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THE SYSTEM OF EXCHANGE CONTROL IN KENYA

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ABSTRACT

The paper tries to give an analysis of the quantitative exchange control system, which Kenya took over from the Colonial Administration at independence. After presenting the legal framework of exchange control, the paper discusses the provisions applied to the various international transactions covered by exchange control. From this presentation it becomes apparent, that the exchange control administration played in the past a minor role in the formulation of policies for imports which in 1971 accounted for 77% of all transactions in the current account. The bulk of the exchange provisions center on invisible payments, which are normally granted upon documentary proof or within specified limits. For the most important item in this section, International Investment Income, the role of the exchange control administration is reduced to policing the very liberal provisions granted to investors under the Foreign Investment Protection Act. The paper closes with a discussion on how the present quantitative system of exchange control could be improved.

INTRODUCTION

The problem of inadequate exchange earnings to finance the import of capital goods needed for economic development is familiar to most less developed countries. In various degrees these nations suffer from foreign exchange shortages which limit their growth. In order to achieve economic progress while avoiding the negative effects of balance of payments constraints,

the less developed countries resort to export promotion, and/or import substitution policies and the implementation of exchange control measures effecting all transactions in foreign exchange by residents and transactions in the domestic currency by non-residents of the country concerned.

For an underdeveloped country exchange control is not a tool to eliminate a structural balance of payments deficit due to heavy capital good imports. It is an instrument to foster economic development by controlling imports and exports as well as payments and transfers in the current account and to prohibit capital outflows.

For a member country of the International Monetary Fund restrictions on capital movements - irrespective of whether long or short term - are in accordance with the Fund's articles. However all payments for current transactions - i.e. generally speaking all payments in connection with trade and services, interest on loans and net income from direct investment, moderate amounts for amortization of loans or depreciation of direct investment and moderate amounts of family living expenses - should be unrestricted. Since this would endanger the precarious foreign exchange position of the developing countries, article XIV of the Fund allows temporary restrictions on current payments. This clause, originally designed to aid the reconstruction of post-war Europe, today serves as a basis for the exchange control restrictions imposed by most African countries.

The exchange control system generally used in Tropical Africa¹ is, a quantitative one,² originally designed by the former colonial power, which was continued after independence. Kenya, which operates a quantitative exchange control system, is no exception to this rule. However unlike most African countries it started its independence with a large foreign exchange reserve accumulated under the Currency Board System in operation in East Africa and ended in most years thereafter with a surplus on the balance of payments.

1. IMF, 22nd Annual Report, Exchange Restrictions, Washington 1971, p.491-495
2. An exception is the Central African Republic which uses a multiple exchange rate system.

Prior to 1970 Kenya did not experience severe balance of payments problems. The steadily growing balance of trade deficit normal for a developing country could be reduced by non-visible earnings, especially from tourism. The remaining deficit in the current account varying between £ 3.3. mill. in 1969 and £ 19.2 mill. in 1967 could, with the exception of 1967 be covered by long term capital inflows such as receipts from foreign investment in Kenya and through grants and loans of foreign governments and international organizations.³ Consequently Kenya experienced steadily rising foreign exchange reserves reaching £ 89 mill. in March 1971.

In 1971, however, the balance of payments situation deteriorated rapidly. The visible balance reached a deficit of £ 88 mill., compared to £ 50 mill. for 1970, the highest deficit so far. The deficit in the current account of almost £ 54 mill. could not be covered by long term capital movements totalling only £ 22 mill. The overall balance of payments deficit of £ 31.5 mill. resulted in a decline in foreign exchange reserves reaching a low of £ 62 mill. despite the allocation of Special Drawing Rights of £ 2.2.mill.⁴

Under these circumstances foreign exchange control had to play an important role in the struggle to stop a further depletion of the foreign exchange reserves.

In this paper the exchange control system of Kenya is outlined and the question analysed, of whether the system is designed to fulfil the role assigned to it. Finally suggestions for improvement of the present exchange control system are put forward.

The paper is not concerned with alternative policies to exchange control per se, nor does it deal with the effects of the present exchange control system upon growth, price level, employment, income distribution etc.

