

Annual Percentage Increase

END OF DECEMBER	TOTAL MONEY SUPPLY	CURRENCY OUTSIDE BANK	DEMAND DEPOSITS	TIME DEPOSITS
1967	10.9	11.0	6.0	16.8
1968	13.0	8.6	11.7	15.8
1969	15.0	19.0	12.0	15.9
1970	23.3	21.7	15.4	32.3
1971	8.7	5.1	8.8	10.6
1972	14.0	20.5	17.5	7.6

Source: Ministry of Finance and Planning, Kenya

TABLE 10 LOANS AND ADVANCES BY COMMERCIAL BANKS

END OF DECEMBER	TOTAL (£ MILLION)	PERCENTAGE DISTRIBUTION		
		PUBLIC SECTOR	PRIVATE SECTOR	
			TOTAL	AGRICULTURE
1968	66.[illegible]	4.6	95.4	11.6
1969	70.0	2.5	97.5	12.3
1970	86.9	5.9	94.1	10.7
1971	120.1	7.3	92.7	10.2
1972	121.4	7.6	92.4	9.9

Source: Ministry of Finance and Planning, Kenya

TABLE II PRINCIPAL INTEREST RATES, 1967-72
(Percentage rates)

	As at June 30						As at March 31
	1967	1968	1969	1970	1971	1972	1973
CENTRAL BANK OF KENYA							
1. Rediscount Rate for Treasury Bills	n.a.	n.a.	4.50	4.00 /1	2.00	4.00	3.79
2. Advances Against Treasury Bills	n.a.	n.a.	5.00	4.50 /1	2.50	4.50	4.29
3. Bills and Notes Under Crop Finance Scheme							
-- Discounts	5.00	5.00	5.00	5.00	5.00	5.00	5.00
-- Advances	6.00	6.00	6.00	6.00	6.00	6.00	6.00
4. Other Bills and Notes							
-- Discounts	5.50	5.50	5.50	5.50	5.50	5.50	5.50
-- Advances	6.50	6.50	6.50	6.50	6.50	6.50	6.50
5. Advances Against Kenya Government Securities	6.50	6.50	6.50	6.50	6.50	6.50	6.50
KENYA COMMERCIAL BANKS: /2							
1. Deposits							
(i) Time							
(a) Minimum 30 days (7 days' notice)							
-- K Sh 200,000 up to K Sh 500,000	3.00	3.00	3.00	3.00	3.00	3.00	3.00
-- K Sh 500,000 and over	3.25	3.25	3.25	3.25	3.25	3.25	3.13
(b) 3 to less than 6 months	3.50	3.50	3.50	3.50	3.50	3.50	3.50
(c) 6 to less than 9 months	3.75	3.75	3.75	3.75	3.75	3.75	3.75
(d) 9 to less than 18 months -- w.e.f. 1-9-68	4.00	4.00	4.00	4.00	4.00	4.00	4.00
(e) 18 to less than 24 months (minimum K Sh 500,000) -- w.e.f. 1-9-68	...	...	4.50	4.50	4.50	4.50	4.50
(f) Longer periods (minimum K Sh 500,000)	...	...	...	...	...	/3	/3
(ii) Savings	3.00	3.00	3.00	3.00	3.00	3.00	3.00
2. Loans and Advances (minimum)	7.00	7.00	7.00	7.00	7.00	7.00	7.00
OTHER FINANCIAL INSTITUTIONS:							
1. Kenya Post Office Savings Bank							
-- Deposits	2.50	3.00 /4	3.00	3.00	3.00	3.00	3.00
2. Agricultural Finance Corporation							
-- Loans	7.50 /5	7.50 /5	7.50	7.50	7.50	7.50	7.50
3. Hire Purchase Companies							
-- Deposits (various periods)	...	3.00- 6.00	3.00- 6.00	3.00- 6.00	3.00- 6.00	3.00- 6.00	3.00- 7.50
-- Loans	...	10.00-12.00	10.00-12.00	10.00-12.00	10.00-12.00	10.00-12.00	7.00-12.00
4. Building Societies /6							
-- Deposits (various periods)	...	4.00- 6.50	4.00- 6.50	4.00- 6.50	4.50- 7.00	4.50- 7.00	5.50- 6.50
-- Loans	...	7.50-10.00	7.50-10.00	7.50-10.00	7.50-10.00	7.50-10.00	7.50-10.00

... indicate data not available.
/1 Valid until April, 1970, when the balance of Treasury Bills outstanding was redeemed by the Treasury.
/2 In Kenya, banks collectively agree on the rates they grant or charge on deposits and loans respectively.
/3 Individual Banks free to determine rate.
/4 w.e.f. July 1, 1968.
/5 Includes Land and Agricultural Bank of Kenya.
/6 Includes Institutions not registered under the Building Societies Act, but whose primary function is to finance the purchase of property.

Source: Central Bank of Kenya Annual Report for the Years Ending 30th June, and Economic and Financial Review Quarterly Vol. V - No. 3 - January-March, 1973.

TABLE 12 SELECTED INTEREST RATES IN EUROPE

	MAY 11-18, 1973	NOV 16-23, 1973
1. United Kingdom		
Long term bond yield	10.24	11.93
Treasury Bill Rate	7.15	12.31
"Minimum lending rate" (former Bank Rate)	8.75 (March 1)	11.50
2. Euro-dollar market		
3-month rate for US$ deposit in London	8.50	10.00
6-month rate	8.688	9.38

Source: Selected Interest and Exchange Rates for Major Countries and the U.S., Board of Governors of the Federal Reserve System, May 23, 1973.

TABLE 13 ICORs IN SELECTED COUNTRIES

FIVE-YEAR AVERAGES ENDING IN THE YEAR	KENYA	BRAZIL	SOUTH KOREA	INDONESIA
1965		4.05	2.12	5.09
1966		4.07	2.06	5.82
1967		3.74	2.09	4.56
1968		3.33	2.18	3.24
1969		2.83	2.30	2.41
1970	3.02	2.45	2.46	2.11
1971				

Source: IBRD estimates.

TABLE 14 STRUCTURE OF DEPOSITS AND CURRENCY IN VARIOUS COUNTRIES

END OF	KOREA (BILLIONS OF WON) DEMAND DEPOSITS	TIME AND SAVINGS DEPOSIT	TOTAL MONEY SUPPLY	TIME AND SAVINGS DEPOSITS AS A % OF TOTAL MONEY SUPPLY	INDONESIA (BILLIONS OF RUPIAHS) DEMAND DEPOSITS	TIME AND SAVINGS DEPOSIT	TOTAL MONEY SUPPLY	TIME AND SAVINGS DEPOSITS AS A % OF TOTAL MONEY SUPPLY	BRAZIL (BILLIONS OF [illegible]) DEMAND DEPOSITS	TIME AND SAVINGS DEPOSIT	TOTAL MONEY SUPPLY	TIME AND SAVINGS DEPOSITS AS A % OF TOTAL MONEY SUPPLY
1964	24.5	14.5	63.6	22.8					3070	130	5343	2.4
65	34.9	30.6	97.1	31.5	.7	.08	2.66	3.0	5800	216	9344	2.3
66	43.5	70.1	157.1	44.6	6.74	.34	22.55	1.5	6193	841	11415	7.4
67	64.7	128.9	252.9	51.0	15.16	2.25	53.67	4.2	9622	1476	16602	8.9
68	73.3	255.5	412.4	62.0	33.98	12.03	125.74	9.6	13481	2413	24051	10.0
69	118.9	451.5	670.7	67.3	59.98	51.61	233.86	22.1	17612	2988	31523	9.4
70	182.7	573.3	890.8	64.4	81.04	80.01	321.07	24.9	22429	4153	40837	10.1
71	218.0	705.1	1073.6	65.7	108.09	145.28	457.83	31.7	29700	6554	54855	11.9

Source: International Financial Statistics, IMF, 1972.

TABLE 15 COMPARISON OF SYSTEMS DYNAMICS WITH DIFFERENT LEVELS OF FOREIGN CAPITAL INFLOW

(US$ Million, at Constant 1970 Prices)

GDP (Y)	GROWTH RATE GDP (%) (GY)	SAVING (S)	FOREIGN CAPITAL INFLOW (F)
LOW LEVEL OF FOREIGN CAPITAL INFLOW			
2085	4.6	332.8	27.7
2188	4.9	347.4	35.3
2297	4.9	361.1	43.2
2413	5.1	372.6	54.7
2537	5.1	402.9	48.8
2664	5.0	464.1	13.5
2805	5.3	493.4	11.8
HIGHER LEVEL OF FOREIGN CAPITAL INFLOW			
2148	7.5	477.5	65.6
2316	7.8	514.5	75.9
2498	7.9	553.3	86.6
2696	7.9	592.0	101.9
2912	8.0	651.3	100.9
3147	8.1	699.4	116.6
3403	8.1	760.9	124.5

Source: Mission Projections

Note: The regression equation obtained from the above data is:

$$\frac{S}{Y} = .043 + .027\ GY - .93\ \frac{F}{Y}$$
$$(7.2) \quad (17.5) \quad (-4.7)$$

$$\bar{R}^2 = .99$$

ANNEX 5

PRIORITIES FOR PLANNING AND PROJECT DESIGN

ANNEX 5: PRIORITIES FOR PLANNING AND PROJECT DESIGN

CONTENTS

CHAPTER 1: PRIORITIES FOR PLANNING

1.01 Kenya has devoted much attention to the preparation of its national development plans, the third of which is to be published shortly. The plans are typically well conceived proposals for the development of the economy, are based on realistic assessments of the revenues likely to be available, and incorporate well balanced public expenditure programs for the financial years covered by the plan period. While setting high targets for growth, Kenya's plans have not been over ambitious in macro-economic terms, and the targets of successive plans have generally been attained.

1.02 Nevertheless, the emphasis in macro-economic planning has tended to be on the production of the published plan, at the expense of the plan as an implementable program of action. The private sector has been incorporated only peripherally, the plans have had little project content, policy proposals are not always previously agreed, and the plan programs have been frequently disregarded during the subsequent preparation of the budgets. Commitment to the plans has been weak, both in the active participation of the people, politicians, or even the major operating ministries in their preparation, and in a disciplined monitoring of their implementation.

1.03 These kinds of emphases and weaknesses in national planning are by no means unique to Kenya, and Kenya's plans are certainly much better prepared and more realistic than most. Sector planning and investment management has been adequate in some sectors and inadequate in others. Historically, investments have been concentrated in the infrastructure sectors, and in these sectors the Government has achieved considerable planning and executing efficiency. Many of the investments were large, productively absorbing investment funds while alternative sectors were not equipped to absorb them. Furthermore, Kenya made use of a large international cadre of consulting experts for infrastructural investment, for both project planning and supervision of construction. The expenditures on consultants by the Roads Branch of the Ministry of Works, for example, average about 6-10 per cent of the investment budgets. For major works in the water supply sector, the consultants budget is comparable. As a result, these ministries now have available to them a local supply of proven expertise to assist in all phases of the investment process. Absorptive capacity is not a problem for these sectors.

1.04 Modern large scale industry has also had the benefit of a large input of planning in its investments. The entrepreneurship accompanying foreign private investment and technical assistance in industry have supplemented Kenyan planning and implementation skills in this sector. As a result, large scale industry has expanded rapidly and efficiently within the price framework set by government policy 1/. There is evidence of excess absorptive capacity, for

---

1/ The framework itself is sub-optimal, and some of the investments are consequently uneconomic, but this is a weakness of general policy rather than an absorptive capacity problem (See Annex 3, Chapter 3).

example, in the waiting list for placement in the expanding industrial estates. In the agricultural sector, on the other hand, and in the small scale industrial and commercial sectors, there has been no comparable input of supplemental manpower. Partly for this reason (and partly because these sectors are more difficult to begin with) absorptive capacity problems persist in these sectors. In the social sectors, the problem is mainly to constrain investment within the limits of available resources and to make sure that the highest priority investments are undertaken first. The Harambee movement, 1/ and the naturally strong desire for social services on the part of Kenya's people, require constant discipline from Central Government to prevent spending in these sectors from getting far beyond what the country can afford.

1.05 In the light of the strategy put forward in this report, and the uneven capabilities for sector planning, the Mission believes that the priority for future improvement in planning is at the sector level, and that the main concentration of this increased effort should be on all phases of micro-economic planning and development management in the directly productive sectors. Intensive work on sector plans per se is needed to establish the main policy parameters for use in evaluating all of the projects and programs in these sectors, and to establish the links between subsector programs and projects. But sector plans must be practical programs of action, not merely statements of philosophy, and very often sector policy will emerge out of the attempt to identify more projects and programs.

1.06 Increased management effort is required to mobilize the large government organization, particularly in agriculture, and direct it to systematic and disciplined performance of development functions, both in conjunction with new projects and in the execution of ongoing recurrent programs. This will require, in the first instance, detailed planning, programming and budgeting for the use of staff.

1.07 With increased concentration on micro-economic planning within the directly productive sectors, the macro-economic intersectoral planning will acquire more substance because the sectoral investment opportunities will, both in the aggregate, and in each sector, exceed the funds allocable to finance them. Only in this situation is it possible, in principle, to maximize social benefit from the investment program by shifting funds, at the margin, between sectors. It seems safe to assume that the other sectors -- infrastructure and the social services -- will continue to be able to absorb more funds than are available.

1/ To the extent that Harambee projects impose either capital or recurrent costs on the Government, an ideal sector plan for a social sector would allocate Harambee support funds in order of the priority of projects. In practice, Harambee funds are allocated according to the initiative and the persistence of the local sponsors of projects. The misallocation involved in this selection method is generally regarded as a necessary cost of the Harambee system; it is generally felt that the benefits of Harambee -- stimulation of grass roots initiative and cooperation, and mobilization of local savings for social purposes -- outweigh these costs.

1.08 The Mission believes planning improvement to be particularly important at this juncture in Kenya's development for four main reasons:

(a) As discussed extensively in the main report and in Annex I, sustaining Kenya's good pace of economic growth will probably require a rapid growth of investment in the directly productive sectors at the expense of slower growth of both infrastructure and social services. Because the micro-economic groundwork for an expanded investment program in the productive sectors is not well developed, this shift cannot be accomplished simply by intersectoral reallocations at the macro-economic planning level; it requires also a concerted planning effort.

(b) As discussed in Annex 3, the resource use in the private industrial sector has not been optimal from the point of view of generating employment or foreign exchange. Within the present policy framework, which is characterized by underpricing of capital relative to labor and of exports relative to production for the local market, it is particularly important to exercise great care in the selection of investments to be stimulated; the price system is not encouraging optimal allocation. Furthermore, local small scale industry, agriculture, and trade are discriminated against by present pricing, exchange rate, and other policies so that additional planning effort is needed to stimulate these subsectors. These are the main employment generating subsectors and probably contain the most important under-utilized development potential.

(c) Because Kenya will become more dependent on external borrowing to finance development expenditures at a time when the performance of donors appears to be shifting to directly productive investments, it is increasingly important that a balanced program of investments be presented for external financing. If, for example, the ability to identify, prepare and appraise projects for foreign financing is concentrated in the infrastructure sectors, this may reduce the amount of aid available and at the same time bias macro-economic allocation in favor of infrastructure.

(d) The priorities for future development expenditure are the hard sectors from the point of view of planning and management. Small scale industry, trade, and agriculture can be expected to respond spontaneously to improvements in policy, but they are presently lagging far behind the urban formal sector in both fixed capital and human capital, and special programs are needed to stimulate them. Many of these programs will be risky, or will involve a preponderance of local cost, or will produce results which are hard to evaluate in financial terms. All of these factors will make it more difficult to identify, appraise and package projects in a way that will appeal to foreign suppliers of investment funds or even to Kenya's own project analysts used to dealing with more prestigious projects. Yet it is extremely important that this effort be made, rather than letting these subsectors continue to lag behind the development trend. Programs designed for these subsectors will also require a large management and programming input per shilling invested. Because these programs will involve very large numbers of firms, the administrative mechanism for executing them could become overwhelmingly cumbersone without a substantial improvement in management.

1.09 It was the clear impression of the Mission that within the whole project cycle, from recognition of a development opportunity to the operation of the project, the most glaring lack was at the first stage -- project identification 1/. Ideally, identification of development projects should become a major concern of the entire field staff and management of the productive sectors, as well as of their separate planning units. The task of project identification is simply too vast for a few experts, no matter how keen and competent 2/. Furthermore, a "project" most naturally develops as a response to growth or to overcome a bottleneck in operations, and is first observed by the operators. The more that the eventual operators of the programs contribute to the decision on where to invest and how to design programs, the less are projects liable to fail at the operating stage. But at the lower field levels, the requisite expertise for project preparation is lacking, which throws the burden of project preparation and identification back on the few planners in the central staff of the ministries or even farther to the macro-economic planners 3/. No conceivable expansion of these central staffs is likely to solve the problem of too few identified projects; unless the field staff can be stimulated to do the bulk of the identification work, a shortage of projects will persist.

1/ For simplicity, we use the term "project" to refer to any special development effort that is undertaken as a separately managed work. This can, and often should, include broadly-based programs identified at the subsector or even sector level of operation. We interpret the term "project identification" to include the demonstration that a profitable investment opportunity exists and that it can be implemented (i.e., designed, "constructed," programmed to operate) within the general policy framework of the Ministry.

2/ The prevalent misconception in many operating ministries that "planning" is a mysterious, and perhaps even dangerous, activity best left to "planners" is a serious obstacle to development in Kenya.

3/ One can observe this process operating in agriculture and it can be anticipated in small scale business if, as planned, the field staff is greatly expanded.

1.10 An important stimulus to field staff to do the initial work of project preparation would be a very quick response by central ministry planning groups to all project ideas emanating from the field. This response would either: reject the project out of hand; accept the possibility of the project on the condition that certain additional information requirements are filled and specify the additional information requirements; or accept the proposal as an identified project and commit the Ministry, in principle, to devote resources to the project 1/. Such a quick response would not only serve to reinforce local initiative in cases of government commitment, but would also have a very strong demonstration effect 2/. For this reason, we believe that a higher priority within the project planning machinery of the central ministries should be given to this immediate post-identification phase, and that Kenyan planners particularly should be concentrated here 3/.

1.11 The decision in principle to commit resources to a given project idea, within a clearly identified sectoral strategy, is an essentially Kenyan decision which cannot be taken outside the economic and political decision-making levels of the nation. But the subsequent stages of the project cycle -- the phases of detailed project preparation, appraisal and implementation, and the design of a management system for operating the project and coordinating it with other activities -- are largely technical and are less concerned with policy decisions. Thus, while Kenya planners should be mainly concerned with the central decisions about policy and the priorities in resource allocation, there is no apparent reason why foreign expertise (in the form of technical assistance or consultant services) could not do much of the work at these later stages in the cycle.

1.12 Once the Government is committed to a reasonably well-identified project, we believe that there will generally be little difficulty in lining up external assistance, including where necessary technical assistance in its preparation 4/. Most bilateral donors have expressed a preference for concentrating technical assistance more heavily in the project cycle, and we believe that this facility -- including the activities of the Bank's regional office -- have not been utilized as much as they might have been.

1/ Initially the commitment need only be to investigate the project in greater depth in the near future with the understanding that further commitment would depend on this investigation.

2/ The immense growth of the Harambee movement in the social sectors illustrates how quickly and widely effective local action can be emulated.

3/ This suggestion differs greatly from "bottom up" planning, which has been tried unsuccessfully. One of the causes of failure of this planning was that too much work was placed on local authorities of limited planning expertise. The result was a series of generally ill-prepared shopping lists. Our suggestion is that single projects, rather than lists or ill-conceived area plans, be submitted and judged.

4/ The common difficulty of donor A refusing to accept the design or the appraisal of donor B is discussed at some length in Annex 6, Priorities for External Assistance. The Mission considers the problem soluble.

CHAPTER 2: PLAN ORGANIZATION

Introduction

2.01 The 1969 Bank economic report gave some attention to the planning organization of Government, and examined several areas in which planning capacity was deficient or absent. Since this report, considerable progress has been made in strengthening the planning organization and in achieving more effective coordination. This section will briefly describe some of the more significant developments in planning in Kenya and suggest some areas in which further strengthening is necessary.

Central Government Planning

2.02 Central Planning Organization: The Planning Division of the combined Ministry of Finance and Economic Planning is now a fully-established Kenyan unit, under its own Deputy Permanent Secretary who, in view of the size and complexity of his task, is of permanent secretary rank. The Planning Division includes 16 planning posts and six senior planning posts and is overwhelmingly Kenyanized. The Ministry still relies heavily on a high quality team of expatriate advisors, supplied principally by the Ford Foundation and CIDA, particularly in a few key fields such as agriculture, rural development and project planning. In spite of the widening and deepening of indigenous planning capacity, these posts will remain a high priority for external technical assistance for the medium term future in view of the requirement for increased absorption of capital in the productive sectors. However, it would be desirable for the Ministry to put less emphasis on the preparation of plan documents and put more emphasis on the management of the economy. The Ministry of Finance and Planning's comparative advantage lies in mobilizing the resources for development, in the allocation of national priorities, in resolving conflicts, in coordinating the public sector and the private sector and the various levels of Government, and in monitoring the implementation of the Plans and ensuring that the resources are provided through the annual budget for their implementation.