A. I. THE LEGAL FRAMEWORK OF EXCHANGE CONTROL.

Exchange control in Kenya was initiated under the Colonial Administration as part of the British exchange control system implemented at the beginning of World War II and continued by the Government of Kenya after Independence.⁵ In 1967 all previous legislation was summarized in the

3. Economic Survey 1969 p.23 and 1972 p.20

4. Economic Survey 1972, p.20 and p.23

5. The Kenya Exchange Control Legislation distinguishes between the Sterling and the Non-Sterling Area. For the United Kingdom this

Revised Exchange Control Act (CAP 113) which gives the authorities the power to exercise almost complete control over all transactions in gold⁶ and foreign exchange by residents and transactions in domestic currency by non - residents.⁷ The Exchange Control legislation still upholds the fiction of a unified shilling currency area existing within the East Africa Community without exchange control measures in force between the partner states.⁸

For the implementation of the Exchange Control Act the government issued a set of Exchange Control Administrative Notices and Instructions (EN) which define the policy decided by the Minister of Finance and Economic Planning in cooperation with the Central Bank. The latest printed version of these Notices and Instructions is the fifth edition from 1972. Subsequent changes are announced through Exchange Control Circulars (Ec) issued by the Exchange Control Department of the Central Bank to whom the Minister of Finance and Economic Planning delegated the administration of exchange control. The Bank in turn delegates most of the routine decisions to "Authorized Dealers" (Commercial Banks) and "Authorized Depositories" (Commercial Banks and Members of the Nairobi Stock Exchange).

In order to enforce the provisions of the Exchange Control Act the Act provides legal sanctions in form of fines and imprisonment for offenders. In 1971 a few cases dealing with exchange control evasion have been publicized in the local press with the clear aim to discourage black market dealings⁹

5.cont/ separation is practical since most of its foreign trade is invoiced in Sterling. For Kenya the separation could be justified prior to 1965 when greater freedom of capital movement existed within the Sterling Area. However in 1964 and 1965 Kenya experienced an alarmingly high rate of a net outflow of long term capital which forced her in June 1965 to impose exchange control restrictions against the rest of the Sterling Area, except Tanzania and Uganda. The separation between Sterling and Non-Sterling Area still existing today does not seem to be meaningful, especially since Britain recently introduced exchange control measures against other Sterling Countries.

6. Residents of Kenya other than banks and authorized industrial users may not hold or acquire gold in any form other than jewellery at home or abroad. An exemption are gold coins acquired for numismatic purposes. Exchange Control Act, Part II.

7. A resident in the meaning of the Exchange Control Act is a person living four years or longer in Kenya. Persons being less than four years in the country are considered non-residents. EN No. 2 (Residential Status)

8. For exchange control measures within the East African Community see section IV below.

9. See for example Daily Nation 16.5.72 p.4; 20.6.72 p.4

II THE EXCHANGE CONTROL SYSTEM.

The exchange control system of Kenya relies solely on foreign exchange restrictions determined in quantitative terms through discretionary action by the authorities.¹⁰ Hence the system is only limiting or curtailing demand for foreign exchange for visible and invisible payments and capital outflows. The overall demand for foreign exchange - in any developing country with exchange control measures exceeding supply - is divided in various sectors for which exchange is granted within defined limits, upon documentary evidence, or for which exchange is refused.

The portion of demand for foreign exchange not granted results in the creation of an (illegal) "black" market in Kenya and a market abroad, where Shillings are sold against hard currencies at a discount of 25 to 30%.¹¹

On the supply side (receipts) the Kenya exchange control authorities act only as supervising agents to insure surrender of exchange earnings to "Authorized Dealers".

These dealers, the Commercial Banks, also handle the various types of accounts allowed for non-residents of Kenya. Upon Exchange Control approval non-residents living in Kenya may open two forms of accounts, whose balances are freely transferable abroad. Residents of Sterling Countries, except those of Tanzania and Uganda, can operate a Non-resident Sterling Account; those of non-sterling countries can open an External Account.¹² Both accounts can freely be credited with "approved payments" by Kenyan residents, with transfers from other Sterling Accounts or External Accounts or from foreign "hard currency" accounts abroad, with proceeds of sales in Kenya of any foreign exchange or gold. They may be freely debited for payments to other Sterling or non-Sterling countries or for transfers to other Nonresident Sterling or External Accounts in Kenya or for purchase of foreign exchange or Kenya Shillings.¹³

Nontransferable funds of persons living outside East Africa are credited to Blocked Accounts. These funds can only be transferred if used for the purchase in Kenya of specified government bonds, which must have a life span of at least five years after acquisition. The redemption proceeds of these bonds as well as interest as when it accrues is then transferable abroad.¹⁴

10. For a theoretical treatment of exchange control systems see IDS Working Paper No. 49: Exchange Control in Less Developed Countries.

11. Newsweek each week gives a table of unofficial foreign exchange rates based on Foreign Banknote selling Rates of the Foreign Commerce Bank in Zurich.

II THE EXCHANGE CONTROL PROVISIONS.

For a systematic treatment of the working of the Kenyan Exchange Control System the role of the administration in the surrender of receipts and in the distribution of payments and transfers will be presented in some detail. In discussing the various receipts and payments involved, the presentation of the balance of payments figures as published in the Economic Survey is used.

1. Credits (Receipts)

One important aspect of exchange control is to ensure that all receipts from outside the Scheduled Territories - Kenya, Tanzania, Uganda, arising from export of goods and services and from capital imports are sold at official rates to a bank in Kenya.

a. Merchandise transactions: Exports to countries outside the East African Community are, with few exceptions, not restricted. However exports of certain foodstuffs and agricultural products, especially tea, require a license or are limited to ensure sufficient supplies for local consumption.¹⁵ Other exports, notably coffee, are controlled through marketing boards of the product concerned. For political reasons shipments to Rhodesia and South Africa are prohibited. The shaping of the Kenyan export policy, however, does not come under the jurisdiction of Exchange Control, its role is limited to one of supervision. It has to ensure that exports are paid in "accepted foreign exchange"¹⁶ and that it is offered to commercial banks for conversion at official rates into Kenya shillings. The Exchange Control Act specifies, that the banks have to check "that payments for the goods has been made in an approved manner to a person resident in Kenya, or will be made within 6 months from the date of Export."¹⁷ To control the legal conversion of export proceeds the exporter has to file two copies of a control document with customs - form CD 3 - stating the fob value of goods exported. Customs then sends one copy to Exchange Control, the other to the exporter's bank. When the latter receives payment from abroad, Exchange Control is informed.

12. Again the separation is taken over from the British Exchange Control legislation. After 1968 it might have been justified by the need of the Central Bank to hold its reserves mostly in Sterling in order to be eligible for an exchange guarantee of the UK. Under this guarantee Kenya was required to hold a minimum Sterling proportion of total foreign reserves and therefore could no longer diversify its reserves at will. B.J. Cohen, The Reform of Sterling, Essays in International Finance no 77, Dec. 1969, p. 24

13. EN No 3 (Non-Residents Accounts)

14. Exchange Control Act, Sect 34 and Third Schedule

15. A license is also required for certain minerals, precious stones and strategic minerals - Exchange Restrictions (1971): Kenya

16. Austrian Shillings, Belgian Francs, Canadian Dollars, Danish and Faroese Kroner, German Marks, French Francs, Italian lire, Japanese yen, Netherland Guilders, Norwegian Kroner, Portuguese Escudos, Spanish pesetas,
cont...pg. 6

This control document was initially only required for exports with an fob value exceeding to K/sh 10,000/- . In September 1969 this amount was reduced to K/sh 5,000/- and in March 1970 the reporting ceiling was lowered to K/sh 1,000/-.¹⁸ The declaration of export value is, however, required for all exports of game trophies regardless of value. The exemption to file an export declaration does not affect the obligation of the exporter to offer proceeds for conversion to a local bank.