2.03 A Project Identification and Evaluation Unit was established in 1970 by CIDA and is the largest single technical assistance project in planning in Kenya. The unit has seven full time expatriate staff working in the central Planning Division and operating ministries, together with a similar number of Kenyans in Nairobi or on training fellowships in Canada. The work carried out by the unit provides a systematic method of codifying projects and monitoring plan implementation. The methodology adopted permits more effective coordination between development expenditure budgeting and recurrent expenditure budgeting, including the provision of manpower. The unit is also undertaking a geographical disaggregation of investment expenditure, which is a useful first step in coordination of Central Government investment activity at the local level.

2.04 Sectoral Planning Units: One of the more serious problems of planning in Kenya is the inadequate planning capacity of many operating ministries. Despite some progress in establishing and staffing sectoral units, the limited planning capacity of some key ministries remains a constraint to sound policy formulation and project preparation and implementation in Kenya. Apart from the scarcity of experienced manpower, three factors seem to have been important in restraining the growth of effective planning units in operating ministries. One has been the reluctance of ministries themselves to accept economic planning, presumably because of the fear that their own technical responsibilities might be eroded. A second and more serious factor has been the tendency to favor the central planning unit at the expense of sectoral units, with the result that most of the more senior and experienced Kenyan economists are located in the Ministry of Finance and Planning. This in turn has resulted in a tendency for sectoral development strategy to be evolved by the sectoral specialists in the central Planning Division rather than by planners in the operating ministries. A third related factor has been a reluctance to accept not only the scale of planning input required in sectors such as agriculture and natural resourees, industry and social services, but the variety of disciplines often required to make up a balanced planning team.

2.05 The two ministries with main responsibility for directly productive investments -- Agriculture and Commerce and Industry -- have planning units which in size and composition could be classified as sectoral planning units. The largest planning unit -- with seven permanent posts and 17 expatriates attached to the unit under various schemes of technical assistance -- is the Ministry of Agriculture. Although large compared with other ministries, this unit has a wide spectrum of responsibilities, including price and general agricultural policy, marketing research and intelligence, project preparation and evaluation, water development programs, the agricultural component of the special rural development program, the development of all crops and livestock, and the provision of general economic support services to the nine technical divisions of the Ministry and to the statutory boards. These numerous functions have allowed little attention to be given to the evolution of a long-term strategy for the development of the industry as a whole. The Ministry has also found it difficult to prepare sufficient projects to take advantage of all external aid potentially available for the agricultural sector. Appendix I to this Annex presents a proposal for increasing the planning capacity of the Ministry of Agriculture.

2.06 In the Ministry of Commerce and Industry, the unit primarily responsible for the project cycle -- identification, evaluation and granting of protection -- is the Industry Division. This division has an established strength of eight positions, of which only five were filled at the time of the mission. A UNIDO project provides funds for seven expatriate advisers to the division, but only three of these posts were filled. The Ministry has virtually no project identification capacity, but concentrates on preparing evaluations of private sector proposals for the New Projects Committee, which, in turn, approves projects, and recommends to the Ministry of Finance whether Certificates of Approved Enterprise should be issued. These evaluations are very short, and, on the basis of the few examples examined, inadequate. Requests for protection are decided upon by the Industrial Protection Committee on the basis of Industry Division recommendations. Evaluation of requests is ad hoc and based on no agreed methodology. There is no apparent limit to the effective protection granted 1/. The Ministry of Commerce and Industry seems to have played very little part in the preparation of the forthcoming Development Plan.

2.07 In the ministries responsible for other productive sectors the planning capability is generally rather weak. Perhaps the most serious deficiency in the past has been the inadequate planning and coordination (both in the Ministry of Tourism and Wildlife and in the Kenya Tourist Development Corporation) given to the development of the tourist industry. There is also inadequate planning staff to give as much attention to the development of such sectors or subsectors as wildlife, fisheries, afforestation and mining as their potential surely warrants.

2.08 We have, at several points, referred to the capability of the Ministry of Works, and particularly the Roads Department, to design and implement projects. However, it is clear that their capacity to identify projects has run ahead of the evolution of a strategy for the transport sector as a whole. The weakness lies mainly in the Ministry of Power and Communications (since the Ministry of Works is the implementing agency and not the policy-making ministry) and, in a broader context, with the political constraints to exploiting the potential for greater coordination of transport services and policy within the East African Community.

2.09 A somewhat similar position exists in the social services, and particularly in the Ministry of Education, where the capacity to use an ever-increasing share of the nation's resources has far outstripped the conception of the contribution which education can make to the nation's welfare. Educational planning was first introduced in Kenya in 1970 when a planning unit was established in the Ministry of Education. But so far the unit has dealt primarily with immediate problems on a piece meal basis, and has little influence on policy issues, the definition of objectives, macro-economic planning decisions or inter-agency coordination. It is understood that it is now the intention of Government to make better use of the unit in the future by involving it more closely in the foundation of longer-term plans, possibly as part of a much wider national review of education. This would be a most desirable move.

Local Authorities

2.10 We have referred elsewhere in this report to the absence of any defined policy towards local government in Kenya. This lack of commitment is clearly reflected in the paucity of planning going into the development of local authorities, both in the administrations of the local authorities themselves and in the Ministry of Local Government. The obvious exception is the

1/ One official, when asked what protection is regarded as reasonable, answered that the reasonable level is that level which ensures "reasonable profitability".

Nairobi City Council which has attempted an ambitious long-term development plan for the city. But this kind of autonomous planning must inevitably be constrained by the lack of an overall national policy for local government 1/.

Conclusion

2.11 This brief summary of planning organization, while focusing on the major inadequacies, is not intended to leave the impression of a generally deficient planning organization. On the contrary, the Mission was impressed by the depth and quality of much of the planning being undertaken in Kenya, and many of the weak points referred to above are now being strengthened, or are at least recognized as weak points. There is no lack of qualified manpower -- both Kenyan and expatriate -- in Kenya, although there will quite obviously never be enough experienced planners to do everything. The problems is more a matter of the priorities for their use. We see a need for a relative shift in emphasis from macro-planning to sector planning, with an emphasis on the one hand on increasing the absorptive capacity of the productive sectors, and on the other hand, on the development of a more systematic ordering of priorities in social services and infrastructure. We point out some of the implications of these priorities, and suggest some economies of operation in the planning process, in subsequent chapters to this Annex.

1/ The Nairobi Urban Study set out to prepare a master plan for the development of the city during the remainder of the century. However laudable this attempt, it was bound to run far ahead of national policy -- even in the short term -- in such critical areas as the overall national policy for urbanization, a workable solution to the problem of local government financing, the development of rational low cost housing policies, or a strategy of dealing with urban unemployment.

CHAPTER 3: EXPANDING PLANNING CAPACITY

Introduction

3.01 In the judgment of the Mission the capacity of the Government to plan for the needed changes in investment emphasis and to prepare and execute new programs is severely limited. There is apparently no pool of surplus planning talent beyond that needed for business as usual. That is to say that macro-economic planning, and the limited sector planning which exists, absorb all the available manpower. Indeed the planning manpower of important ministries concerned -- Agriculture and Commerce and Industry -- is already overloaded. To make rapid progress in planning and implementing productive programs, therefore, will require improvements in planning efficiency and an innovating approach to project preparation and organization. It is particularly important that each trained and capable Kenyan planner have leverage over as wide a range of investment plans as possible. Some possible devices for gaining this leverage are supplementation of Kenyan planning skills, economies of scale in project preparation and encouraging local initiative in the identification of projects and programs to relieve trained planners of this task.

Supplementation

3.02 Two forms of supplementation have been tried with great success but on too limited a scale: supplementation of manpower and supplementation of the administrative structure itself through the semi-autonomous productive institutions and closer cooperation with the private sector. Both types of supplementation should be expanded, always on the condition that policy formulation remains firmly under Central Government control. We believe that policy control will become more effective as the cadre of experienced Kenyans is relieved of much of the burden of technical work: an overworked administration, attempting to do more work than it can do, is likely to lose control of policy through its inability to give due attention to policy issues.

3.03 The Central Government can dispose of part of its burden of detailed project preparation and implementation by making greater use of both the private sector and specialized parastatals. Compared to the ordinary bureaucracy, these organizations have obvious potential advantages of flexibility and motivation, for example:

(a) A much greater flexibility, in manpower policies and wage rates. 1/
(b) A merit system for tenure and advancement of personnel.
(c) Relatively small (potential) size, avoiding diseconomies of scale.

1/ We do not mean to imply that parastatals should raid the bureaucracy by offering high wages for skills in inelastic supply. Rather the point is that the parastatals can respond to labor markets (e.g., by hiring surplus school learners at lower wages, by hiring only the labor needed for the development task, by doing their own specific training, etc.).

(d) Profit (in the case of parastatals, reward to management for financial success) as a discipline and a motive.
(e) The potential for organizing all supporting services under one administration.

The primary disadvantage of these organizations is the possible divergence between private profit (or institutional financial success) and social benefit. The problem for the Government is how to make maximum use of the flexibility of the private sector and parastatals within a framework giving maximum profit and financial incentives for socially useful activities.

3.04 In general, all policies which bring market prices of inputs and outputs closer to their social values will improve the framework for operation of the private sector by making socially useful actions more profitable. These policies -- exchange rate adjustment, more uniformity of effective protection, incomes policies, interest rate policies -- have been discussed at length elsewhere in this report. The only additional point is that the same type of policies are useful in dealing with the production-oriented parastatals; if the prices facing such parastatals conform fairly closely to social values, then the test of profitable operation is sufficient for appraisal of potential parastatal activities and for judging the performance of operating organizations. On the other hand, projects which depend on very high effective protection for their profitability, or which cannot be profitable at all, are dubious uses of funds, either in parastatals or in the private sector. It is becoming increasingly clear that private foreign investment can be very expensive to the economy in the long run if it is channeled into such activities.

3.05 In addition to the correction of price signals referred to above (and discussed much more extensively in the main report and in Annex 3), the Mission recommends that the Government pursue a more active program to directly promote private investment of the right type, both foreign and domestic. In the industrial sector this would imply expanding the team of experts in the Industry Division of the Ministry of Commerce and Industry to give it some capacity both for subsectoral planning and for project identification. To discover what product lines offer potential for development and to do the necessary preappraisal work to attract foreign or domestic firms into these lines, including a systematic presentation of the infant industry protection available and its duration, are probably the minimum terms of reference for this unit 1/. Small-scale African businessmen in established product lines also have clear capacity for improvement in efficiency and subsequent growth, and the Mission endorses the Government's plans for a Small Business Administration, with the reservation that the effort might well be even greater than planned 2/.

1/ We are assuming that the negative function of this unit, to prevent profitable but uneconomic investments, will be taken care of by policy reform. If not, then expansion of MCI, just to perform this negative role, is necessary.

2/ A discussion of small business opportunities, the Government's proposed response and a type of small business project is included in Appendix 2 to this Annex.

3.06 Promotion of agricultural production and the associated processing facilities appears to be one area which could benefit greatly from a policy of active encouragement of private investment. Potential investors are likely to be unnecessarily uncertain about such questions as access to land under long-term leasehold, estates versus outgrowing arrangements, the willingness of Government to provide infrastructural services and extension, the extent and duration of expatriate management that will be permitted, and so forth. Although the details of some of these questions will have to be negotiated on a case-by-case basis with potential investors, general statements of policy, appropriate to the pre-identification stage of investigation, would be helpful for some of them. Such statements are lacking.

3.07 The Government should particularly encourage foreign private investment in those subsectors within agriculture where market connections and high-specialized skills are prerequisites to success. The current development of the pineapple industry illustrates both a successful application of this principle and a weakness in the Government's approach to such investments. The pineapple industry, a single largely foreign-owned and controlled firm, exports about \$2.5 million worth of pineapples per year, provides steady employment to about 3,500 Kenyan workers at wage rates ranging from Sh. 225 per month for unskilled field labor (2,000 workers) to Sh. 1,500 per month for the factory mechanics to Sh. 2,000 per month for foremen. The total investment in this project was about \$7 million. Production of the fruit is heavily concentrated (97%) on the company's estate.

3.08 This industry illustrates several important points:

(a) Given the oligopolistic competition in the product, the entire industry development probably depended upon the foreign firm's market connections and brand name.

(b) The industry is very productive of wage employment both in agriculture and processing, with a very low investment cost per worker (\$2,000) or per dollar of annual exports (2.8).

(c) The industry has done very little to support or encourage Kenyan entrepreneurship. The reason for this is the failure of the outgrower scheme which was intended to produce a high percentage of the fruit. According to most commentators, the outgrower scheme failed because of difficulties in transportation (high cost and too low a reliability to insure the delivery of high quality fruit) and the low priority that the company assigned to outgrower production. It is generally alleged that the company would prefer to produce on its own estates in a completely integrated chain from farming to final product, an altogether understandable, risk-minimizing strategy on the part of the private firm.

Nonetheless, the failure of the outgrowing scheme represents a lost opportunity for real development of African entrepreneurship -- in farming, in management for agricultural markets demanding high quality, and in transport. The early identification of these opportunities, the stimulation through credits and extension of the required activities, and the assumption of risk on the part of the Government to guarantee that outgrowers would produce and deliver a certain amount of fruit, 1/ could have confined the foreign firm to its comparative advantage -- the international marketing and organization of processing. This would have made this particularly good project even better. It is the Mission's opinion that the opportunities to involve foreign private capital in similar ventures can be exploited on a much greater scale with proper identification work and that, by careful design of Kenyan participation, the benefits to the economy can be greater.

3.09 The parastatal form of organization could be more useful for rapid development of commercially profitable activities, such as high valuable crop cultivation. Some of the existing production-oriented parastatals could be strengthened with this aim in mind, and parastatals with surplus administration capacity might be given development responsibility for a wider range of products. We do not advocate the creation of new institutions; rather that better use be made of existing ones. The advantages of small size and specialization, relative to the Ministry of Agriculture, and the potential for efficient organization of supporting services have already been pointed out. These advantages seem to outweigh the difficulties inherent in bureaucratic fragmentation.

3.10 Supplementation of the bureaucracy through the addition of production subsidiaries has proven successful, most notably in the tea industry through the Kenya Tea Development Authority but also in the industrial estates program through Kenyan Industrial Estates and the large-scale industrial lending field through the Industrial and Commercial Development Corporation. In the opinion of the Mission, delegation of operating responsibility to productive subsidiaries is a sound procedure, subject only to the condition that the policy framework within which these subsidiaries operate is itself sound 2/.

3.11 Because the tea program has been particularly successful, it is worthwhile comparing this industry with the situation in other major agricultural programs where few working projects have emerged. The reasons for the

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1/ Although guarantee arrangements could prove costly to the Government in event of default, this mechanism seems the only way to keep risk of non-performance (a "development" rather than a "business" risk) from being an impediment to development.

2/ Elsewhere in the report we have commented unfavorably on some of the policy parameters within which these subsidiaries operate. It is not an adverse reflection on the subsidiaries that by efficient management within that framework, sub-optimal results are obtained.

comparative lack of progress in implanting major programs lie partly in the organization of the bureaucracy. The Ministry of Agriculture, with over 14,000 employees, probably suffers from serious diseconomies of scale, compared, for example, to the compact tea authority (KTDA). Undoubtedly, its extension agents have a much more difficult task -- general extension and farm management advice, rather than the promotion of a single crop. In addition, the Ministry works under the considerable handicap of the civil service system, supporting a large percentage of relatively untrained and incapable extension agents who, in effect, hold tenured positions. KTDA, by contrast, can work on a merit system of tenure and promotion. And finally, the Ministry suffers from fragmentation since, although it probably suffers from diseconomies of scale in extension proper, the logical correlative activities -- marketing, stocking of inputs, irrigation, land settlement, cooperative management -- are often under the control of more or less autonomous marketing agencies, the private sector, or other ministries.

3.12 No single stroke, least of all massive reorganization, is likely to solve all of the problems which impede the planning and implementation of agricultural programs within the Ministry. Rather the transformation of the Ministry into an effective development institution for small farmers is a process which must be begun now and which will yield results only over a number of years. Meanwhile, the Mission suggests a new concentration on planning and implementation of productive programs which can be split off from the slower-moving government machinery. This offers the prospect for effective implementation of these programs even in the short run, and should serve, in general, as a supplement to programs designed to increase Ministerial effectiveness, rather than as a substitute for that effort.

3.13 The example of the KTDA suggests that it is possible to organize a complicated small farmer production and marketing program quite efficiently when the scale of the overall operation is manageable and the management is able to concentrate, with some autonomy, on a single specialized activity which offers high potential returns to croppers. These organizational features of KTDA, combined with the relatively high return in tea, offer the best explanation of the apparent anomally of very efficient operation of a complicated production and handling process within a sector which has not succeeded very well in organizing the much simpler and less demanding processes of maize or cotton production by small growers. The Mission suggests, therefore, that in other fields of potentially high return to croppers, the basic organizational structure of KTDA might be duplicated 1/. This would require reorganization or expansion

1/ An obvious objection, that manpower would not be available for duplication of KTDA management and extension teams, is not valid in the opinion of Kenyan specialists in government personnel. Sufficient underutilized talent, particularly in middle management, appears to be available from within the agricultural bureaucracy. The same experts in personnel point out that KTDA has expanded and succeeded under Kenyan manpower, most of it drawn from the agricultural bureaucracy.

of existing parastatals to bring extension, input management, wholesaling, and exporting for a particular crop under the direction of a single agency responsible for its development. The existing Horticultural Crops Development Authority could, for example, provide the nucleus for several specialized crop development efforts 1/. The Mission does not have the qualifications to determine which parastatals should be upgraded to first class development institutions. (HCDA was cited as an example of a possibility.) Rather, our recommendation is that serious attention should be given to upgrading and assigning development responsibility to some of the parastatals which now serve only regulatory or marketing functions or, if necessary, to creating new parastatals for development purposes 2/.

3.14 By delegating a large segment of the implementation and operation of required productive investment to the private sector and parastatals, the Government reduces its planning task to setting out the correct guidelines and incentives within which these organizations will operate. Control is not lost in this process; it is indeed probable that these organizations will perform more efficiently than the Government since private (institutional) project incentives can be equated to social profit incentives through correct use of policy tools.

3.15 A second form of supplementation that is now underutilized is the direct addition of manpower from outside the Government establishment to work in micro-economic planning. Most of this manpower would have to be recruited from outside the country. This could be accomplished through a redirection of bilateral technical assistance. Kenya could also make greater use of resident consultants from the private sector and such groups as the Institute for Development Studies could be recruited for project work. Local knowledge is of course desirable, but except for initially identifying projects, it is not indispensable for most of the technical project preparation work. Therefore, in our opinion, the Government should be even-handed in its recruitment of technical experts 3/. It is worth noting again that in just those areas where supplemental manpower has been most heavily utilized for planning, absorptive capacity has ceased to be a problem.

1/ At present HCDA has neither the staff nor the budget for a major development effort but important pre-conditions to a development effort -- large productive potential, some experience, a wealth of studies -- already exist.

2/ The recent Agricultural Sector Survey has made various suggestions for the merger or expansion of boards. See IBRD Report No. 254-KE, Volume I, Chapter V.

3/ An exception would be the manpower required at the immediate post-identification stage. Since this initial evaluation is less technical and more a matter of quick judgment of the feasibility of the proposal within the context of the economy and the Government administration, local expertise and judgment is a primary requirement. This is why (para. 1.10) we have suggested that Kenyan experts, suitably supplemented with technical subordinates on long-term contract, be concentrated at this level.

Economies of Scale

3.16 It is a cliche among planners and among donors that the planning work going into a one million dollar project is very similar in extent and difficulty to that of a twenty million dollar project. It follows that the larger the projects are, on the average, the more can be done to increase the rate of growth of investment in the productive sectors with given planning skill. There is no apparent disagreement from Government that large projects should be sought. This section will not therefore discuss the principle of large projects but rather some ways in which larger projects can be identified and implemented 1/.

3.17 The most obvious way to achieve economies of scale is to define projects as broadly as possible. A "project", subject only to the condition that it retains sufficient clarity to be managed to the production stage in a unified effort, might, at an extreme, embrace an entire subsector program. We have found much support, both in the planning organization, and in the external aid community, for very broadly-defined projects which aim to affect a great number of people and to concentrate decisions about sectoral and sub-sectoral alternatives within a given project preparation 2/. Some of the most urgent planning tasks in agriculture could be approached on this basis. For example, the future development of crops such as sugar, oilseeds, tree crops or horticultural commodities probably needs to be planned on a nation-wide basis, through broadly-based programs designed to integrate all aspects of research, production, marketing and program. On the other hand, other priorities in the agricultural sector - and particularly the design of a major development strategy for the drier arable areas - seem more suited to broadly conceived regional programs. But the broad approach need not be confined to agriculture. We suggest elsewhere that small business assistance and even road planning would benefit from a broader sector or subsector investment program preparation (see Annex 6). This process is virtually automatic in the case of some development oriented parastatals (e.g. the existing organization of the tea industry), where everything from input supply through extension and processing to final marketing is the function of a single management. Elements of a broad program can be organized, however, without necessarily concentrating all power within a single agency. The Government has already had some successful experience along these lines in such programs as livestock development and industrial forestry; but in general, the device of unified subsector programs is underutilized.

1/ The Mission found that some people interpret "large" projects to mean "capital intensive" projects or, worse still, that this is the criterion by which a project is judged to be "Bankable". Let it be clear, on the contrary, that our concept of "large" projects are typically programs of low unit cost, which are large mainly because they are designed to benefit a large number of people.

2/ The Mission found a great eagerness on the part of donors to support integrated programs of sectoral or subsectoral development, with greater or less stress on their preparation as identifiable single projects depending on the sector and the donor. It is our impression that the Government underestimates the donors' flexibility in the design of major subsector programs.

3.18 The preparation of these broad-based projects or programs is anything but easy. But they are worth striving for, not only because they can use planning manpower more efficiently, but because they should result in more effective planning and a better allocation of resources. A single nationwide oilseed development program, for example, would be less likely to make allocation errors, or to leave gaps or cause duplication, than a series of smaller and uncoordinated oilseed production projects. Moreover, at a time when Kenya is short on well conceived sector strategies, this subsector or program building can go a long way towards assembling the components of an agriculture sector strategy 1/.

3.19 A second scale-increasing device is to expand a production-oriented project to include both indirect benefits and indirect costs. This may simply mean undertaking several separate but related investments concurrently and treating them as a unit. For example, a project to improve husbandry methods of subsistence maize producers in a given locality might be combined with the introduction of a high value crop, the provision of required water, transport and processing infrastructure and the provision of basic health and technical education services. Not only would this bring many separate fixed investments under one planning exercise, but it would also bring into the project analysis many of the indirect benefits and costs. In our example, the latter would include the increases in Government overheads and recurrent costs caused by the different services required in going from the minimal government support for subsistence maize farmers to the more complex package required for diverse market production.

3.20 There will, of course, be a loss of apparent precision in project evaluation with such broad project definitions. On the plane of pure logic, it is clear that this loss is apparent rather than real; the indirect costs and benefits are the same as those required for the success of a much simpler maize project, but they would typically be covered by fairly imprecise assumptions about indirect project effects in a narrowly-defined maize project if indeed they were considered at all. The accuracy of the micro-economic analysis is thus seen to improve as the project is broadened, although the project itself is more difficult to evaluate. As to the planning and financing problems associated with such complex projects, we can only repeat that donors appear anxious to direct technical assistance effort to this kind of work, and that foreign financing of the indirect project components is clearly more likely if they are included in production programs than if they were excluded.

1/ This is another example where the best can be the enemy of the good. To wait for a fully-fledged agricultural development strategy - in which everything is optimized and coordinated - is to wait for a long time. In the meantime, four or five soundly-conceived subsector or commodity programs, with a heavy emphasis on implementation, could have a marked effect on agricultural production and incomes in a relatively short period.

3.21 Program planning and operation would be more difficult than project work because by its nature a program cannot be managed as a unit up to the operating phase. For example, elements of a major maize production program (if one were launched) already exist; the extension agents to service the program are already effectively tenured, a marketing board is already operating, and various public and private input supply agencies (from fertilizer and hybrid seed to credit) are already in the field. Program design would imply a massive coordination effort of agencies only partially suited to a development effort, rather than the creation of a unit to undertake a specific development task. Each of the existing units which would have to be incorporated in a maize production program has its own bureaucratic inertia and its own set of operating policies. The Mission suggests that the Government give strong consideration to preparing one or two major crop development plans, complete with required management systems. If such a program or two could be identified, and obtain Government commitment in principle, the technical work of preparation could be delegated to suitably directed technical assistance teams. We believe that financing for such a major crop program could be arranged with little difficulty (see Annex 6).

3.22 Another proven method for achieving economies of scale in investment is to design projects which can be replicated with little or no variation. This method is particularly suitable for use when the target activity is carried out by a number of small enterprises all of whom need a package of project assistance. It overcomes two difficulties in this type of project situation; the ineffectiveness of a single service (e.g. credit) when a number of services are required (e.g. credit, extension, input supply, marketing) and the scarcity of personnel required to plan and implement the package of services 1/.

3.23 The planning economies in replicable projects come from spreading a given planning effort over many project units. Given the fact that it will be reused again and again, the plan for a very small project can economically be given the same attention that would be given a project equal in size to the sum of the many replications of the small project. In other words, a serious project identification, financing plan, detailed preparation and execution can be carried out for a small project.

3.24 Examples of project replication are treated in Appendix 2 to this Annex. The Mission believes that this approach is applicable to at least the following:

(a) Minimum package programs for small-scale agriculture. Under these programs, a representative unit is identified. The

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1/ An important side effect of replicability is that it makes it easier to avoid the use of foreign personnel in actual project implementation. Experts, from whatever source, can do the preliminary design and planning work and the model applications of the project while leaving the replication process to local personnel. Moreover, standardization and simplification of design can usually allow personnel of limited academic qualifications and experience to be employed in implementation.

required services and other inputs are planned in detail, the representative unit is appraised, and, if economic, the units similar to it are provided with the planned services.

(b) Small business credit and extension services. For each of several activities (each containing a large number of small firms) a detailed operations plan (including plans for investment, production, inventory management, sales, accounting and control) is designed. This package of information, together with needed technical assistance and credit, are then provided to as many potentially viable firms in the business as can be identified.

(c) Site and service programs for agriculture. In each of several regions, a small parcel of land is procured and prepared with all necessary services and inputs to produce a high value crop suitable to the region. Farmers from the immediately surrounding region are invited to rent on a share-crop basis a portion of this land (say, half acre to an acre per farmer) to produce the designated crop under close supervision and guidance of an extension agent whose responsibilities include looking after input supplies and transport/marketing arrangements.

3.25 A desirable feature of each of these programs is that they attack directly the problem of the small, usually poor, and usually hard to educate Kenyan small businessmen and traditional farmer. Once designed, all of the programs can be staffed by relatively junior personnel because the job of project management is very specialized; it requires far less skill and training to teach several clients the same thing than to give unique assistance to each client. Each of the projects affects a great number of productive units which otherwise might be too small to be assisted.

Encouraging Local Initiative

3.26 There is little scope for local initiative in project planning, implementation, or operation within the present vertically-organized ministries. Local governmental units have no development funds of their own and no hope of generating them given their present tax base. The historical pattern has been to increase concentration of revenues, planning, decision-making and administrative control under the Central Government Ministries in Nairobi. Although this centralization was probably necessary because of shortages of trained administrative personnel, it has effectively cut off the flow of productive ideas from the local operating units of the ministries. The coordination of inter-ministerial activities at the local level, which would be necessary for all but the simplest projects, is quite difficult in a situation where each local officer is primarily responsible to his Ministry in Nairobi. There have been some attempts at investment planning from the bottom up, but these have resulted in impossible shopping lists of inadequately analyzed ideas; their effect on the investment program of the ministries has been minimal.

3.27 As discussed earlier in this Annex, we believe that local initiative in project identification is a necessary condition for an adequate investment pipeline in the productive sectors and that the best way to stimulate this initiative is by central response to the project ideas coming from the field staff of the ministries. To the extent that a project falls within the jurisdiction of a single ministry, this implies nothing more than strengthening the ministry ot provide staff for this function. Inter-ministerial projects, which probably constitute the majority of worthwhile ideas, will require a more cumbersome working group approach, but the sponsorship of the project by an expanded ministerial staff can speed this process.

3.28 The Development Opportunity Team is an experiment in its early stages, hardly more than a concept. The idea of the D.O.T. is that a team of project evaluation specialists based in Nairobi, probably in the Ministry of Finance and Planning with channels into ministerial headquarters, would do field work to help in the preparation and appraisal of projects identified at the local level. In our opinion the D.O.T. could be most useful as an instrument for performing the screening function for projects financed by district development grants.

3.29 District development grants, a device for transfering small allocations of Government funds to the districts for use in approved investments, have potential to become an important stimulant to local initiative. They have, until now, been quantitatively unimportant and their use has not been tightly controlled. Lacking central control, these grants have often been diverted either to projects of doubtful productivity or to projects in the social service sectors which have little to do with the basic development purpose of the grants. If the transfer of resources to the district were accompanied by a strong screening process, however, the grants could become a useful device for decentralizing investment to some extent and thus shifting some of the burden of development planning and execution from the central ministries.

3.30 A project consisting of funding for an expanded district grant program plus a project evaluation team, such as the D.O.T., to screen and improve local project proposals would also introduce some flexibility into the government investment program, which is now too centralized, and would make use of the initiative of the district governmental team in projects of a manageable scale. In expanding this program, by adding a project team, and increasing allocations, the control mechanisms would be strengthened automatically both by the process of economic evaluation and by the increased visibility of the program. This combination of increased visibility and effectiveness might also have a strong education effect for local politicians. To the extent that these projects produced noticeable increases in employment, incomes, and standards of living in the local area, they should pay political dividends. In the relatively short run, it might therefore be possible to attract the kind of political attention to the productive sectors that has so far been monopolized by the social services sectors, which are now under strong direct local pressure to expand through the Harambee device.

3.31 The emerging practice of disaggregation of the national plan and the investment budget to the district level will also encourage local initiative to the extent that district officers become involved in constructive criticism of the plan. Because ministerial plans are prepared independently, there is ample scope for imbalances and inconsistencies in any single district. To bring these to the attention of the Central Government is a useful bureaucratic function as well as a potentially important learning exercise in planning and coordination. At present, plan disaggregation is concerned only with identified projects. It would probably be useful to expand the exercise to include indicative investment totals that could be financed if well conceived projects were found, disaggregated by district and by economic sector.

3.32 Although attempts have been made at district development planning, ranging from solicitation of investment plans, from general district level ministerial staffs who are inadequately trained to produce them, to the preparation of detailed comprehensive plans for some districts by a team of experts, these attempts have not produced a worthwhile increase in workable investment projects. For the present, the Mission does not expect district planning to be a stimulus to local initiative: district staffs themselves are too inexperienced in the art, and imported experts have not succeeded in stimulating local input into the fancier plans that they have attempted 1/. In the longer run, with growth in the number and quality of planners available, the district planning idea might profitably be reintroduced. For now, what planning talent can be spared for work on the district level, should probably be channeled into work in project identification.

1/ There is an additional problem of effective policy making by foreigners if these development plans are taken seriously. It appears far more advisable to confine the foreigner to a technician's role.

CHAPTER 4: IMPLICATIONS FOR PROJECT DESIGN AND APPRAISAL

The Need for New Types of Investment

4.01 The need to increase investment in the productive sectors has implications for project design as well as for planning. We have already noted some of them in the discussion of Chapter 3 (covering economies of scale in project preparation). Broadly-defined projects and programs were shown to be ways to get more investment per unit of planning effort. More broadly, the situation in the Kenyan economy dictates that any large increase in productive investment will imply movement to new types of investment. Sector by sector we observe:

(a) In manufacturing, the scope for efficient import substitution - which has been the main engine of industrial growth in the past - is diminishing, and the potential for further export of import substitutes to the EAC market is also limited by the industrialization programs of the other Partner States. The underlying strategy of this report has emphasized the major priorities for industry; to place greater emphasis on resource-based manufactures for export, to promote small-scale enterprises, and to reform the incentives system to improve the efficiency of the private manufacturing sector and avoid the more costly, later phases of import substitution. 1/ We have indicated in the previous chapter that new directions of this kind will require an increased planning capacity. But there is also a clear need for new and better project ideas if the desired new emphases are to be attained without a slackening in the momentum of industrial growth.

(b) In the agricultural sector, the potential for productive investment and growth is enormous. But the opportunities as well as the priorities are changing. Some of the export crops (such as coffee and tea) on which Kenya has built up her agricultural industry are facing uncertain market prospects. Investment associated with the transfer of the previous Scheduled Areas to Kenya ownership will dwindle as the remaining foreign farms disappear, and other large programs such as land registration are reaching diminishing returns. A great challenge lies ahead in building on to and extending the firm foundation already laid in the agricultural sector. But like manufacturing industry,

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1/ In fact, Kenya has already gone well beyond reasonable exploitation of the import substitution device for industrial growth in several fields. "Deepening" import substitution by producing a wide range of protected intermediate goods is discussed, with strongly negative conclusions, in Annex 3.

agriculture is another case where new sources of growth must be found. The obvious under-exploited resources are the land and labor presently locked up in the agricultural smallholdings, including the subsistence agricultural sector. But as the Bank's recent agricultural sector survey has pointed out, the techniques for developing this potential are not yet generally available. If a large incremental investment in agriculture is to be achieved, new projects will have to have a new style and a new and greater scope.

(c) In the infrastructure sectors, where there is excess absorptive capacity in the sense of the capability to identify and implement investment projects, our macro-economic strategy calls for a stabilized, if not declining, allocation of resources. In some sectors this will also entail a lower growth rate, while in others it will hopefully be possible to maintain past rates of growth, despite a lower investment rate, through the more efficient use of resources. This will demand not only the careful consideration of priorities within each sector, but a systematic effort at designing projects which can be made to stretch the available resources further. 1/

(d) In the social sectors, Kenya is faced with the need to clear up distortions in incentives and provide a development focus to its investment effort (education sector) or to start virtually from the beginning to design whole programs (population control) or to decide on the very highest priority services in cases where the obviously desirable level of services is beyond the budget capabilities (health care, potable water, water supply in general). In none of these sectors are there obvious solutions awaiting only the infusion of large amounts of investment funds. Furthermore, clear international as well as Kenyan precedents are lacking; program preparation will be very tough work and innovative approaches are clearly necessary. 2/

1/ As pointed out in the main report, we feel that there is considerable scope for lower ICORs (and thus greater output per unit of investment) in the infrastructural sectors, particularly in construction.

2/ The rural water supply system of financing and planning is both an exception to the general rule of inadequate program development and an example of the type of innovative approach that Kenya can and must develop in the social sectors.

4.02 Even if there were no absorptive capacity problem as such, other goals (in addition to growth of output) would require innovative approaches to project preparation. Kenya is committed to helping its poor to develop, be they subsistence farmers or small-scale businessmen and their employees, and this commitment would call for direct investment action in support of these groups, even if ample potential for inducing growth existed in the modern industrial sector, the large farm sector and large-scale business. Trickle-down effects have not been reliable in relieving poverty either in Kenya or in many more advanced countries. Direct investment action to improve the productivity of poor persons is probably called for, pursuant to the goal of eliminating the worst excesses of want, whether or not this would maximize growth. However, the macro-economic and sector analyses seem to indicate that there is not much of a trade-off between growth and poverty relief; the more prosperous sectors are not the sectors where rapid growth in investment can be anticipated. The maximum under-utilized potential appears to lie in the resources: land, labor and small business ownership, of the poor.

Methodological Problems for Required New Projects

4.03 The stress on new types of projects which must characterize any serious effort to increase investment in the productive sectors will bring with it an accentuation of some common methodological problems and some new ones. In this section we attempt to anticipate some of these problems and suggest solutions.

4.04 Evaluation of Outputs and Inputs at Economic Prices: Many of the required projects would produce outputs which until now have been relatively discriminated against by major Government policies. Thus, for example, the value of foreign exchange earned by agricultural exports, the correct domestic price of foodstuffs, and the value of the output of informal sector manufacturing as compared to domestic industry, would all have to be calculated. Observation of present prices would be misleading, given the distortions in the pricing system. An internationally agreed system (or rather a set of closely related more or less agreed systems) exists for evaluating project outputs and inputs at economic prices even in the presence of serious distortions in observed prices in the market. The problem is a technical one and considerable experience with the solution has been compiled by the Institute for Development Studies and various international consultants to Kenya. The problem reduces to one of calculation of the relevant package of shadow prices within the Kenyan growth program, factor endowment, and policy framework. 1/ Using all these sources of expertise, there should be enough manpower to subject at least the more important projects to an adequate evaluation.

4.05 Were it not for the fact that price distortions facing the productive sectors are so many and so large, the risk of error inherent in departure from observable market prices would perhaps outweigh the advantages of a calculated-economic-value approach. The risks are clearly great; for example: the use

1/ See Appendix 1 to Annex 3.

of shadow prices to reflect no more than prejudice, the "justification" of projects with rigged but superficially plausible shadow prices, and the risk of gross error in observation given the generally weak statistical base. But the solution seems to be to approach shadow prices (particularly those prepared ad hoc for a particular project evaluation) with caution and suspicion, checking to determine that they are firmly based on careful calculations of opportunity cost. The shadow price tool is simply too valuable and necessary to throw it out because of its frequent abuse.

4.06 Quantification of Benefits and Costs: Quantification of benefits and costs will become more complex and subject to greater apparent error as projects are defined more broadly or as sector programs are introduced. We have argued earlier that the analysis of broadly defined projects would probably be more nearly correct, and that the apparent increase in error is an illusion created by including more of the errors in the project itself rather than omitting them from consideration altogether by defining projects narrowly. Nonetheless, broadly defined projects do introduce serious quantification problems, for example, if health services are included in a rural development project, quantification of health benefits is necessary.

4.07 The increased complexity of broadly defined projects or subsector programs implies an irreducible effort in their preparation, and the Government is not yet equipped to prepare and execute many such projects using its own planning and management resources. On the other hand, most of the donor agencies would be more than willing to undertake a large part of the preparatory work and the execution phase of major programs, either by diverting technical assistance or as part of a project loan or grant, if the Government were committed in principle to the project. The Government's input could thus be reduced to project identification and the crucial commitment in principle to undertake the project. An additional problem in connection with financing of a major project may arise if the project is too big for the single donor who does the preparation to undertake alone. However, with early commitment to the project on the part of the Government, international sharing of the financing burden can usually be arranged concurrently with the project preparation. It need not necessarily produce an additional long delay.

4.08 Definition of the Project: The logical limits to an expanded project or program will generally be far less obvious than those of an infrastructure project. To cite only one example, much of the expense of a successful maize production program would be incurred in further training, management, and employment of extension agents and more generally in the overhead activities to set up a machinery for delivering development services to smallholders. The infrastructure for such a program might be very small, the imported inputs relatively minor, and the expense spread out over many years, so that the inclusion of import costs or infrastructure costs or even of start-up costs misses much of the expense. Another difficult evaluation problem for Government is caused by the need to allocate shared costs and joint products between the programs in question and the ordinary recurrent budget. A counterpart to the evaluation problems caused by the difficulty of defining a project will be the difficulty of agreeing with donors on the reasonable limits to projects.

As projects shade off into ordinary administrative recurrent cost on the one hand, or into parallel investments out of favor with donors, one the other, the Government can anticipate greater trouble in negotiation for support.

4.09 To the extent that methodological problems arising from logically indefinable limits to a program are mostly due to the institutional rules of donors, they can be solved by pragmatic compromise on a case-by-case basis. The Mission has no solutions to suggest beyond early definition of the Government's view of the proper limits of the project so that these difficult, often multi-lateral, bargains can be struck during the preparation phase thereby reducing delay to a minimum. In addition, it is the Mission's clear impression that donors are, with few exceptions, prepared to be more flexible than the Government gives them credit for. We would urge the Kenyans to be less restrictive in their own definition of projects. No time is lost in going to a fallback position, if necessary, provided this is done early.

4.10 The more technical problems of project valuation can be relieved, to some extent, by a much greater stress during project preparation on the management system and the programming of inputs at the operating stage. This concentration is necessary, in any case, if the transition to operations is to be smooth and quick, and the identification of input costs can be considered a by-product of good preparation for management. Joint cost and multiple product problems will, however, persist as "judgement areas" where reasonable men can disagree. This puts a premium on early preliminary identification of the program's limits in order to clear up these disagreements as soon as possible.

4.11 Risk. Risk is an ordinary problem in project evaluation to be handled by careful analysis of the sensitivity of the social return on investment to reasonable probable variations in the benefit and cost elements. If probabilities can be assigned to various possible costs and outputs, risk can be quantified and the social return on the project expressed as a net-of-risk return. For the innovative projects recommended in this annex, risk will not generally be quantifiable because we have no experience with similar projects. Risk is an important problem if the innovation depends upon the cooperation of the private sector. For many activities, ordinary business risk may be minimized by a less innovative approach having less development impact. In such cases the Government should probably intervene as risk taker, isolating the private sector from some of the uncertainties of developmentally motivated processes.

4.12 The example of the pineapple canning industry cited in Chapter 3 is a case in point. Had the Government been prepared to assume the risk of guaranteeing a supply of suitable fruit to be produced by outgrowers, this good project might have been made much more productive of small-scale entrepreneurial incomes and management experience. As it is, the entire production chain is under the central entrepreneurship of a foreign firm.

Some Difficulties Arising from New Project Designs

4.13 Programs that are large, geographically diffuse, and concentrated in software, rather than infrastructure, present special difficulties of project preparation and financing. This section attempts to anticipate some of these, as well as suggest solutions.

4.14 Loss of Visibility. Project visibility may become a major issue as programs with a larger scope are introduced. Not many of the new type of investments have built-in monuments, such as large infrastructural or fixed-plant requirements, and even where such requirements are present, a range of much less visible software will usually constitute a greater part of project cost. Very heavy local concentrations of software effort are probably not economic, considering the widespread national need, so it is doubtful that visibility problems can be solved by donor identification with development in an isolated area. 1/

4.15 The problems of visibility will eventually be solved, if at all, mainly by a change in donor attitudes. There is simply no way to make some of the most important projects visible in the sense that infrastructure or fixed capital is visible. However, visibility of a different type can be obtained by skillful packaging and by an unremitting stress on the output of the programs rather than the inputs. 2/ If, for example, an investment package could be designed so that donor A can be clearly associated with the increase in sunflower production due to oilseeds project (or better still with the value of that output, or the increased income to the rural poor as a result of that output) a considerably more meaningful visibility could be achieved.

4.16 Critical Mass and Political Constraints. In some instances, opportunities for productive investment will be geographically concentrated. For example, the Nairobi area and the areas surrounding the Mumias sugar project or the Broderick Falls pulp and paper project would be logical locations for projects designed to stimulate small-scale business, because of the existing or emerging concentration of consumer purchasing power. In other instances, the attempt to bring about any development may require so large a minimum package of Government inputs, that the areas would be getting a disproportionate share of public help. In still other instances a larger package of Government inputs may be the most efficient way to plan and promote development. In all of these cases, projects face strong political opposition to the geographical concentration of expenditures.

1/ The concentration of great resources in a small area, which has occurred under the Special Rural Development Program, being irreplicable on account of insufficient funds, has generated reasonable jealousy and antagonism from the much more numerous excluded areas. Thus a political problem has arisen in addition to the economic one mentioned here. S.R.D.P. has nonetheless, made important contributions. See Agricultural Sector Survey, Kenya, op cit, Annex 8.

2/ When the usual visible project is "completed", after all, the road or the factory is still only an intermediate good.

4.17 To the extent that the services provided are social services more or less loosely related to the productive investments, the Mission has no advice other than that the Government attempt to extract payment for services from persons able to pay for them. In the case of directly productive investment, for example, building up consumer-oriented industries to serve the 10,000 newly-emerging middle-income earners at Mumias, the Mission would urge a focus on the income level of the beneficiary of the Government service rather than the income level of the area. If projects are concentrated on the small entrepreneur and the small farmer, and through them aid their wage employees, they will be directed to the very lowest income groups. And, in the Mission's opinion, the Government should make every effort to overcome the political obstacles to helping these groups in those areas where high concentrations make this aid most efficient.

4.18 It goes without saying, that, in cases where a package of services is required (e.g., improving productivity in subsistence crops), the provision of Government services at sub-minimal levels in order to spread the services geographically is wasteful of resources. The question is partly technical (how does the marginal return to a third dose of services to one subsistence farmer compare with the marginal return of a first dose to another?) and partly political (at what level of development should a farmer be left on his own in order to aid less developed farmers, regardless of the comparison of marginal returns?). The Mission feels that the technical choices should be made by carefully weighing the alternative economic benefits against the cost. As to the political problem of just how far the relative economic benefits should determine allocation, we have no suggestion except to note that to the extent a program takes the very poor as a subject for development, even a heavy concentration of services would tend to improve the overall equity of the system.

4.19 Project and Program Administration. Finally and perhaps most seriously, the details of project and program administration, in broad-gauged projects, will tend to merge with the ordinary workings of the bureaucracy. This is all to the good, if the program is planned well enough so that it continues uninterruptedly from implementation to operation. But the control of processes and procedures very quickly passes out of planners' and donors' hands. Project leverage, as such, just won't amount to very much and the emphasis must shift to improving the ordinary institutions of Government to a point where both Kenya's planners and donor agencies can be confident that the program will be well administered within the bureaucracy.

4.20 The problem of reduced project leverage and control, and the consequent uneasiness of donors, can probably best be handled by an additional emphasis during project preparation on the management mechanisms for the operating phase of the project. There is no reason in principle (or apparently, in fact) for donors to prefer separate administration and levers on that administration if they can be assured in advance that the program will be well administered within the ordinary bureaucracy. On the contrary, since the development of an efficient and development-oriented bureaucracy is partly a precondition to and partly a highly desirable result of development, the early and effective merger of a program into the bulk of the Government programs, while it continues to produce its development impact, is in a real sense an ideal result. To demonstrate that this result can be achieved -- first by showing in careful project preparation how it could be achieved and later by making a success of such a broad-gauged program -- is a clear challenge to the planners, to the cooperating donors, and to the bureaucracy.

Packaging Projects for the Donors

4.21 Each of the donors who support Kenya's development effort has special institutional rules and, at least to some extent, unique preferences. The large number of donors involved relieves Kenya of the need to tailor its development effort to the investment preferences of any one of them, and donors who might be extremely ill-equipped, institutionally, to handle some development programs might be ideal for others. 1/ Matching these specialized donor availabilities and insitutional constraints to the requirements of productive investment programs is a high priority planning task which would pay dividends in increased aid, the best available terms, and minimum delays. It is the Mission's clear impression that Kenya is devoting far too few resources to this matching problem. Only about five professionals (including the supervisor) are employed in the unit in charge of coordination of all technical assistance and international aid -- an annual program of commitments in excess of $100 million in total, scattered among a dozen significant donors, and literally hundreds of separate grant, loan, and technical assistance projects. This is not enough personnel to maximize the Government's investment flexibility by making full use of the insitutional differences between donors.

4.22 Cooperation and coordination of several donors may be required for some of the most important projects. Although necessary, this coordination is an additional project task, and has its costs. An important special case of problems of coordination is the reluctance (or refusal) on the part of some donors to accept each other's identification and appraisal work. The least offensive result of this policy is duplication of work and delay. The most serious result is the (often tacit) refusal to consider projects which are being or have been considered by other donors. This will become a still more important problem to the extent that project identification and pre-appraisal bottlenecks to increased investment must be broken with the aid of foreign technical assistance.

4.23 International cooperation and coordination, on the program or project level, is a very difficult task given the differing institutional limitations of the donors and the varying delegation of responsibility to their Kenya-based representatives. It is the Mission's impression that there is a great potential for vastly improved coordination of this kind. At a minimum it should be possible to decide for each donor the general limits of acceptability, of preliminary project or program work done by other donors. The Mission also suggests for the Government's consideration, that the Bank might provide a useful coordinating service whenever the Government has committed itself to

1/ An interesting case in point is the general surplus in U.S.A.I.D. of funds, including funds for local procurement and recurrent cost support, earmarked for use in family planning programs.

carry out a large program which will obviously need help from several donors. Although we can claim no expertise in this role, it appears that an honest broker could solve many of the coordination problems before they delay execution of projects.

Conclusions: Residual Problems for the Donors

4.24 This annex has made several suggestions for improvements, and changes in emphasis in Kenya's development planning. Each of them was made in the spirit of expanding the development effort, closing the gap between Government investment goals and the volume of well-prepared projects, and easing the problems of international cooperation in Kenya's development effort. At the end of the day, however, it must be recognized that greater concentration of Government effort in productive sectors and among the poorer portions of these sectors is inevitably going to put intense strain on the usual practices of donors. To cite only the most obvious examples, large geographically dispersed programs aimed at aiding the large mass of business or farms are inevitably going to entail, among other things: a closer coordination between technical assistance and the project cycle, a higher proportion of local costs, much smaller procurement packages requiring more flexible procurement rules, a need (often) to cooperate with other donors or accept their preliminary evaluation results, and (often) an early loss of project control. Because we consider the solution to these problems to be of major importance we devote a large part of the next annex, "Priorities for External Assistance" to a discussion of possible donor responses to them. In conclusion to this annex, we recommend to the Government of Kenya that they be bold, innovative and aggressive in preparing and presenting projects for financing, and that they act on the assumption that sound, well-prepared projects will generally find financing (up to a fairly flexible limit to financial availability) in spite of the institutional limitations of the donors. We reiterate that these limitations are, in general, probably flexible enough to achieve this result.

APPENDIX 1: STRENGTHENING MANAGEMENT IN THE MINISTRY OF AGRICULTURE

1. There is a concensus that the Ministry of Agriculture is weak in its detailed programming of work to be done by its large and scattered field staff, its management of that work and its monitoring of the results. To some extent this has been reflected in the implementation of individual capital projects, leading to dissatisfaction within the Government and complaints among aid donors of a planning-implementation gap. But it is still more noticeable and certainly more serious in the programming, management and monitoring of activities covered by the ordinary recurrent budget. Being about half of total expenditures of the Ministry, recurrent budget activities are clearly important. Furthermore, any agricultural project eventually comes under the ordinary workings of the Ministry when, in its operating phase, it loses its identity as a project and becomes only one of many facets of the operating program. 1/ The eventual productiveness of any project, therefore, will depend largely on management within the Ministry; "shielding" a project up to the operational stage by isolating it from Ministerial management closes only the planning-implementation gap, and may do very little for the output-effectiveness of the project.

2. A second weakness of the Ministry which has been discussed in this annex is insufficiency of project planning and sector and subsector planning. This is due partly to a shortage of planning personnel and partly to the organizational position of the planning staff within the Ministry. As presently organized, the planning staff performs a mixture of macro-economic planning, policy planning and administrative functions, with detailed project and program planning being a residual claimant of time.

3. This annex presents a suggestion for reorganization of the planning staff to include a strong programming, management, and monitoring function (which is at present simply absent), to clarify the responsibilities for micro-economic planning within the Ministry, and to increase the staff for this planning. The suggestion will require substantial increases in manpower and most probably in expatriate manpower. Indeed the entire set of recommendations can be viewed as a proposal for a large bilateral or multilateral technical assistance project, and the Mission strongly commends such a project to those bilateral donors anxious to shift their technical assistance toward directly productive programs.

4. Because the Ministry of Agriculture is responsible for directing the Government's agricultural program in close coordination with several other ministries, for supervising the very large agricultural extension service and for controlling many parastatal agencies, the Permanent Secretary of Agriculture

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1/ Exceptions are projects operated as separate entities by parastatals, where the control of the Ministry is indirect and day to day management functions reside in the parastatal. It is this feature of parastatal which prompts the Mission to recommend their expansion during the early phase of the development of the Ministry's management ability.

probably has the most complex management task in the entire civil service. The single most difficult and most important part of this task is to design and implement a more effective system for delivering development services to smallholders. With the growing emphasis within the Ministry on development of small scale farmers, there is a good opportunity to reinforce the Ministry's efforts to develop such a delivery system. More generally, the management arm of the Ministry for delivering and coordinating all forms of development services needs to be strengthened.

Programming and Budgeting

5. Reflecting the Ndegwa Report's recommendations for the systemization of management procedures, the Mission recommends that a Programming and Budget unit (P. and B.) be permanently established in the Ministry. Its exact location is of less importance than that it be established, but it is essential that it is located where it can perform its true function of supplementing the management function of the Permanent Secretary. The Mission feels, for this reason, that the P. and B. unit and the Planning Division must be closely linked, if not merged, with direct access to the Permanent Secretary.

6. The first major task of P. and B. would be to design and introduce the operation of an integrated delivery system for services to increase the productivity of small scale farmers. The focus of the unit's work would be on detailed management, ensuring that efficient systems were developed for using the skills and the time of ministerial field staff and for coordinating with counterparts in other ministries and the private sector in order to complete the tasks set by policy makers and planners as efficiently and quickly as possible. P. and B. would have no policy-forming functions, and would work entirely through the existing mechanism of the Ministry.

7. Other tasks for P. and B. would arise at intermediate and later stages in the project/program cycle. For any project which would use Ministerial personnel in its operating phase, P. and B. would design the delivery system for the services, do the necessary financial budgeting and detailed programming of manpower use, and finally monitor the operating phase of the project to enforce and/or correct the plan for use of manpower and other resources. With the extension of detailed programming and monitoring over a wider and wider range, it is natural that P. and B. should be responsible eventually for such overall tasks as the preparation of the annual financial and manpower budget, for preparation of general management systems and for outlining programs of work and manpower use for the Ministry. Thus, we suggest that it should become the primary management tool of the Ministry.

8. The demands that P. and B. would eventually make on qualified Kenyan staff are substantial, reflecting the fact that management is an important and very difficult task in such a large ministry. At the outset, however, the nucleus of the unit sufficient to the task of designing and managing a system for delivery of development services to small farmers might be composed of a few competent Kenyan officers:

Head of Division (Administrative experience)
Manpower Programmer (Personnel experience)
Financial Planner (Financial experience)

supplemented by a team of specialists recruited under technical assistance arrangements from a bilateral donor:

Team Leader (Public Administration)
Deputy Leader (Management Systems, P. and B.)
Credit Specialist (Financial Economist)
Credit Specialist (Agricultural Economist)
Marketing Specialist (Farm Management)
Marketing Specialist (Marketing Organization)

The composition of the unit reflects the main needs of small scale farmers -- extension, credit, provision of inputs and marketing assistance. In order to insure consistent focus on the initial problem of designing and operating a delivery system for smallholders, the expatriate assistants should have a group identity and a clear group goal. For this reason it is probably desirable that they be recruited from a single bilateral source or that a multilateral institution serve as executing agent reponsible for recruiting a task oriented group.

9. The longer term development of P. and B. would require additions to staff and training would be a priority task. The development and operation of management systems is a relatively new skill in Kenya; this could well be an example of the type of skill which, having proved itself effective, will be raided by the private sector and other government agencies for a long time to come before the general Kenyan market is well supplied. For this reason, technical assistance for the P. and B. should be put under as long a time contract as possible since it might be some time before the unit could be completely Kenyanized.

Development Planning

10. A Development Planning unit is needed to serve three main functions:

(a) Sector Planning, including the design of major strategies for the Ministry (e.g., national agriculture policy, regional integrated development programs);

(b) Commodity programming to determine (for all main commodities) price policies, guidelines for investment and current expenditure in commodity development, and, in conjunction with P. and B., to design delivery systems for getting the required development services to farmers;

(c) Market research, to assemble and analyze information on supply, demand, stocks and prices of major commodities and to seek new market opportunities through promotion activities where appropriate. 1/

11. The proposed development planning unit is not completely different from the planning unit as now designed. The main innovation in establishing this unit is to give it narrower and deeper terms of reference. For example, a maize program might be designed by this unit, considering every question from land use alternatives, through production and marketing management to rules for pricing inputs and outputs. Whether each of these operating functions is done within the Ministry or in coordination with others, the "package" for maize is best planned and programmed as a whole. Some of the more urgent planning tasks -- such as the preparation of comprehensive programs for maize, oilseed, or cotton, might best be undertaken by relatively small, but highly competent "task forces", recruited for that one purpose.

Project Preparation

12. A Project Preparation unit consisting of specialist officers would identify viable projects and prepare them for effective implementation in accordance with the sector guidelines provided by the Development Planning unit and with the assistance of P. and B. in detailed programming and monitoring. This division should be aggressive and innovative and it should be judged primarily on the number of well prepared projects that it brings to the implementation stage. A secondary function of this unit would be to provide on-the-job training for Kenyan entrants into the Development Planning and P. and B. units. Because individual projects lend themselves to practical case-study training techniques, training combined with substantive work might be carried out very effectively by this unit. An additional advantage would accrue if the aggressiveness which should characterize this unit is communicated to new entrants.

13. Strengthening the planning and implementation capacity of the Ministry of Agriculture in this way would require an increase in manpower. In the first instance, this might consist of a few professionals to begin the Commodity Policy work with concentration on one or two commodities, and perhaps two project teams in the Project Preparation unit. Senior and experienced Kenyans should lead both units and qualified expatriates, preferably with Kenya experience, should be recruited under technical assistance agreements to do much of the initial work. A heavy stress on operations, on-the-job training should ensure that expatriates can be phased out of project preparation. Because many commodities have very special problems, temporary expatriate help on individual commodity problems should be programmed in advance of most new concentrations of effort on particular commodities.

1/ The fact that pyrethrum, a non-polluting insecticide, is not yet a recognized retail commodity (under its generic name or any brand name) in the American market is an example of underutilized promotion.

APPENDIX 2: SOME EXAMPLES OF REPLICABLE PROJECTS

1. We have argued in this annex that a shortage of planning, programming and management skills can be expected to constrain absorptive capacity in the productive sectors for the medium term future. Although this can to some extent be relieved by expatriate manpower supplementation and by a greater stress on micro-economic planning and programming, it will still be necessary to get maximum output from each planner. Designing replicable projects is one device for multiplying the effect, not only of planning effort, but of efforts to design management systems and manpower-use programs. In addition, project replicability provides a vehicle for learning from past experience; monitoring the operation of a given project is given greater impetus because the results can be incorporated into successive similar projects.

2. In this appendix the development of the small-scale business subsector is examined to show how a replicated project could operate there. Secondly, two alternatives are considered for use in the agricultural sector: the minimum package approach and a type of site and services program. Both of these agricultural efforts would be replicable.

Small-Scale Business Development

3. There can be little doubt that the development of the small-scale business sector is extremely important in the overall development of the Kenyan economy. Small-scale firms provide a wide variety of cheap goods and services for the poor. They absorb the surplus labor force which does not find an outlet in slow growing formal employment supplying well over half of the non-farm, non-government employment. They provide an avenue for capital and skill accumulation by new migrants.

4. At the same time, labor conditions and real wage rates in the small-scale business sector are probably lower than most in the Kenyan economy, so that any development here would have maximum distributional benefits. It can not be expected, however, to elevate the small-scale sector in isolation, because their position as residual employer or migrants will hold down the wage rate as long as the large gap between formal sector wages and farm earnings induces large migrations in search of formal sector jobs. On the other hand, measures to improve the productivity of labor in the small-scale sector can have an impact on the returns to capital in this sector, on the number of laborers employed and under some conditions, a short run effect on small-scale business wages.

5. Small-scale business can be developed given adequate extension, credit and training, but no one of these services, in isolation, is likely to accomplish much. Hence, the entire literature on small-scale business in Kenya has stressed an integrated approach, and some of the programs which have provided a full range of services with such an integrated approach (e.g., industrial estates programs and the Partnership for Productivity program) have so far experienced a relatively low failure rate. A serious problem arises, however,

because in small-scale business the small investment required for each operating firm and the lack of standardization of these investments, combine to make the subsector a very large potential user of extension and training capacity per shilling invested. There can be no thought of an input of expertise, on a firm by firm basis, comparable to the input into a large infrastructure or large industrial project. The low failure rate achieved by both the industrial estates and Partnership for Productivity is based on inputs of expertise which simply cannot be duplicated over a significant number of small-scale firms using present methods.

6. The Government's programs of support to small-scale business are undergoing a transition. Emphasis is apparently shifting from an excessive reliance on concentrated assistance on a few firms at the upper end of the small business scale. This past effort directed toward relatively large firms was quite successful in creating new African firms and maintaining them in profitable operations but the Government has recognized that it did so at a high capital cost and a high cost to the consumers in terms of protection. The new emphasis in government policy is toward assistance over a much broader spectrum of smaller firms.

7. The final form that the Government's program of assistance to small business will take is not yet decided. The recommendations within the Government, however, are consistent with a shifting emphasis toward very small firms and toward a much greater number of firms. According to the most advanced formulas available to the Mission this would entail the following:

(a) Assistance to small business would be centralized under the jurisdiction of the Ministry of Commerce and Industry (MCI). The Industrial and Commercial Development Association (ICDC) under MCI would be directly responsible for the administration of the program and would create a Small Business Development Agency (SBDA) as a subsidiary to handle this task.

(b) The functions of all the present agencies for the support of small business would be subsumed within SBDA. In particular, the Kenya Industrial Estates (KIE) program, the recently inaugurated Rural Industrial Development Center (RIDC) program, the Kenya Industrial Training Institute and the District Joint Loan Boards as well as the present Small Business portfolio of the ICDC itself would all be coordinated by the SBDA. The KIE would continue to function in much the same way as in the past. But the RIDC program, the ICDC lending program and the activities of the District Joint Loan Boards would all be changed rather fundamentally as their activities were coordinated.

(c) The SDBA would attempt to provide the full range of necessary services to small businessmen, consisting of business analysis and feasibility studies, training, credit, and extension services.

8. While the Mission concurs with the new emphasis on small business and with the proposals that a single agency provide a package of development aids to these businessmen, we feel that there is a serious risk of inefficiency in the new organization. As the Government itself has recognized, it is necessary for services to be closely coordinated and tailored to the needs of the individual entrepreneur. Each small businessman needs credit, training and advice in proportions which are unique to his enterprise. But the main loci of these services are the RIDC (to be renamed Small Business Development Centers). The SBDC will, for the next few years, have a relatively small cadre of experts scattered very thinly. One center per province is recommended as the near term goal. It is fairly obvious that only with a much larger staff could serious advice and extension unique to the individual firm be given. There is little doubt, on the other hand, that the present program of development of the Small Business Development Centers will place a heavy strain on the supply of manpower of the type required, i.e., highly trained and experienced men with enough general business sense and experience to design unique advice for many firms and enough leadership ability and personal presence to command attention of businessmen.

9. It is because the task is so large and the available cadre so small that the Mission believes that radical innovations in program design are necessary. Two features of any design that will be efficient, given the extreme scarcity of experts available, will be that the work of experts will be reusable and that the scheme itself will generate additional expertise. As illustrations of contrasting schemes which would fit within the proposed government framework for Small Business assistance, the following paragraphs examine first a scheme supported by Swedish grant aid, which incorporates considerable foreign expertise as a supplement to Kenyan personnel and follows the industrial estates model with some modifications, and second, a more radical project proposal, specifically designed to save expertise, which has received some support from Government during our Mission to Kenya.

10. The Swedish credit is designed to support small-scale manufacturing enterprise in the Kisumu region, roughly coincident with Nyanza Province. It includes financing in the following amounts:

(a) An amount of up to Sh 4.7 million for construction of an industrial estate as Kisumu.

(b) Up to Sh 1.7 million for equipping a Rural Industrial Development Center and a Technical Service Center.

(c) An amount not exceeding Sh 7.7 million for a revolving credit fund. This fund will be used to finance up to 80% of initial capital cost of entrepreneurs (approximately 25) who will be provided with rental sites by the estate management either within the industrial estate (about 20 firms) or elsewhere in the Kisumu region (about 5 firms). The fund may also be used to finance up to 90% of initial capital cost of firms outside the estates, to finance working capital as a lender of last resort or guarantee working capital loans, and to hold equity in new firms to a limited extent.

(d) A sum of up to Sh 5.6 million for personnel and a small allowance for contingencies.

11. The portion of the funds going into the industrial estates -- perhaps two-thirds of the total grant on the assumption that just over half of the revolving fund and the personnel grant will be used for the firms in the Industrial Estate -- is not particularly innovative. Very few firms, with high capital cost per firm, will be supported so that this portion of the loan will have little effect on the overall problem of support to a large number of small firms requiring assistance. 1/ But the RIDC segment, the remaining portion of the revolving fund and the remaining personnel assistance give this grant some flexibility. If half of the personnel grant is used to provide technical assistance to small firms outside the industrial estate, either through the RIDC, in conjunction with the administration of the revolving fund, or as a supplement to the government's incipient Small Business Development Authority, this would add 11 man years of expertise spaced over four years. This is a significant supplement to the expertise expected to be available for Kisumu through the normal Small Business Development Authority, but it hardly represents a critical mass for a full scale attempt to develop small business. It is worth emphasizing that the Swedish grant does constitute an advance over the ordinary industrial estates development project. The point of the above description is simply that the bulk of funds of even the most recent industrial development effort is still committed to a very few firms who will be helped very extensively and quite expensively. The remaining funds in the program and still more the remaining expertise are too small to affect major technical assistance using conventional methods.

12. In our opinion, it is necessary to supplement such programs as the Kisumu program just described, and the industrial estates program generally, with additional aid to a much greater number of firms. The average monetary assistance to these firms might be as low as £5,000. Some firms in this size range are already assisted primarily by ICDC programs but the total number of ICDC loans to small industrial business up to March 30, 1973, was only 572, of which 59 were simple transfers of established businesses.

1/ Some of the traditional problems of the industrial estate program will perhaps be minimized. In particular, there is considerable awareness of the possibility of promoting export firms, or failing that of supporting firms which can compete economically with imports, and there is an equal awareness of the capital intensitivity problem. How far this industrial estate will succeed in establishing labor intensive and internationally competitive firms remains to be seen.

13. There are several small manufacturing and service activities in each of which a large number of small firms operate. By specializing part of the cadre of development assistants in the activities containing the greatest number of small firms, or in those activities where demand is obviously great enough to support a large number of small firms, several advantages would be gained. First, market surveys could be conducted, not only to devise marketing procedures for the firms in the activity, but to determine the number and size of firms that the local market can support. This will help to limit market overcrowding, or excessive shortage of firms in the activity. Second, plant design, production planning, simple bookkeeping systems and control mechanisms, inventory plans, and so forth -- in other words, overhead knowledge required for technical assistance and the evaluation of the need for and potential productivity of government assistance -- could be obtained once for all the firms in a given activity. For each activity selected, much more expertise could be invested in forming up a prototype of an efficient operation, because the prototype will be reused. The cost of a thorough, first rate analysis would be small per firm assisted. Third, because the heavy emphasis on design will permit advice to be much more precise and detailed, a relatively inexperienced man can quickly be trained to undertake the actual extension work in a single activity. In contrast, only a highly competent and experienced expert could be expected to advise many firms in many different fields. Since Kenya is rapidly developing an oversupply of young, well-educated but inexperienced men, the economic cost of the actual technical assistance would be small. Fourth, the extension worker would quickly develop into a first-class expert in his very limited field able to evaluate, advise and command respect for his ability. The number of failures due to unwarranted advice or error in evaluating a firm's procedures and development aspects should be relatively small.

14. To adopt a specialist approach to development of small business would obviously be inadequate in itself because there are many firms that are either truly unique or too large (actually or potentially) relative to the market for replication to be economic. But this approach would fit in very well as a supplement to the government's industrial estates program and as a subsidiary function of the proposed Small Business Development Agency. We do not suggest that a few specialists can substitute for the staff of the proposed Small Business Development Centers. On the other hand, the task of each of the regional centers would be greatly simplified if, for five or six important types of activities covering perhaps half of the small firms in the area, pre-trained experts with pre-packaged projects were available.

15. It remains to be investigated how many activities have enough firms to make specialization in them worthwhile and how great a percentage of the total of small businesses could be served in this manner, but some indications are available. ICDC data, for example, show that 88% of their loans to small business have been concentrated in only ten rather narrowly defined activities, with the number of loans in each activity ranging from 14 to 216. ICDC management doubts that they have come close to exhausting the market in more than one of these activities. It would seem from these numbers that the potential for conscious specialization of assistance is reasonably large. Nearly

homogeneous groups of firms in the service trades would probably be still more common, for example, retail trade of various types, commercial handling and bulking of agricultural products, small transport firms, or food preparation firms.

16. Although we are persuaded that a specialist approach such as the one outlined above would produce large savings of skill in planning and operation, compared to other methods of assisting small business, it cannot be denied that, in its initial phases, such a program would require a lumpy investment of planning. A unit to lay the groundwork for assistance to be channeled to a number of specialized activities would have to be highly skilled and liberally financed. For this reason, we suggest that the Government seek foreign expert advice, under technical assistance, for the nucleus of these planning units. This assistance should be available not only for the design and testing of the most suitable prototype businesses, but also to help in the initial implementation period. In this way, the training of Kenyans who would serve as loan officers, the initial field trials of the prototypes, and any amendments to the package of services which initial experience reveals to be necessary, could also be assisted by the expatriate experts.

Minimum Package Programs for Small-Scale Agriculture

17. The Special Rural Development Program, which is at present the leading effort in small-scale agricultural development, suffers from the same lack of replicability as the successful industrial programs. Once again the problem is less that the SRDP areas have not made development strides (although the record has been spotty) than that the development has been purchased at too great a cost in terms of skilled manpower and financial resources. It is clear that Government is seeking an alternative to SRDP type development efforts. 1/ A feature of these efforts must be the applicability to a large segment of the rural area, since it is apparently politically unpalatable as well as inefficient to concentrate resources in a few small areas.

18. An approach that offers some hope for broadly based improvement in a short time is the minimum package approach. The central ideas of this approach are (a) to select one or two key services which can make a noticeable impact on production of an important crop; (b) to design a plan for the use of these one or two services; (c) to design a mechanism and an optional management unit for delivering them; and (d) to replicate the management unit as fast as possible. The minimum package approach proceeds from a recognition that the Government is in no position to launch a "best practices" development effort over any large share of the agricultural sector. The minimum package approach is to settle for some second best combination which will nonetheless be effective, and spread this second best alternative as broadly as possible.

1/ See Annex 8 of the Agricultural Sector Survey, op cit, for discussion of SRDP experience, including some of the benefits that have been gained.

19. In some countries, the IBRD has recommended a separate administrative unit for minimum package programs, partly in response to an absolute shortage of technical personnel doing extension work. 1/ In the Kenyan case it would probably be more appropriate to design a minimum package effort to work directly through the Ministry of Agriculture. Even in Kenya, however, some specialization by area, and a thorough and deliberate programming of effort of ministerial personnel specializing in minimum package assistance would be necessary.

20. We believe that there are many applications of the minimum package approach. The Ethiopian kind of project concentrates on an area in an attempt to bring a critical mass to bear on the poverty of the people in a particular area. Another variant is to concentrate on one crop. A minimum package arrangement for an important subsistence crop such as maize, is an excellent example fo the shadow area between "projects" and "programs". Enough project elements exist, that is, enough work must be done in identification, preparation for financing, detailed planning and programming of staff, so that a minimum package approach to maize development would greatly benefit from a project approach. No doubt any "project" prepared would have very large local cost elements; except for grain handling and importation of recurrent inputs, it is hard to isolate any foreign cost elements. On the basis of discussions with bilateral donors the Mission believes that this type of project would nonetheless appeal to several of the important bilateral donors and we strongly recommend that the Government seek assistance for the design and implementation of this type of development effort.

21. Another example, already tried with some success in the horticultural industry is the concentration of a minimum package of marketing services (e.g., collection, grading and packing centers) or of stockist services (supply of seed, fertilizers and chemicals, in appropriately sized packs). Often, these two forms of service will be combined into a wider package, combining both the supply of inputs and the provision of marketing.

22. This approaches what the Mission feels is probably the most valuable variant of the minimum package approach -- the entrepreneurial package. This concept, which is very similar to our proposals for small-scale business, entails the identification of one type of activity -- most probably the production of one commodity -- and designs a complete, but standardized, management system, covering design of the operation, the flow of inputs, technical production requirements, and the sale of the product. Like the small-scale business project, this need be neither costly nor require much manpower. The essential features are that it supplements (or replaces) the small farmer's limited entrepreneurial ability, and is replicable many times over.

23. Much of the national commodity planning should, in our opinion, be designed with a more-or-less standardized production unit of this kind in mind.

1/ See, for example, Pa-143a, Annex 10, Agricultural Sector Survey, Ethiopia.

This kind of approach has already demonstrated its relevance to special crops such as tea or pyrethrum; we feel it could be extended more than it has been in commodities like horticulture, pigs and poultry production.

24. One final application of the minimum package approach relates to the particular problem of subsistence farmers who have too little land to break out of their cycle of subsistence production. In outline form the problem can be summarized:

(a) Subsistence farmers are growing low value crops, primarily cereals.

(b) Land crowding and poor husbandry practices combine to hold output down to a bare subsistence level, or even below subsistence levels.

(c) The traditional farmer's desperate response is to concentrate more and more on the subsistence crop. If all of his land and labor resources are not sufficient to grow enough food, it is impossible to convince him that he should divert any of his resources to anything else.

(d) But, given the land endowment, many farmers are doomed to subsistence or subsistence levels of income unless they shift into higher value crops. There just isn't any way to become even modestly well off by supporting several people on a few acres by growing traditional grain crops.

(e) Hence a dilemma exists. To become reasonably well off a farmer must change cropping patterns but to change cropping patterns he must feel secure in his basic food supply, which is difficult given his land endowment.

25. We feel that there may be a way out of the dilemma if the Government can only get hold of some land in the area -- either by using State land, or by buying or leasing Trust land or registered private land. The requirements for a site and service project are:

(a) A sizeable tract of land, say fifty acres, located in a densely populated subsistence farming area with potential for growing high value crops.

(b) Market connections (a road and market knowledge) for supplying necessary inputs to this tract of land, and for marketing the high value crops.

(c) A single extension agent who understands the technology of the crop, and who can organize the supply of inputs and the marketing of crops.

26. The method of operation of the site and service project is to rent small portions of the land, say one acre per farmer, on a crop year basis to subsistence farmers in the immediate neighborhood, on the condition that they use the land to grow the high value crop under the supervision of the extension agent. Land rental would be on a proportion of sales basis and inputs would be provided without liability except the claim on a proportion of sales. In other words, the growing of the crop is a no-risk venture to the farmer except that he risks his labor time. The project acts as entrepreneur, except that some of the profit accrues to the farmer as a payment for his labor risk.

27. A project of this kind might increase the income of subsistence farmers very quickly at small cost, and introduces them to a cash income, without the awful risk they now run of running short of food if they take a risk. The Mission does not believe that a site-and-service project is the single answer to rural development, but we recommend that this approach might be tried on an experimental basis. We also think that the site-and-services approach may also have relevance to more sophisticated farmers who would be willing to pay a site rent for a plot of land, on a block where certain minimum services (perhaps irrigation) are provided and charged for. We even think the concept might be applied to the urban areas, if land could be made available for market gardeners to use.

ANNEX 6

PRIORITIES FOR EXTERNAL ASSISTANCE

ANNEX 6: PRIORITIES FOR EXTERNAL ASSISTANCE

CONTENTS

CHAPTER 1: INTRODUCTION

1.1 In assessing Kenya's progress during the past decade and attempting to set out the main elements of a strategy of development for the next decade, we have reached the following conclusions which have special significance for shaping priorities for foreign assistance:

(a) Kenya will probably face a more stringent resource position during the second decade than she did in the first. This is partly because Kenya's investment needs are growing in absolute terms and partly because the early growth phase of private and government savings has ended.1/ From the balance of payments point of view, the same conclusion of growing resource difficulties emerges. Import replacement will become much more difficult than it was during the first decade and export growth outside the agricultural sector will require penetration of new and more difficult markets.2/

(b) The desirability of a shift in investment priorities toward more directly productive investment, particularly in agriculture and resource based processing has been indicated by the macroeconomic analysis in the report.3/ Our microeconomic analysis indicates that there is considerable scope for improvement in the quality of investment in larger scale manufacturing,4/ and a need for a national program to support small scale businesses in all kinds of activities.

1/ The present average rate of savings out of GDP is already high (about 19-20% of GDP) and an increase in this rate would imply quite a strenuous efforts for modest advances. See Annex 4 for an analysis of private savings and Annex 2 for a discussion of the prospects for increased public savings.

2/ The East Africa Community markets, which has until now supported both Kenyan import substitution, by allowing larger scale, and export promotion by providing potential markets, is now fairly well supplied with simple import substitutes. See Annex 1 for further discussion of export prospects.

3/ In particular, we have emphasized that agriculture has a high export content of output, low import content of inputs, low ICOR, high employment/investment ratios, and is the most suitable sector through which to intensify the attack on the poverty. See the main report and Annex 1.

4/ See Annex 3, Chapters 3 and 5.

(c) However, we have concluded that Kenya does not appear to be well equipped for the large additional effort that is required to plan, execute, and operate expanded development programs in the productive sectors.1/

1.2 This annex considers the requirements and priorities for foreign assistance which can be deduced from these conclusions. To a great extent the aid issues are qualitative issues, but before considering these issues, we attempt to answer two quantitative questions. Is prospective aid sufficient for a continuation of rapid growth? Are the terms of aid reasonable in view of Kenya's long run development prospects?

1/ See Annex 5, Chapter 2 for a detailed discussion of this point.

CHAPTER 2: AID REQUIREMENTS AND THE TERMS OF AID

Past Aid Flows

2.01 Since Independence, Kenya has received a large and growing volume of official aid. The annual level of disbursements has more than doubled during the period (from about £10 million in 1964 to over £21 million in 1972) and the total value of external debt has also doubled (see below). On a commitment basis, this has meant that Kenya has received about $4 a year per capita, between 1965 and 1971, which is around the median for countries at a similar stage of development.1/

2.02 Loan commitments have increased quite rapidly, particularly in 1972, when they jumped to £37.2 million, compared with £19.7 million in 1971 (see Table 2). This surge in commitments has resulted in a large increase in undisbursed debt (nearly £56 million at the end of 1972), so that disbursements can be expected to rise quite sharply in the near future. Thus, in general, it can be said that there has been a movement towards a substantially higher level of assistance, not yet fully reflected in the disbursement data. Taking in account the existing undisbursed debt, together with the new commitments expected over the 1974-78 plan period,2/ it is projected that annual disbursements might increase to about £50 million by the end of the period.

2.03 The amount, source and terms of external assistance to Kenya over the last five years are given in the tables to this annex.3/ Some of the more noticeable features of these figures are the changes and diversification which have taken place in the sources of external aid to Kenya (see Tables 1 and 2). As recently as the end of 1968, over half of Kenya's external debt was held by the United Kingdom. All other bilateral donors accounted for 20 percent of debt, and international institutions held less than 15 percent. By the end of 1972, the United Kingdom's share had fallen to only 28 percent, other bilateral donors maintained their combined share at about 20 percent, but international institutions had increased their share to over 37 percent. As we shall refer to below, this changing composition of aid -- as well as the increasing magnitude of aid flows -- has considerable significance for Kenya.

1/ See Table 8. Nearly half of the countries in the $100-200 per capita income categories had per capita commitments within the range of $3-5 per year.

2/ New commitments are projected by the Mission to be about £56 million a year over the plan period.

3/ See also Table 4 in the main report for more information about Kenya's external debt.

2.04 The terms of financial assistance to Kenya have tended to harden somewhat in recent years (see Table 3). Although the average terms are still reasonable, since 1968 the average interest rate on all loans outstanding has increased by about 1/2 percent (to nearly 4% in 1972), and average maturity has slightly fallen. As a result, the grant element of all loans outstanding has fallen from 51 percent in 1968 to 48 percent in 1972 (see Table 3). The terms of new debts contracted during recent years have deteriorated even more significantly. A recent Bank report[1/] shows the following comparison between new debts contracted during the periods 1965-68 and 1969-71:

	1965-68	1969-71
average interest rate	2.2%	4.8%
average maturity	29.6 years	27.9 years
average grace period	4.8 years	7.2 years
grant element of loans (for discount rate of 10%)	60%	40%
grant element of loans and grants (for discount rate of 10%)	77%	67%

2.05 The primary reason for the deterioration in the average terms of lending to Kenya is the changing pattern of lending described above, and particularly the growing weight of multilateral aid in Kenya's external debt. The blend of aid from multinational agencies has hardened very considerably since 1968, as the ratio of IBRD and ADB loans to IDA credits has increased (see Table 1). The composition of Bank Group lending is an especially sensitive variable in the average terms of Kenya's external aid, not only because of the growing weight of Bank Group assistance in meeting Kenya's resources requirements, but also because IBRD and IDA terms tend towards the two extremes in the range of terms now available to Kenya.

2.06 The average terms of loans from bilateral donors have remained virtually constant over the last five years (see Table 4). However, the average interest rates changed by individual donors have risen in some important cases, and as a result, the average terms would have hardened if it had not been for the fact that the share of new commitments provided by the soft-term donors (particularly Sweden, the Netherlands and more recently Canada) been rising over the period.

2.07 Thus, the experience of the last few years has been for Kenya to face a generally hardening blend of aid. But many bilateral donors have gone a long way towards liberalizing the terms of their lending, and some, together with IDA, are providing loans virtually on grant terms. There is also some evidence that the terms of financial assistance from Governments have tended to soften in 1972 and 1973. Interest rates on loans have been lowered: almost all new commitments in 1972, for example, were at interest rates of less than 3 percent,

1/ See "World Debt Tables", IBRD Report No. EC-167-72, December 15, 1973.

and rates of between 2 and 3 percent were typical for aid planned in 1973. The lower interest donors -- Sweden, Netherlands, Canada, Denmark and Norway are also becoming proportionally more important sources of funds, and pure grant aid is increasing. Important portions of the Swedish program (the 1973 small industries loan), the U.K. program (land transfer), the U.S. program (population control) will be in grant form, in addition to smaller grants available from Norway, Denmark and Netherlands. As a result, there is some prospect that the grant element of bilateral aid may increase still further in the coming years. However, many bilateral donors have already gone as far as their national policies allow in softening their aid to Kenya, and there is probably only limited scope for a continuing improvement in the average terms of all lending.

2.08 Moreover, the supply of concessionary aid is limited and certainly nowhere sufficient to meet Kenya's increasing needs for external capital. In the past, therefore, Kenya has had to rely to an increasing extent on harder-term sources of assistance -- primarily IBRD, but more recently a growing amount of commercial borrowing. As we discuss below, Kenya is presently quite capable of absorbing some further hardening in the average terms of lending, but there is a limit to how far it will be in Kenya's own interests to increase its borrowing, at the margin, on terms which will significantly increase the future burden of debt servicing.

Debt Service and Creditworthiness

2.09 Although the marginal cost of borrowing from abroad has been rising, as indicated above, most of Kenya's external debt is still held on generally favorable terms, and her present creditworthiness is not in any dispute. The total debt outstanding at the end of 1972 was just under $510 million (of which $354 had been disbursed) or about 30 percent of GNP. On a per capita basis, Kenya's total outstanding debt has risen from about $32 in 1968 to about $40 by the end of 1972, which is a high, but not excessive, level for countries at Kenya's stage of development (see Table 8).

2.10 The cost of servicing debt has not so far been a significant burden on Kenya's foreign exchange earnings. Total service payments due in 1973 amounted to $33 million, of which $17.7 million was for repayment of principal and $15.3 for interest charges. In 1972, the debt service ratio was 4.2 percent, and it has never been higher than 4.5 percent in the previous five years. The repayments schedule on existing debt suggests no servicing problems in the future, except perhaps for one isolated year (1978) when a substantial portion of one loan falls due for repayment. At present about 30 percent of total outstanding debt is undisbursed. But even so, allowing for the likely schedule of disbursements, the cost of servicing existing debt will not rise appreciably.

2.11 Kenya also has obligations under loans made to the East African Community, most of which are jointly and severally guaranteed by the governments of all three Partner States. At the end of 1969,[1/] the East African Community had external debts outstanding of some $216,000 and annual service payments which were projected to amount to some $26 million by 1972. Compared with the Partner States' external debt, the East African Community has borrowed on generally hard terms. Even in 1969, some 44 percent of the Community's debt was held by the IBRD, and this proportion has almost certainly increased further since then. Another third of the Community's debt was held in the form of public bonds issued in the United Kingdom. No IDA funds have been available to the Community and only the United Kingdom has been a substantial source of bilateral official aid. Since 1969, bilateral aid has increased, including commitments from new donors such as Canada, but an up-to-date report is not available.

2.12 Bank reports have conventionally assigned a one-third share of the outstanding debt contracted by the Community (and of the servicing costs) to each Partner State in the analysis of debt.[2/] If this notional one-third share is added, Kenya's total external debt is probably in excess of $600 million in 1973, and her notional debt service ratio about 5.3 percent. Even allowing for the additional cost of Community borrowing, therefore, it is clear that Kenya's external debt position is still basically sound. As we indicate below, the extent to which Kenya's debt becomes more burdensome in the future will depend upon the magnitudes and terms of new capital flows, but particularly upon the availability of concessionary aid.

Future Aid Requirements

2.13 It had been anticipated that the Mission would look at Kenya's aid requirements during the period of the forthcoming 1974-78 Plan. However, at the time of the Mission's visit to Kenya neither the plan investment program nor the financing plan had been finally determined and we shall not therefore

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1/ This is the last year for which a full report on the external debt of the Community has been provided. The only information available on new commitments over the last four years (1970-73) is for the Bank Group which made IBRD loans, amounting to some $87 million over the period.

2/ This notional allocation of debt is not very satisfactory since it represents neither the legal responsibility for debt nor the economic impact of Community borrowing on the three Partner States. The Community is presently undertaking a study of the national distribution of community services which might subsequently provide the basis for a more useful formula.

address ourselves to Kenya's quantitative aid requirements in this Annex.[1/] However, the analysis of Kenya's longer term resource availability undertaken by the Mission does allow a number of general conclusions to be drawn about future aid requirements.

2.14 The most obvious feature of the "basic scenario" projections, derived from the macro-economic model used by the Mission, is the very large residual balance of payments gap.[1/] To fill this gap with increasing flows of concessionary financing from official sources would call for a much larger volume[2/] of new commitments from bilateral donors than are anticipated in the near future (see Table 6) or could reasonably be expected in the longer term, even on the most optimistic assumption about future aid flows. On the other hand, an attempt to finance a residual gap (of the size implied by the basic scenario projections) on commercial rates of borrowing would eventually lead to a debt service burden of unmanageable proportions and would in any case be

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1/ The macroeconomic model used in our analysis of a strategy for development is basically a requirement model. The model derives Kenya's requirements for foreign assistance from target growth rates combined with empirical observations and reasonable assumptions about ICORs, exports, savings propensities and so forth. A "residual gap" is then calculated. The residual gap is the difference between the requirements for foreign assistance as calculated by the requirements model and the probable disbursements of foreign assistance as calculated from assistance already committed but undisbursed plus the probable disbursements on commitments (as shown in Table 6) planned by aid donors. The primary use for a model of this type is to compare the long-run results of adopting various policy options that the Government has at its disposal. For this purpose, several versions of the model were constructed. The extreme versions are the Basic Scenario (a set of projections based largely on the assumptions used by the Government in preparing a preliminary financial projection for the Plan) and the Preferred Strategy (a set of projections including relatively higher investments in agriculture and industry, relatively lower investment in infrastructure, and changes in macroeconomic policies, all compared to the projections of the Basic Scenario).

2/ An improvement in terms of bilateral aid cannot help much. As previously discussed, these terms are already relatively soft, and even moving to pure grants of the projected amounts would leave a large residual gap. Only a much larger volume of aid on concessionary terms could be sufficient to fill the residual gap.

self-defeating as a mechanism for securing external capital.1/

2.15 The general conclusion which we draw from the basic projections, therefore, is that it is not feasible for Kenya to continue a rapid rate of growth, along the same development pattern as in the past, without running into an unmanageable balance of payments problem. The first obvious implication of this conclusion is to suggest a lower overall rate of growth. But we have rejected this alternative, primarily because of its undesirable effects on employment and the income level of the poor. We concluded, therefore, that the fast growth rate envisaged in the Plan (around 7 1/2 percent) could not be supported for long without changes in the historical pattern of investment and macro-economic policy, and a package of such changes were included in the "preferred scenario" set of projections.

2.16 The projections under the preferred scenario present a much more optimistic outlook for continued growth in Kenya. 2/ Under the hypothetical

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1/ To illustrate this point, the table below shows the debt service results of financing the Basic Scenario residual gap on IBRD terms.

Debt Service Projections - Basic Scenario
(Residual Gap Financed on IBRD Term, 5 years grace)

	1975	1980	1985
Interest on Public Debt Exclusive of Residual Gap a/	24.4	43.1	60.5
Amortization of Public Debt Exclusive of Residual Gap a/	23.9	42.1	69.9
Interest on Debt to Finance Residual Gap b/	17.3	111.3	397.8
Amortization of Debt to Finance Residual Gap b/	-	11.7	57.2
Total Debt Service	65.6	208.2	585.4
Debt Service + Exports	9.0	17.1	30.2
Debt Service + GDP	3.1	6.9	13.1

a/ Source: Table 14, Annex 1.
b/ Financing "Gap in Balance of Payments," Table 14, Annex 1, with net transfers on IBRD terms.

2/ The underlying assumptions are the same as those of the basic scenario, but the pattern of investment is assumed to shift in favor of the directly productive sectors and some changes are assumed in macro-economic policy. See Annex 1 for a full discussion of the various sets of projections.

assumptions of the preferred scenario, the restructuring and reform of the economy would allow Kenya to become less dependent on external capital for her continued growth, and the projections suggest that the balance of payments position could be held within manageable limits over the next decade, even with a rapid pace of growth. However, even under the hypothetical and rather unrealistic projections of the preferred scenario, which assume that a major restructuring and reform of the economy can be implemented immediately, the anticipated level of official aid would still not be sufficient to eliminate the resource gap altogether, and an accelerated growth of commitments would be required. Thus, even on the most optimistic assumptions about Kenya's performance, the economy will continue to need a considerable expansion in capital inflow if it is to maintain its present high and desirable rate of growth. And most of this aid will have to be on concessionary terms if debt servicing costs are not to become a serious threat to Kenya's continued creditworthiness.

2.17 Of course the assumptions made under the preferred scenario are, as conceded above, highly idealized, and are not intended to be forecasts of what could actually be accomplished over the 1974-78 plan period and beyond. In particular, while most of the reforms referred to are in our view feasible, the model ignores the time lags which must be provided for in real life. Some of these -- such as the need to build up the absorptive capacity of the agricultural sector -- may have to be measured in terms of several years, and the model also ignores the political constraints to adopting some of the more unpopular changes in policy.

2.18 Thus, while the Government has accepted the broad strategy underlying our preferred projections, it must be realized that the restructuring and reform of the economy which would, among other things, move Kenya towards greater self-reliance, will necessarily take a long time. In fact, even assuming that policy decisions are taken immediately, many of the basic reforms indicated in the preferred scenario could only be expected to bite towards the end of the 1974-78 plan period. In the meantime, and particularly during the next plan period, Kenya's reliance on external capital will continue to be rather large, and may in fact reach its peak, in relative terms.1/

1/ The Bank is presently undertaking further projections of Kenya's longer-term development prospects on more realistic assumptions of a slower shift towards the preferred strategy than those given in the preferred scenario. The preliminary results of these projections, which will be used as a basis for an appraisal of the 1974-79 plans, suggest that aid commitments would need to be boosted some 15-20 percent above the level which is already projected over the plan period. However, on the assumptions made about the speed and extent of restructuring of the economy, Kenya's resource gap would decline (as a percentage of GNP) soon after the plan period, and she would therefore become relatively less dependent upon foreign aid.

2.19 Since a fast rate of growth is in fact a necessary condition for Kenya to achieve the objectives of the preferred scenario, it is particularly important that Kenya should be able to obtain the resources she needs. But at the same time, as we discuss at greater length later in this annex, the donors can do much to help Kenya, not only in providing the increased resources required, but in supporting the restructuring and reforming process, in the pattern and quality of their aid.[1/] In this way, donors could, during the next plan period, help to reduce Kenya's dependence on external aid on the longer term.

1/ In particular, the sensitivity analysis done on the projections reveal that the residual gap is highly sensitive to small changes in the rate of growth in the agricultural sector, on our assumptions.

CHAPTER 3: SECTORAL COMPOSITION OF EXTERNAL ASSISTANCE

Overall Priorities

3.01 This chapter will examine the historical characteristics of foreign assistance and the declared intentions of the major donors regarding future aid commitments to see whether the pattern of aid flows is likely to match Kenya's development aid requirements in the qualitative sense. In the opinion of the Mission, this is the most important question regarding the sectoral composition of foreign assistance. There is little doubt that Kenya's priorities for external aid are changing and will continue to change, and that donors will need to adapt their aid programs accordingly. We have in this report suggested a reorientation in Kenya's investment programs towards productive sectors, and it follows that we would hope to see a similar shift in emphasis in both financial and technical assistance. However, two important qualifications have to be made to this general conclusion.

3.02 First, while it is very important that donors should actively encourage and support desirable changes in Kenya's development programs and aid requirements, there is a limit to the extent that donors can or should attempt to influence the country's development philosophy or major allocative decisions. Of course, the flexibility of Government's financial planning will increase in any case as the country becomes more self reliant. The donors should probably try to enhance this flexibility as much as possible, limiting their influence over allocative decisions to a purely advisory role. It seems at least futile and perhaps perverse for an individual donor (or for donors as a whole) to try to shape the development allocations through their aid programs.

3.03 Second, the fact that there may be a need for external aid as a whole to shift in emphasis towards agriculture or other productive sectors does not mean that every individual donor should aim to channel aid along identical lines. Nor is it necessarily desirable for large donors to spread their assistance over all sectors of the economy. Some degree of specialization would seem to be of benefit to both donors and recipient, and, as we point out later, one objective of aid coordination might be to encourage donor agencies to channel their aid into those kinds of activities in which they appear to have a comparative advantage.

Sectors of Aid Concentration

3.04 Table 7 shows the average flow of Government investment into the main sectors in the last three years and compares this "average structure" of government investment to the sectoral composition of the projected future flow of financial assistance already committed and the disbursements expected from planned commitments. The directly productive sectors appear to be well taken care of in aid commitments. However future commitments are only unofficial statements of intent. They are, by and large, not yet "projectized", nor have alternatives to project lending been developed to absorb these funds.

3.05 Technical assistance has been much more concentrated than financial aid. In 1968, agriculture accounted for about one quarter of the program and education about one third. Technical assistance in industry was comparatively slight, reflecting the heavy involvement of private enterprise in industry and the general lack of Government attention to detailed work in the sector.

Technical Assistance in Selected Sectors
£ thousand
(at cost to donor)

	1968	1973
Agriculture	1,604	2,199
Education	2,252	2,128
Industry	73	70

Sources: "A Proposed Five-Year Program of Technical Assistance to Kenya", 1968-73, Volume 1, page 9; Mission estimates based on "Development Assistance to Kenya", UNDP, Nairobi, May 1973.

By 1973, the combined agricultural programs led all sectors of technical assistance, having increased by about one-third in the 1968-73 period. Education programs had declined slightly and industrial technical assistance remained comparatively small.

Future Commitments

3.06 The planned commitments of the major donors for both technical assistance and financial aid point to a continuation of the trend toward a greater concentration in the productive sectors. In technical assistance, the slight decline in education which has characterized the 1968-73 period should accelerate, with the rapidly growing cadre of qualified citizens replacing expatriates in most of the actual teaching positions. 1/ Meanwhile, the expressed intention of virtually all of the important donors is to look for acceptable technical assistance projects in the agricultural sector. It also appears likely that opportunities for technical assistance in business and industry will increase due to the expected increase in Government support to small-scale industry and the planned Government program for extension services to business and industry. It is probable that these expanded needs will be met, as donors, particularly Britain, attempt to diversify their technical assistance into productive sectors.

1/ Kenya may actually face a surplus of teachers, or a fairly general overqualification of teachers, for primary and secondary school posts within the next decade.

3.07 On the financial aid side, the sectoral preferences of the donors are so clearly concentrated in agriculture, or in closely related fields of agro-industries and rural water supplies, that the sectoral composition problem is actually reversed. There is in fact little chance that absorptive capacity in agriculture can grow fast enough to permit the commitments of all of the aid that would be available for that sector for the next few years, according to the declared sectoral preferences of the donors. Realized commitments may therefore have to differ considerably from donors plans, with more aid concentrated in infrastructure or social services sectors unless technical assistance to the agricultural sector can be more closely associated with project identification and implementation.

3.08 In the industrial sector, the prospects for sufficient aid to finance a rapid growth of Government investment are also very good. This growth will require new types of projects to be evolved as suggested in Annex 5, and this may in turn lead to short run absorption problems. But there is little doubt that the present aid donors in this field are evolving project methods which can be expanded or duplicated. Although confined to the medium-to-large scale industries so far, the industrial aid program of the Federal Republic of Germany can probably continue to expand and some of the more recent donors, notably Japan, have shown considerable aggressiveness in searching out ad hoc investment opportunities. The experience of Norway in helping to promote a single specialized business/industry (local contracting), with a "program" approach, can provide important lessons to donors desiring to innovate in this sub-sector, and in industry generally. The recent grant of financial aid by Sweden for a large, reasonably balanced, regionally-based expansion plan for industry breaks new ground for an institutional point of view, and represents a considerable advance over single project loans. Overall, the bottleneck to absorption in the sector is likely to be the shortage of qualified personnel for the speedy preparation and execution of programs from among the Government's many new initiatives in the sector.

3.09 In general, therefore, the Mission finds no problem with the anticipaged sectoral composition of foreign assistance. The concentration by the donors on the productive sectors is in line with Kenya's requirements and should succeed in supporting increased investment in these sectors if sufficient programs can be prepared for financing. Only two reservations to this optimistic conclusion need to be made. First, is a cautionary note to donors that they should be prepared to shift some of the funds now (more or less) earmarked for productive sector investment to other sectors, unless they can directly help through technical assistance, in building up the absorptive capacity of the productive sectors. The second is the reservation that donors may have to be more flexible in the conditions of their aid if they are to realize their sector preferences. We shall discuss this latter point at greater length in the following chapter.

CHAPTER 4: CONDITIONS OF FINANCIAL ASSISTANCE

4.01 As we have seen in the previous chapters of this annex, the prospects for gross aid flow and its sectorial composition are quite favorable, both for technical assistance and for financial aid. Plans of the donors are clearly consistent with the needs of Kenya. But these plans can be realized only if programs can be prepared for financing. 1/ The Government faces a large planning and management task to absorb aid as productively as possible. Their success will depend partly on how flexible the donors are prepared to be on the conditions of assistance. In the opinion of the Mission there is considerable scope for improvement in the conditions of both financial aid and technical assistance. This will be the subject of this and the following chapter.

Priorities for Reform

4.02 Conditions of financial assistance run the gamut. At one extreme are tied loans to finance only part of the foreign exchange costs of a project selected more for its "aid-ability" than for its contributions to Kenyan goals. At the other extreme are free foreign exchange loans for general support of the Government's investment plan, or programs combining liberal local cost financing, untied foreign financing and technical assistance. Quite clearly, the more that aid resembles free foreign exchange, the more readily the Government can make use of aid in advancing its highest priority programs. Thus we agree with the spirit of the discussion of aid in the recent ILO/UNDP Report; for example, that tying should be lessened, local cost financing increased, program lending increased, procurement conditions made more realistic and so forth. Because most of the donors have their own administrative limitations, however, determined by their national governments or legislators (on a global basis rather than on a country by country basis), the terms of lending to Kenya are not likely to show such dramatic improvement in the near future.

4.03 In the opinion of the Mission, the highest priority for reform in the conditions of lending should be given to the changes required to increase external support for "mass programs" in the productive sectors. This priority corresponds with our analysis of the needed change in Kenya's own investment pattern. These mass programs potentially involve a very large number of separate productive units at the lower end of the efficiency scale, the income scale, the education scale, and the organization scale. There is no use pretending that these programs will be easy or that they can be prepared to fit the mold of conventional projects. The more broadly-based a program becomes and the more it is involved with masses of people rather than a few, the more inextricably will it have to be integrated into the ordinary day-to-day operation of the administrative structure. For example, any program designed to

1/ Prospects for general support for the development budget are extremely limited; aside from the 1973 U.S.A.I.D program loan for financing imports, the Mission found no plans for general purpose foreign assistance unrelated to specific developmental plans. This question is considered in more detail in paragraphs below.

uplift subsistence agriculture would overlap with the general functions of the already very large extension service. Because duplication is clearly undesirable, elements of the extension service would have to be part of the program "package", and its financing integrated into the Ministry of Agriculture's budget. Similar overlaps will arise between any broad-based small business project and the proposed small business assistance program. It is conceivable that several conventional projects could and will be devised by nibbling at the edges of these two major problem areas. But an effort to develop these sectors at any speed, across the board, will require that the special problems associated with these mass programs be faced up to and solved.

4.04 The present assistance policies of most donors discriminate against mass programs in the productive sectors in a number of ways. These are probably accidental biases, since it is clearly not the intent of the donors to discriminate in this direction - rather the reverse. But the cumulative effect of these biases may in some cases be sufficient to thwart the best intentions, of both donor and receipient, to channel aid into the most productive uses. The paragraphs below discuss some common aid practices and their inherent biases.

4.05 While the financing of foreign exchange costs may be sufficient in hardware type projects (infrastructure, heavy industry, etc.), this type of aid simply does not go far enough in the kind of broadly-conceived project which will be required to bring a growing level of income, employment and services to the mass of the population. Foreign exchange costs, perhaps 90 percent of some infrastructure projects, might constitute only 25 or 30 percent of the best program for small scale agriculture. If the grant element in foreign assistance is very large, as it is in Kenya's bilateral aid, financing for 90 percent of an infrastructure project is equivalent to a grant for about 60 percent of the project, while the "equivalent grant" for a mass project with a large software component might be about 18 to 20 percent. Such a vast distortion in the costs to Kenya as seen by the Government planners is bound to bias their decisions in favor of import-intensive projects.

4.06 The following numerical example, showing the costs of hypothetical projects which differ in their foreign exchange components, may help to clarify the nature of the bias which is introduced when only foreign exchange costs are financed by external donors:

	1 Project Cost (£)	2 Foreign Exchange Cost (£)	3 Project Rate of Return (percent)	4 External Financing (=Foreign Exchange Cost) (£)	5 Grant Element as Percent of Loan (percent)	6 Grant Element as Percent of Project Cost (percent)	7 Effective Cost of Project to Kenya1/ (£)	8 Rate of Return to Kenya on Cost to Kenya (percent)
I	100	90	15	90	65	58	42	35.7
II	100	70	15	70	65	45	55	27.3
III	100	30	15	30	65	19	81	18.5

1/ Effective cost to Kenya is project cost less the grant element of the loan.

In the example, three projects are financed by soft loans to the extent of their (differing) foreign exchange cost. The terms, summarized by the grant element (column 5) are the same for each loan. The rate of return on total cost is the same for all three projects (column 3). But if aid is provided for only the foreign exchange element of these projects, the effective rate of return as far as Kenya is concerned - that is, the rates of return on the costs to Kenya - varies very markedly between projects (column 8). This surely constitutes an undue bias toward projects of the Row I type (infrastructure, heavy industry, import-intensive investment in general) compared to projects of the third type (mass-impact projects, and projects which make intensive use of domestic goods and services and software in general).

4.07 The obvious, but difficult, solution is to equalize the grant elements of programs financed by foreign assistance, by increasing the grant elements of the mass programs. This will necessarily imply financing some portion of local costs. The Mission's suggestion is that enough local costs be financed to leave the percentage of Kenya cost (program cost less grant element of financial aid) about the same in these sectors as in the infrastructure sectors. This can be done by financing the same percentage of project cost for all projects, assuming that the terms of assistance are the same. This suggests a simple formula for local cost financing. If the total assistance for each project is to be about the same percentage of project cost, say 66 percent, the required local cost financing can be derived as the difference between 66 percent of project cost and the foreign exchange cost of the project.

4.08 It should be stressed that the above local cost financing "formula" merely equalizes the rate of return to Kenya from her own investment (total cost less grant element) in programs having equal rates of economic return. 1/ It cannot be viewed as specially favorable treatment for mass programs, but would go some way toward removing the discrimination imposed on these projects in the past.

4.09 In addition to the "price signals" argument for financing local costs in mass programs, there are balance of payments arguments for financing local costs in the aggregate external financial assistance program. During the next few years, disbursements of foreign financial assistance to the public sector will probably constitute about 50 percent of total fixed public investment. To finance this percentage of the total investment will require financing a larger percentage of each assisted program, because many Government investment programs will not be assisted. Assuming that 75 percent of Government fixed investment is assisted, it would be necessary to finance about 66 percent of project costs, on the average, to cover the balance of payments gap. The assisted projects might have foreign exchange costs on an average of about 45 percent of project costs. Thus about 40 percent of the local costs of those projects receiving foreign assistance would have to be picked up to cover the exchange gap.

4.10 The required local cost financing as calculated above (40 percent in the example) is a useful tool in evaluating the lending program of individual donors. If a donor's program consists only of a selection of import-intensive projects of which only the foreign exchange portions are financed, then the remaining projects offered to other donors will have a lower average import

1/ Using the same numerical example given on the previous page, this formula would give the following results:

	1 Project Cost (£)	2 Foreign Exchange Cost (£)	3 Project Rate of Return (percent)	4 External Financing (=Foreign Exchange Cost) (£)	5 Grant Element as Percent of Loan (percent)	6 Grant Element as Percent of Project Cost (percent)	7 Effective Cost of Project to Kenya (£)	8 Rate of Return to Kenya on Cost to Kenya (percent)
I	100	90	15	66	65	43	57	26.3
II	100	70	15	66	65	43	57	26.3
III	100	30	15	66	65	43	57	26.3

When the external finance provides the same percentage of project cost, irrespective of their foreign exchange component, the rate of return to Kenya (on the cost of Kenya) is the same for all projects having the same economic rate of return.

content and a greater need for local cost financing. The Mission therefore suggests that a fair distribution of the overall aid program among donors implies that a single donor should attempt to balance his own aid program, so that in financing 66 percent of project costs, he finances around 40 percent of local costs. One way of achieving such a balance would be by sharing in some of the local-cost-intensive mass programs. 1/ This guideline should, of course, be flexibly applied, with liberal exceptions for special cases, but a guideline on this style appears to be necessary.

4.11 The financing of discrete projects, through autonomous agencies or with autonomous management, is a practice well adapted to the big hardware project. The ultimate form of this practice is the so-called turnkey project, usually associated with power projects or heavy industry, but variations on the same theme can be devised through skilful manipulation of requirements for autonomous existence of a project management that can be closely controlled by the donor. The more that a program has a mass character, the more closely integrated will it be with the ordinary makings of the indigenous administration and the less discrete and donor-manageable. For mass programs in the productive sectors, the Ministry of Agriculture itself and the proposed Small Business Assistance Agency will inevitably be central to the management of the programs. If the donors are to be of real assistance with these programs, they must necessarily work through these agents and, in the process, sacrifice a good bit of the usual control over project implementation and operation. 2/ With this in mind, the most efficient way to "relate technical assistance to the project cycle," a stated aim of many of the donors, is probably to use technical assistance to supplement the capacity for development effort of the ministries and implementing agencies themselves. Although "institution building" is an overworked phrase, it is still true that a far more ambitious effort is needed to strengthen the central institutions, that is, the relevant ministries and agencies, so that broad-based ministerially-managed programs can be supported with confidence.

4.12 The practice of unilateral appraisal and single donor financing although slowly eroding, still favors the discrete and relatively small project over the mass programs. Shared financing arrangements have been tried in a number of occasions, but the requirement for individual donor appraisal is still a serious impediment to joint developmental effort by the donors. This is a most severe constraint for more complicated projects; because the potential for misjudgement is greater and the possibility for honest disagreement is greater. It will probably be necessary for donors to commit themselves to supporting a program earlier on in the project cycle, so that an appropriate preparation and appraisal methodology can be derived for a program that, when completed, will be acceptable to all donors involved. Shared financing is

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1/ These figures are used merely to illustrate the principle. A better assessment of the desirable average proportion of local cost financing can be made when the 1974-78 Development Plan is available.

2/ This is not to say that nothing can be accomplished by programs working parallel to the ministries. (See for example our suggestions in Annex 5).

particularly important in mass programs for two reasons. First, the programs are potentially so large that any single donor would have difficulty fitting the disbursements into the assistance budget. Second, and probably of even greater practical importance, the programs contain a disproportionate share of unpopular elements (e.g. local cost financing, management problems, procurement problems, risks of failure and so forth). There is a clear danger that this combination of problems would be more than any single donor would be willing to put up with, whereas spread over all of the donors, these problems become an unattractive but minor part of a single donor's assistance program. Short of inducing a large donor to specialize in troublesome programs - an unlikely eventuality - shared financing appears to be the best answer.

4.13 The desire to run a self-contained aid program, on the part of each bilateral and multilateral assistance agency, militates against mass-impact programs. Even assuming that a donor would be willing to tolerate considerable departures from standard operating procedure in order to participate in important development programs, donors naturally shrink from the complications inherent in multi-party compromises. Yet the preferences of donors to negotiate with Government on a bilateral basis is an important impediment to getting mass programs started. We therefore feel that serious and continuous multilateral discussions, addressed to the problems involved in mounting large programs designed to benefit the mass of the people, should be a routine tool to improve the efficiency of assistance. 1/

4.14 Summing up, the necessary improvements in conditions of assistance, if Kenya is to succeed in maintaining growth and accelerating the development of the poor, appear to be the following:

(a) A progressive move toward support of major programs, rather than isolated projects. Because many of these programs will have a predominant local cost element, this implies a willingness to finance at least some local costs.

(b) A willingness to participate and cooperate with other donors in all phases of a project's preparation and financing of major programs. This will require a new attitude of mutual effort among donors as well as cooperation in financing. It will also require innovation in the sharing of different types of costs. Because it seems unlikely that lenders can be found to specialize in concessionary financing for local costs, for example, it will be necessary to agree on the distribution of local costs financing and foreign exchange financing. 2/

1/ On this point, see the concluding section of this Annex.

2/ This is the main use we see for local cost financing formula such as that suggested in this Annex.

(c) A willingness to compromise, in a multilateral context, on conventional donor requirements (e.g. requirements for autonomous project control and identity, requirements for procurement procedures, tying arrangements), when this compromise is necessary to carry out the project most efficiently or when compromise arrangements are necessary to line up joint or parallel financing.

Toward Further Improvements in Lending Conditions

4.15 Sector and subsector lending is a logical direction for external assistance to take in the future. We have discussed at some length in Annex 5 the advantages to be gained in Kenya's planning and project identification activities by a progressive shift from projects to programs, subsectors or even sectors as the basic unit of planning. There are, we believe, very considerable economies in scale to be achieved by such a shift in the emphasis of planning. But, perhaps more important, it seems that for some of the more difficult and urgent development tasks facing Kenya (such as many proi grams for assisting the mass of small scale farmers or businessmen) planning in a broad framework is indispensable if all the necessary conditions for the success of the program are to be included on a coordinated basis. There are also several obvious advantages to the donors -- both individually and as a group -- to be gained from a shift to larger and more broadly-defined projects. For example, it is clearly one of the more efficient ways of tailoring aid, more exa·tly, to the needs of Kenya. But it also provides greater scope for donors to coordinate their financial aid and technical assistance within a clearly defined sectoral strategy, and opens us new opportunities for cooperation and coordination among the donors.

4.16 We have previously stressed that the advantages of broad-based planning project identification and lending are more relevant to the complex challenges which still lie ahead in the agricultural sector, where the capacity to prepare individual projects is a major constraint. 1/ But the desirability of sector lending can also be shown in the road transportation sector, even though this sector has a very good capacity to identify and and implement individual projects, particularly for external financing. However, normal practice is for the Government to submit a package of individual road projects to a donor, who appraises the package on the basis of the justification for each road included in the package. Partly because of this emphasis

1/ Appendix 1 to Annex 5 discussed a plan for strengthening management in the Ministry of Agriculture, particularly for a delivery system to get services to small farmers. In the context of a subsector loan for maize production, this technical assistance effort would surely be seen as one indispensable component. How many similar components would be missed by a piece-meal, autonomous-agency, unique-project, approach to development of this subsector?

on the project approach, the Government concentrates a disproportionate share of its road planning staff in project preparation activity and devotes relatively little effort to sector strategy or assignment of priorities among the projects in the road sector. Moreover, since there are a number of donors providing capital assistance to the road sector, each of them independently appraising a different package of projects, there is no strong impetus for sector planning arising from the donor's operations.

4.17 Within the strategy recommended in this report -- to decrease the relative share of investment in infrastructure -- there must be an effective sub-strategy to choose those infrastructural investments with the highest priority. During the next plan period (1974-78), the total road development program which the Ministry of Works has proposed for implementation amounts to twice the provisional allocation for roads in the plan. While most of the program is suitable for foreign financing, on the basis of their individual merits, the Government will have to assign priorities to the various categories of road, and reduce the total roads program if it is to stay within the overall plan allocation. This will require a much greater emphasis on sector planning, as against project identification and appraisal.

4.18 This evolution in planning would be encouraged and accelerated by a corresponding shift in emphasis, on the part of donors, to a sectoral approach. Once the Government had devleoped a road investment program, which clearly identifies road priorities over the plan period within the resources allocated to the road sector, donors would have a clearly defined framework within which to identify their assistance programs. Donors could then appraise the strategy for the road subsector as a whole, and assess the benefits of the total investment plan to the economy. Such an approach would open up opportunities for much greater coordination between donors, including possibly joint appraisal, financing and supervision of the complete sector program. But even if each donor wished to continue financing its own package, the sector approach would ensure that his particular package fitted in to a broader program, and neither overlapped with nor conflicted with the activities of other donors.

4.19 The Government would gain by being able to operate with more flexibility to plan the entire road sector investment program within the overall allocation for the sector; the question of which road segments are easily aid-financed would no longer be an important criterion for road investment. And, perhaps most important, considering the emerging resource constraints, a fixed allocation could be agreed on in advance for road investment with the assignment of priorities to individual road segments being made within that allocation.

4.20 The Mission found that several major donors favor a sector or subsector approach to lending, particularly in those areas where individual projects compete for the same resources (e.g. land use or water use alternatives), and a number of donors are already providing assistance at the sector or subsector level in such programs as power and rural water supplies. 1/ There is also wide support among donors for the principle of cooperation and coordination in sector lending, and some progress has been made in this direction. One of the earlier ventures in donor cooperation in Kenya was the joint Nordic program to support the development of cooperatives. More recently, an ambitious livestock development program has been identified, with the assistance of the World Bank, in which five donors will be participating, and the Government has succeeded in coordinating the participation of seven donors in supporting a five-year population program.

4.21 The experience to date in these initial experiments in broad-based donor cooperation suggests that this can be a most valuable approach, but that donors still have a long way to go in learning how to cooperate. It has also shown that the complexities of sector-wide coordination of aid places a much larger demand upon the rather frail aid coordinating machinery of Government. We would suggest, however, that the obvious advantages of such cooperation warrant perseverance on both sides.

4.22 The recently negotiated (April 1973) program loan from U.S.A.I.D. for balance of payments support, which should disburse very rapidly, is a good example of the best uses of this device. A time when no large, fast disbursing project was readily available to U.S.A.I.D., coincided with a period when a reasonably serious balance of payment stringency threatened in spite of generally good economic management, 2/ the program loan was an excellent response. It is the opinion of the Mission, however, that program lending can be confined to such instances. Generally, program lending would not solve any of the Government's problems that can not be solved just as efficiently by project or sector lending, with the improvements in conditions and design that have been discussed above. In particular, the main impediments to an improved investment program -- which might loosely be labeled absorptive capacity problems in the productive sectors -- can not be relieved without the design and implementation of more and better programs, whether the assistance involved is directed to the project or subsector level or effected through program lending.

1/ The World Bank's lending to the EAC corporations (telecommunications, harbors and railways) is also essentially at the sector, or subsector level.

2/ In the event, the balance of payments picture improved quite dramatically from the time that negotiations were started to the time when the loa- was made. This "accident" does not alter the principle.

CHAPTER 5: CONDITIONS OF TECHNICAL ASSISTANCE

5.01 The discussion of technical assistance is divided into three main classes; manpower supplementation, advisory assistance, and training assistance. The tasks of an expatriate technical assistance officer or the components of a technical assistance project may include elements of all three classes or of only one.

5.02 Manpower supplementation has two main forms. The first is usually called consultancy, in which a technical expert, or team of experts, is employed to perform a specific task, with well defined terms of reference and with a short term of office. Consultancy arrangements are straight-forward purchases of specific services for which the consultant has the required background of knowledge and experience. In general the task is so specific, for example, a single project evaluation, that the question of tenure of the consultant or replacement of the consultant does not arise except in cases of nonperformance of the agreed task. A single consultant or a pool of qualified consultants may undertake many similar tasks in succession, and may as a result become more valuable to the permanent bureaucracy, since they acquire experience in applying their particular expertise to local conditions. 1/ As Kenyan consultants become competitive in experience and expertise, one would expect them to share in this work.

5.03 It will probably never be desirable to incorporate many of the tasks done by consultants into the bureaucracy, however, since the highly specialized tasks and the intermittance of work fit better within the more flexible consultancy form. We have argued (Annex 5) that the Government should make greater use of consultants, particularly in the preparation or supervision of investment projects. The Government is reluctant, in many cases, to purchase this project software, particularly where consultants have a relatively high foreign exchange cost. To finance consultants under technical assistance grants, thereby assuring the availability of the best available project advice, has been a highly productive form of assistance. But this assistance has generally been tied aid, with the consultant being hired from the bilateral donor's country, and generally it has been confined to assistance for a single project to be financed by the same donor. Any liberalization of the tying arrangement, which would both widen the consultant market and prevent undue bias in favor of the techniques in vogue in the donor's country, would improve the efficiency of consultancy expenditures and encourage their expanded use. If consultancy assistance can be broadened beyond the single project level (e.g. a sum granted for hiring consultants to prepare and execute a series of projects in small scale industry) the intelligent programming and use of consultants by the ministries would be greatly facilitated. 2/

1/ It is no coincidence, as we have pointed out in Annex 5, that ministries such as the Ministry of Works, which have established a pool of tested consulting firms in their sectors, have substantially expanded absorptive capacity.

2/ Both forms of liberalization strongly imply that donor's cooperate in preparation and use of consultants reports. It would be of little use to build up multinational, sector-specific consultancy experience, if in the event of each loan, a bilateral (or multilateral) donor insisted upon duplicating the consultant's effort.

5.04 The second form of manpower supplementation is the provision of expatriate manpower to do professional work in those areas where the (temporarily) fixed supply of Kenyan manpower is less than the permanent demand. In these cases, to simply ration the available Kenyan manpower would be inefficient; truly competitive bidding for their services would raise their wage rates without increasing the quantity of services, causing distributional problems and complicating the problem of Government wage policy. For this reason, importation of talent makes economic sense. If demand is very large or growing very rapidly relative to Kenyan supply, it is probably sensible to hire expatriate supplementary manpower on long term contracts, recognizing that qualified Kenyans will not be available sooner. The planning horizon for supplementation is the length of time required for training a pool of Kenyan manpower equal to the demand and growing at a rate equal to demand growth. It is quite inefficient to hire such supplementary manpower on a short cycle, constantly replacing them with other experts who require considerable running-in time before they are effective in the Kenyan content.

5.05 For those professionals with alternative employment opportunities in private industry, in other government agencies, or in other closely related professions, the relevant supply/demand considerations pertain to the entire market. It would be frustrating and short-sighted to expect, for example, that the Ministry of Commerce and Industry could train the number of financial analysts that it requires for its own personnel establishment and then dispense with supplemental manpower. They will in practice need supplemental manpower until the supply/demand relationships for financial analysts in the labor market as a whole have achieved equilibrium and the ministry can hire and retain qualified analysts at a reasonable price. It is poor economics to expect any one ministry or industry to Kenyanize any occupation before that point is reached. To continue the example, the Ministry of Commerce and Industry may have trained several times the number of Kenyan financial analysts it needs, and still require expatriate assistance because the analysts have found employment elsewhere. The manpower policy of the ministry can legitimately be judged on its training rate and on the effectiveness of its trainees, wherever they end up working, but it cannot be criticized (legitimately) for its failure to retain the services of the men it has trained. Donors who insist that a Government institution gets into a bidding race, in such a situation of inelastic supply, only complicate the maintenance of a reasonable wage policy and shift the problem of manpower shortage to other (perhaps non-aided) Government institutions or private firms.

5.06 The main implication of this discussion for the donors is that they should be prepared to provide supplementary manpower, of a given type of skill, with a minimum of turnover, for as long as the scarcity of qualified Kenyan manpower is projected to last. Only by coincidence would this period coincide with the disbursement period for any particular project using this skill, or with any period arbitrarily chosen in advance. The result of shorter-term time horizons will probably be excessive costs of turnover of expatriate personnel. If a short time horizon leads to frustration and the withdrawal of needed technical assistance, the cost will clearly be much higher, taking the form of inadequate expert inputs into the planning and execution of Government programs. 1/

5.07 A second kind of technical assistance is advisory assistance. This is temporary assistance designed to provide Kenyan officials, who are themselves in an operational job, with technical or management advice, particularly during the running-in period after their first appointment. This type of assistance can be particularly valuable when the newly appointed Kenyan official is well qualified technically, but lacks operational or management experience. This advisory assistance may be combined with manpower supplementation in a single technical assistance project, but if an individual is assigned both supplementary and advisory duties, confusion and poor performance of the advisory function are invited, because the line of job responsibility is easily blurred. The advisor may end up performing the duties of the officer (usually badly because of an unclear job description), at the expense of both the routine tasks and the advisory function. In this case the advisor would only undermine the confidence of the official and delay the time when he can stand on his own feet.

5.08 A third class of technical assistance is <u>assistance in training</u>. Unfortunately, there is a great deal of confusion over the process of training, and the responsibility for training, under the kind of manpower circumstances which face Kenya. All too often, expatriates in operational or advisory positions are expected to "undertake training", in addition to their primary responsibilities, but their job descriptions fail to specify how, or when, this function should be carried out. Moreover, in many cases, their workload leaves no time for any kind of training, formal or informal. In our opinion, it is very desirable to include a training function in the terms of reference of expatriate officers and consultants, whether they are in operational or advisory positions, whenever this can be done without conflict with their other responsibilities. But their job descriptions must make clear what their training functions are.

5.09 In most cases, training will be directed at relatively junior officers or apprentices, preferably in an explicitly designed and budgeted training program. In some cases, technical assistance personnel might be called upon to give training courses for several hours a week in a formal training environment. This would have the additional advantage of exposing students in academic institutions to problems in the real world. More frequently, however, we believe that the most valuable service is to provide on-the-job training, guidance and encouragement to young and newly qualified Kenyans. This can seldom be accomplished through a process of osmosis; the

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1/ A frustration often mentioned by the donors was the disappearance of "counterparts", and the Mission got the impression from several donors that the failure to retain counterparts was in their opinion a Government failure. Whether any technical assistance was actually terminated or discouraged because of this supposed "failure" was not clear.

function has to be explicitly defined, responsibilities allocated, and time budgeted for individual contact. Unless this is done, the result is almost invariably that other pressures prevail, and excellent young Kenyans fail to gain the experience and the guidance they need.

5.10 It may often be advisable for the training function to be at one stage removed from the expatriate personnel. For example, an expatriate may supplement an experienced and senior Kenyan official, who can then devote more time to training his subordinates because the expatriate is doing some of his more routine work. If the result is that the Kenyan senior officer, by virtue of his local knowledge as well as his own competence, can do an exceptional job at training junior personnel, such an arrangement should get high marks for training, or even for replacement of expatriates in a broader, longer-run sense, in spite of the fact that there is no "trained counterpart" to point to as evidence of success.

5.11 In the Mission's opinion, a great deal of the confusion about training could be avoided if the "counterpart" notion were dispensed with. In most cases, training should probably be directed at junior officers or apprentices, preferably in an explicitly designed and budgeted apprenticeship program. The suggestion that the trainee should replace the trainer is applicable only in the very special case where a local officer is needed to be exactly the same task as the trainer and has the academic qualifications and practical experience necessary to replace the trainer in a fairly short time. And in that special case, it would probably be better to appoint the Kenyan to the job immediately with the trainer reverting to a role of advisor (see above). There are in fact no circumstances we can think of in which the provision of a counterpart seems to be appropriate instrument of training or Kenyanization. If training can shed the counterpart requirement, technical training assistance will be more flexible and straight-forward. Consultancies or long run manpower supplementation will also be relieved of a constant source of friction.

5.12 In a developed non-colonial administration, the usual "counterpart" to an official is his subordinate, all the way down the line. It is generally regarded as good management practice to grade officials partly on how well they are training subordinates to replace themselves. Surely such a self-training bureaucracy is desirable for Kenya in the long run. The implication is that a good deal of training might take the form of advice to senior officials on how to train subordinates, plus the supplementation of manpower which would be necessary to allow every competent Kenyan civil servent or manager time to carry out a training function.

CHAPTER 6: AID COORDINATION

The Coordination Problem and Its Real Costs

6.01 Both the Government and the donors stand to gain in efficiency of planning and effectiveness of aid from an improvement in aid coordination at all levels. Chapter 4 of this annex argues that, for support of the sectors of investment concentration recommended in this report, the agricultural and industrial sectors, an increase in coordinated effort is almost essential, mass programs would be insupportable if left to a single donor. The integration of technical assistance projects with financial assistance was one of the main themes of Annex 5, and Annex 3 showed fairly clearly the need for similar coordination between technical assistance and the administrative arms of the Government dealing with conditions and incentives for private investment. The Mission encountered no argument from Government or from the donors against the proposition that coordination should be improved. Surprisingly, there do not seem to be even the usual bureaucratic reservations about loss of flexibility or freedom of maneuver.

6.02 Immediately below this "coordination is a good thing" plane of generalization, however, some real impediments are quickly obvious. First and most obvious are the institutional weaknesses of both the Government and the donors. The Government is simply not using enough manpower to do a thorough job. The donors are, by and large, represented by field staff having very little negotiating power, except as delegated on a case by case basis, from their national headquarters. 1/ Thus the usual procedure is for a small Government staff to conduct a good deal of the actual business of assistance negotiations outside the country, thereby spreading the Government resources even more thinly and isolating each bilateral negotiation. Coordination based on quick response to detailed proposal and counterproposal is clearly impossible in this context.

6.03 A second obvious impediment to coordination is competition among the donors for "the best" projects. The operational limitations on the donors are remarkably similar. Almost all of them finance foreign exchange costs more easily than local costs. They all favor easily managed projects because of the common shortage of management personnel. They all prefer to be associated with visible projects which have a high probability of success. Although there is some diversity in stated goals of individual aid programs, it remains true that from a given list of government development programs, readily available donors would cluster arond a very few. This competition for the few

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1/ The field staff of the United Kingdom ODA office have recently been given considerable freedom of operations. Loans up to £ 0.25 million can be approved by the field staff subject to the overall limit on aid from ODA and within the guidelines of an annually revised policy paper. This recent innovation is a hopeful contrast to past ODA practices and the usual practices of other donors.

projects that fit well with donor preferences is surely unfortunate, but it is hard to imagine changing it in the short run.

6.04 A third impediment to coordination grows out of the first two. This is the (often expressed) impression of the donors that the Government is purposefully vague and uncommunicative in coordination matters in order to plan one donor off against the other. An apparent result is that donors sometimes set up counterstrategies of vagueness with both the Government and one another, in order to compete for the best projects at the greatest advantage. For the donors as a group, the competition is useless and, for the Government, the only possible gain is better matching of investments and donors. Meanwhile, the attitude of secrecy (most often expressed as the statement that everyone else is secretive) has real costs to the Government:

(a) uncertainty over who is to finance which project leads to delays in project preparation and appraisal since donors are, by and large, unwilling to accept each others appraisals;

(b) switching of (usually implied) project commitments from one donor to another wastes technical assistance or aid management because of duplication of preparation effort;

(c) uncertainty biases donors against the more complex project, with a longer preparation period, in favor of the project that can quickly be negotiated, committed, and disbursed. 1/

Some Suggestions for Improvement in Coordination

6.05 Any attempt at improving the machinery and coordination should probably take as given, at least in the short term, the manpower shortages in the Government staff and the limited authority of the donors' field staffs. 2/ But even working within these constraints, there is, in our opinion, considerable room for improvement. Some suggestions are:

(a) Early commitment in principle, on the part of the Government, to undertake a given project or program, should be given wide publicity among the donors, and this publicity should include

1/ The area or country desks in aid agencies are naturally inclined to grasp any "bird in the hand" project in the country for which they are responsible, if the alternative is to see their financial provision run out at the end of the fiscal year by default, or reallocated to another project. It is by no means unusual for a country's allocation to be influenced, if not determined, by the speed with which the previous tranche was disbursed.

2/ This is not to go back on our former recommendation (Annex 5) that Government increase its aid coordination staff. Rather, it is a recognition that, even with good effort to build up that staff, the scarcity will remain for quite some time.

an approximation of the financial aid and the technical assistance that will be required. Technical assistance requests should be liberal, to give donors the opportunity to realize, in fact, their stated intention to relate technical assistance to projects.

(b) The donors should, in their own interests, attempt to establish their own assistance programs on a long term basis; a rolling four year operations program for each of the donors would probably suffice, for practical purposes. Such a program would allow both Government and donor to plan manpower and financial budgets, establish the critical path for individual projects, line up necessary joint donors and so forth. In order that these programs should have real operational content, they should be based as much as possible on the Government's investment commitments. The four year operations programs of the lenders should be the basis for (perhaps yearly) discussions with Government, and a statement of intent by the Government and the donor should be issued as a result of that meeting. Clearly, these statements of intent would only be morally binding, and even this depends upon the program or projects being judged to be sound in a final appraisal. 1/

(c) Wherever necessary, the Government should attempt to confront donors with the necessity for cooperation at the project level. For example, if apparently available technical assistance from one source would fit efficiently with financial aid apparently available from another, the two donors should be given adequate opportunities to confront and, where possible, compromise their institutional limitations at the earliest possible time.

(d) The Government should seek very wide joint involvement in the major programs, particularly in the productive sectors. Risk of failure is a legitimate cost of vigorous development efforts, but this risk is best shared as much as possible. Similarly, projects having a high local cost or imprecise

1/ Several donors have now introduced this form of aid programming and it is to be hoped that others will follow suit. Some donor agencies carry out elaborate internal programming exercises, but do not have a procedure for discussing their programs with the Government. But to form operations programs without discussions with Government is no more sensible than it would be for a commercial bank to decide on its lending to Mr. Jones without consulting Mr. Jones.

borderlines should be presented to all donors on the understanding that they are asked to take only a part of the burden of the hard project. Donors should respond in a generous spirit to this Government request for support in administratively difficult projects.

(e) The earliest agreement on all joint projects and programs should be the agreement over technical assistance (joint, multilateral, or bilateral) and the agreement in principle to accept the results of the analysis of the program, with ample provision for participation in staffing or supervision of work in progress. Once again, the technical assistance should be requested early, in liberal amounts.

(f) The Government should be seen to be cooperative and even-handed in dispensing information to other donors concerning its commitments and agreements on bilaterally aided projects. This appears to be perfectly compatible with shopping for the best terms, attempting to match donor limitations with the requirements of the overall investment program, and so forth. This would require increased government manpower to present data and descriptions systematically and periodically; indeed much of the criticism on the part of the donors of government "secrecy" may be due to a failure of the donors to understand the extremely tight limits on the Government's staff. Systematic tabulations of the state of play of various assistance negotiations simply do not exist.

6.06 Although improvements in coordination at the project level seem to be the most necessary and the most probable coordination attempts at the level of the overall investment program and its financing should be continued and, if possible, upgraded. Preparation of the project list for the Consultative Group meeting, for example, appears to have been useful and should be continued, with whatever refinements in the project descriptions that are practicable. The UNDP effort to present a periodic overview of technical assistance is also useful. If it could be supplemented with a forward view of Government technical assistance it would be still more helpful in general program planning by the donors. It is the firm impression of the Mission, however, that additional effort to increase coordination at the level of the individual development undertaking (discrete project or major program), would have the highest rate of return of all marginal coordination efforts.

Aid Coordination Machinery

6.07 The major formal mechanism for coordinating external aid in East Africa is the Consultative Group for East Africa which meets separately on the three East African countries under the chairmanship of the World Bank. There appears to be agreement from both donors and the Government of Kenya that the Consultative Group is performing a useful function, particularly in providing a periodic opportunity for reviewing the overall priorities for external assistance to Kenya. However, the Consultative Group meets only every second year and has little or no function between times. There have been several suggestions from members of the Group that the World Bank, in its capacity as secretariat to the Group, might undertake a more continuous function in coordinating aid, particularly at the project level and in Kenya.

6.08 This raises the question whether the World Bank should take on a wider function as broker in the coordination of aid. It can be argued that the Bank, as an apolitical but project-oriented international agency, might be in a position to help the Government and other donors in streamlining the flow of external aid. Elements of the Bank's experience, in Kenya and elsewhere, such as serving as executor for special project-oriented studies, identification and appraisal of projects, and cooperation with other donors in joint or parallel financing, would clearly be valuable as a background to this effort, as would the Bank's position as chairman and secretariat to the Consultative Group. For all of this experience, however, the Bank can claim little special achievement in coordination per se, and the Bank's main desirable attribute as broker would be a genuine disinterest in the special goals of the other donors. The Bank's own objectives appear to coincide fairly well with those required of a broker: the Bank is concerned to maxamize the flow, the speed and efficiency of aid, to support the efforts of the Government in developing difficult mass programs, and to promote joint or parallel financing whenever possible.

6.09 As a broker, the Bank has shown that it can establish liaison with both the field staff and the headquarters staff of the various bilateral donors. These contacts could be further used in an attempt to generate wide support for programs to which the Government has committed itself, particularly for the more difficult mass programs in the productive sectors. The Bank's reputation for serious and disinterested project analysis, as well as its financial participation, is useful in lining up support for such programs. The Bank may also help to eliminate some duplication of bilateral donor's effort, and to minimize delay. The Bank has already undertaken some brokerage of this kind, and could no doubt do more if requested by the Government and by other donors. 1/

6.10 There is also scope, in our opinion, for much closer cooperation among donors in country economic work and sector analysis. As things stand, each donor country, as well as the World Bank and the International Monetary Fund, feels obliged to mount its own economic missions from time to time. While each agency onviously has special interests to follow up in such missions, there is much common ground, and much of the time of each mission is spent in asking the same questions of the same hard-pressed Government officials as the

1/ It should be emphasized that these suggestions only relate to the possible role of the Bank as an honest broker. Any assistance which the Bank might give would in no way lower the basic responsibility of Government for aid coordination. Nor could it interfere in the bilateral relationships between Government and other donors, or in the valuable role played by UNDP in programming its technical assistance work.

last mission. This is not only an unfortunate duplication of effort on the part of the donors but, much more serious, preempts a great deal of the time of senior Government officers.

6.11 We are not overly optimistic about a dramatic change in these procedures; there is certainly no immediate prospect of achieving, for example, a unified annual review mission, however sensible that might seem in principle. But some closer coordination is clearly both possible and necessary, if only to relieve the burden on Government. Again, it is possible that the World Bank might provide some leadership in coordinating the activities of donors, not only because of its central role in the Consultative Group, but because it is the only donor which regularly makes available its economic reports (such as this one) to other donors. As a start, it might be useful for all donors to assess the extent to which Bank reports can be relied upon to provide the information and analysis they want in planning their own program. The bi-annual meetings of the Consultative Group provide an obvious (but seldom used) opportunity for donors to suggest any improvements or addition to the Bank's economic work which would make it more widely useful. In addition, there is no reason why bilateral donors should not participate in joint economic missions with the Bank, and this might be of particular value to some of the smaller donors operating in Kenya.

STATISTICAL TABLES

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TABLE 1: DEBT OUTSTANDING AND LOAN DISBURSEMENTS, 1968-1972

(US$ Millions)

	Total Debt Outstanding at Year-End (including Undisbursed)					Annual Disbursements				
	1968	1969	1970	1971	1972	1968	1969	1970	1971	1972
International Organizations	51.2	74.6	102.0	128.8	187.4	8.5	10.5	10.0	9.7	26.5
of which IBRD	6.3	29.7	36.9	59.8	88.6	0.1	0.6	2.9	6.6	19.5
IDA	42.6	42.6	61.3	61.8	91.8	8.2	9.7	6.6	3.1	5.9
ADB	2.3	2.3	3.8	6.8	6.8	0.1	0.2	0.4	-	1.0
Governments	226.2	227.8	234.5	232.3	245.3	21.2	16.1	18.8	21.7	16.6
of which UK	181.1	177.7	175.3	152.5	144.3	15.0	13.8	15.1	4.5	1.9
USA	16.5	15.9	18.8	26.1	27.6	2.1	1.2	0.7	11.1	0.6
Germany	12.2	15.6	16.6	19.3	18.2	1.9	0.5	1.5	2.7	1.5
Sweden	3.7	3.7	6.3	15.5	26.1	-	-	0.1	0.8	4.7
Italy	7.5	7.5	7.5	8.1	8.1	-	-	-	-	5.5
Netherlands	-	-	-	1.8	8.6	-	-	-	-	1.2
Others	5.2	7.4	8.0	9.0	12.4	2.2	6.0	1.4	2.6	1.2
Private Sources a/	65.9	62.6	57.1	69.7	77.3	7.3	0.1	1.5	11.5	16.1
TOTAL	343.3	365.0	393.6	430.8	510.0	37.0	26.7	30.3	42.9	59.2

Source: Table 4, Main Report.

a/ Including small amounts of unidentified debt.

TABLE 2 NEW COMMITMENTS OF EXTERNAL LOANS BY SOURCE, 1968-72
(US$ Million)

SOURCES	NEW COMMITMENTS 1968	1969	1970	1971	1972	Amount Undisbursed at the end of 1972
IBRD	-	26.1	8.3	23.0	29.0	56.0
IDA	16.4	-	18.7	-	28.0	48.0
Other International Organizations	-	-	1.5	3.5	-	5.2
TOTAL INTERNATIONAL ORGANIZATIONS	16.4	26.1	28.5	26.5	57.0	109.2
Canada	-	0.5	-	-	3.7	4.0
Denmark	2.7	-	-	-	-	0.7
Germany	1.1	3.1	1.8	1.2	-	2.5
Israel	1.5	-	-	-	-	-
Italy	-	-	-	-	-	2.6
Japan	-	-	-	0.7	-	0.2
Netherlands	-	-	-	1.7	6.8	7.4
Norway	-	1.4	-	-	-	-
Sweden	3.6	-	4.6	6.2	17.1	20.3
United Kingdom	0.5	0.5	-	0.1	-	4.1
United States	-	-	3.5	7.8	2.3	2.7
TOTAL GOVERNMENTS	9.4	5.5	9.9	17.7	29.9	44.5
Private Banks	-	-	-	3.5	17.3	2.4
Suppliers Credits	-	-	1.1	7.3	-	-
Unclassified	-	-	2.1	-	-	0.1
TOTAL PRIVATE	-	-	3.2	10.8	17.3	2.5
TOTAL ANNUAL COMMITMENTS	25.8	31.6	41.6	55.0	104.3	
CUMULATIVE UNDISBURSED COMMITMENTS AT YEAR END	96.1	97.7	109.9	124.5	156.3	156.3

Source: Economic Analysis and Projections Department, IBRD.

TABLE 3: AVERAGE TERMS OF LENDING, 1968-1972

(1) Lending Terms on Debt Outstanding at Year's End

	1968	1969	1970	1971	1972
Average interest rates (percent)	3.38	3.59	3.54	3.90	3.87
Average original grace period (yrs)	4.6	5.0	5.6	5.2	5.7
Average original maturity (yrs)	29.4	29.2	30.2	29.4	29.4
Average grant element of loans (percent)*	51	50	51	47	48
Grant equivalent of loans at discount ratio of 10% (US$ millions)	174	181	199	203	244

*At Rate of Discounts of 10%

(2) Average Interest Rates on Debt Outstanding at End of Year

Sources:	1968	1969	1970	1971	1972
International Organizations					
IBRD	5.82	6.86	6.97	7.08	7.14
IDA	0.75	0.75	0.75	0.75	0.75
African Development Bank	5.00	5.00	5.39	5.66	5.66
International Coffee Organization	0.00	0.00	0.00	0.00	0.00
Governments	3.44	3.41	3.41	3.61	3.43
Suppliers	6.87	6.87	6.89	5.86	6.11
Privately Placed Bonds	8.00	8.00	8.00	8.00	8.00
Publicly Issued Bonds	4.02	4.03	4.21	4.21	4.23
Banks	5.99	6.04	6.08	5.82	5.88
Average Interest Rates on Total Debt	3.38	3.59	3.54	3.90	3.87

Source: Economic Analysis and Projections Department, IBRD.

TABLE 4: TERMS OF LENDING ON LOANS FROM GOVERNMENTS, 1968-72

(1) Average Terms of Government Loans to Kenya on Loans Outstanding at Year's End

	1968	1969	1970	1971	1972
Average Interest Rate (percent)	3.44	3.41	3.41	3.62	3.42
Average Grace Period (years)	4.5	4.6	4.9	4.6	5.0
Average Original Maturity (years)	27.7	27.7	27.9	28.1	28.0
Grant Element of Loans (percent)*	49	50	50	48	50
Grant Equivalent of Loans ($ millions)*	111	113	118	112	123

*At rate of discount of 10%

(2) Distribution of Outstanding Loans by Interest Rate (US $ Million)

Interest Range	1968	1969	1970	1971	1972
0 to 3 percent	109	113	120	112	130
Over 3 to 6 percent	48	47	46	54	52
Over 6 to 9 percent	69	67	66	63	61
Over 9 percent	0.2	0.2	1.9	2.1	2.1

(3) Average Interest Rates and Loans from Governments by Donor, on Loans Outstanding at Year's End

	1968	1969	1970	1971	1972	Percentage of Outstanding Loans by Donor 1968	Percentage of Outstanding Loans by Donor 1972
Canada	-	-	-	-	-	-	1.7
Denmark	-	-	-	-	-	1.2	1.2
Federal Republic of Germany	3.32	3.26	3.17	3.10	3.08	5.4	7.4
Israel	6.00	6.00	6.00	6.00	6.00	0.8	0.5
Italy	4.50	4.50	4.50	4.50	4.50	3.3	3.7
Japan	-	5.75	5.75	5.75	5.75	-	0.9
Netherlands	-	-	-	2.50	2.50	-	3.5
Norway	-	0.75	0.75	0.75	0.75	-	0.6
Sweden	0.75	0.75	1.48	0.85	1.01	1.6	10.6
United Kingdom	3.61	3.60	3.66	4.04	4.13	80.1	58.8
United States	2.07	2.06	2.10	3.27	3.03	7.3	11.2
USSR	2.50	2.50	2.50	2.50	1.47	0.2	0.2

Source: Economic Analysis and Projections Department, IBRD.

TABLE 5: TECHNICAL ASSISTANCE AND FINANCIAL AID ON GRANT TERMS, 1969-71
(Annual Average, US $ Million)

	Technical Assistance	Financial Grants	Total Grants
Austria	0.2	0.0	0.2
Australia	0.1	0.0	0.1
Canada	1.9	0.1	2.0
Denmark	1.3	0.2	1.5
Federal Republic of Germany	2.6	0.1	2.7
Italy	0.2	0.0	0.2
Japan	0.6	0.0	0.6
Netherlands	1.5	0.0	1.5
Norway	1.4	1.1	2.5
Sweden	2.5	0.4	2.9
Switzerland	0.1	0.1	0.2
United Kingdom	7.2	0.7	7.9
United States	4.3	1.0	5.3
TOTAL	23.9	3.7	27.6

Source: Economic Analysis and Projections Department, IBRD
(Data Retrieval System)

TABLE 6: ANTICIPATED ANNUAL COMMITMENTS OF FINANCIAL ASSISTANCE, 1973-1975
(US$ millions)

Donor	Anticipated Commitments (Annual Average)
IBRD/IDA	87.0
United Kingdom	13.0
Sweden	10.5
United States	9.0
Federal Republic of Germany	6.0
Netherlands	3.0
Denmark	2.5
Norway	3.5
Canada	2.5
Japan	1.5
All other Bilateral Loans	3.0
All other Multilateral Loans	5.0
Suppliers Credit	10.0
Loans from Private Financial Institutions	3.5
Total Commitments	160.0

Source: Mission estimates

TABLE 7 EXPECTED DISBURSEMENTS OF FINANCIAL ASSISTANCE, 1973-76
COMPARED TO RECENT GOVERNMENT INVESTMENTS
(Millions of $U.S.)

	Expected Disbursements a/				Government Investments b/
	1973	1974	1975	1976	1970/71 - 1972/73
					Annual Average
Agriculture, Veterinary and Forestry	8	14	22	32	23.2
Industry and Commerce	4	8	15	18	10.3
Infrastructure	46	60	65	65	59.6
Social Sectors	3	5	7	8	29.7
Other (including General Purpose)	6	6	8	8	36.1
Total	66	93	117	131	159.0

a/ Source: Mission estimate 1973 sectoral disbursements proportional to estimates of sector distribution of undisbursed debt outstanding, January 1, 1973. Thereafter, sectoral composition shifts according to sectoral plans of donors for commitments, 1973-74.

b/ Source: Annex 2.

TABLE 8: INDICATORS OF DEBT IN KENYA AND OTHER COUNTRIES
(For selected countries with an average per capita income of US$101-200)

Country	Loan Commitments Per Capita 1965-68 Average	Loan Commitments Per Capita 1969-71 Average	Debt Service Per Capita 1965-68 Average	Debt Service Per Capita 1969-71 Average	Debt Outstanding Per Capita End 1968	Debt Outstanding Per Capita End 1971
Bolivia	6.66	18.89	1.51	4.08	81.21	120.17
Botswana	1.49	27.03	1.09	1.15	16.98	93.72
Mauritania	4.98	16.33	1.77	2.53	33.38	76.31
Swaziland	4.75	3.62	5.22	4.94	72.16	71.96
Tanzania	2.41	10.41	0.59	1.27	17.97	44.40
Cameroon	4.85	5.68	1.00	1.62	26.14	38.88
Kenya	4.33	3.96	1.77	1.73	32.05	36.68
Pakistan a/	4.02	4.20	0.88	1.30	26.58	34.49
Sudan	3.30	3.57	1.09	2.02	21.25	26.83
Togo	1.66	1.60	0.83	1.11	22.15	24.67
Dahomey	1.44	3.66	0.68	0.95	15.89	24.08
Central African Rep.	1.41	4.51	0.76	1.22	14.21	22.45
Uganda	2.45	1.98	0.76	1.19	17.80	20.03
Malagasy Rep.	2.20	1.78	0.83	1.03	17.46	19.26
India	2.12	1.57	0.75	0.92	15.53	17.91
Lesotho	1.77	0.34	0.31	0.39	8.31	8.70
Nigeria	1.29	1.79	0.73	1.01	12.00	1.34

a/ Includes Bangladesh.

Source: "World Debt Tables", IBRD Report No. EC-167-72, December 15, 1973.