The filing of the CD 3 form can also be used for checks against falsification of export documents. Due to the absence of an export subsidy system the problem of overinvoicing exports¹⁹ does not exist in Kenya. Under-invoicing of exports, with the tacit understanding that the difference between real value and invoice value is to be paid in an illegal account of the exporter held abroad, does not arise in connection with most agricultural products exported, which are controlled through a system of licensing and/or marketing boards.²⁰ Since agricultural exports make up around 75% of total export value, the exchange control administration does not check on under-invoicing. Assuming no manpower problem, the cost to do so would probably outweigh the gains.

Non-commercial shipments such as gifts in kind above a fob value of K/sh 500/- require exchange control approval. The same applies to exports which are not paid for in approved foreign exchange or for which no return is expected.²¹ If exports are made by a subsidiary to a parent company abroad and payment is made through an Inter-Company Account held outside Kenya, the approval of Exchange Control is needed. If granted, the company concerned may not retain large credit balances overseas. Regular transfers of funds must be received from abroad to reduce the balance of the account to a minimum.²² In recent years the number of firms allowed to operate an Inter-Company Account has been restricted.

16. pg. 5 cont./ Swedish Kroner, Swiss Franks, US' Dollar, and all Sterling Area Currencies other than Kenya, Tanzania and Uganda Shilling.

17. EN No. 13 (Export Payments)

18. Ec 10/1970 and Ec 6/1971 - the previous regulation requiring a declaration for all exports to Zaire, Ruanda and Burundi above a fob value of K/sh 2000/- is outdated through the lowering of the general ceiling to K/sh 1000/- in March 1970

19. Theoretically it might also be profitable for an exporter to over-invoice exports. As usual the exporter must surrender the full declared value of exports, which requires the purchase of illegal foreign exchange to make up the amount of declared over actual value of exports. This practice becomes profitable if an ad valorem subsidy rate exists which is larger than the

b. Services.

Receipts from the export of invisibles must be paid in foreign exchange to be sold to a bank in Kenya. Companies, firms and institutions operating in Kenya providing services to persons living outside the Scheduled Territories, e.g. safari firms, travel agents, accountants, insurance companies etc must bring into Kenya the proceeds of their services provided to persons living outside the East African Community.

The only item worth commenting on is foreign travel, i.e. the income from tourism which in 1971 amounted to £ 24, 1 mill or around 25% of export proceeds. Tourists coming to Kenya are of course required to convert their foreign notes or traveller cheques at a local bank.²³ Also the importation of Kenya currency notes into the country is prohibited since March 1971. As far as tourists are concerned there is no machinery to control the movement of funds in order not to disturb this important source of foreign exchange. Thus incoming tourists do not have to declare their foreign currency holdings and only occasional checks for imported Kenya currency notes are made, nor are official exchange receipts demanded upon departure.

c. Long term capital movements. There is no restriction on the import of foreign capital for investment. On the contrary Kenya strives to attract foreign investment in wanted production lines and hence guarantees eventual repatriation of the invested capital to the entrepreneur. This is done in form of a "Certificate of Approved Enterprise" issued by the Treasury under the terms of the Foreign Investments Protection Act 1964 (Revised Edition 1967). However foreign investments in certain lines of production also require approval under the E.A. Licensing Ordinance.

19. pg. 6 cont./ premium demanded for foreign exchange on the black market.
- see Jagdish Bhagwati, "Fiscal policies, the faking of foreign trade declarations and the balance of payments", Bulletin - Oxford Univ. Institute of Economics and Statistics, vol 29 (Febr. 1967), No 1p.61-77

20. The underinvoicing of exports as a vehicle for illegal capital transfers is only one aspect of this practice. The exporter can earn a handsome profit if he can charge a premium, when selling the illegally acquired foreign exchange. Where an export tariff is levied his profit is increased through tariff payments saved. But even if a subsidy is paid for exports, underinvoicing will be profitable if the subsidy paid is smaller than the premium earned by the sale of foreign exchange on the black market.

21. EN No 23 (Cash gifts) and No 13 (Export Payments)

22. Ec 24.3.1971 and EN No 26 (Inter Company Accounts)

23. Prior to November 1970 tourists could re-exchange an unlimited amount of local currency upon proof of official exchange. Due to irregularities the amount available for re-exchange prior to departure was reduced in November 1970 to K/sh 1000/-. At the same time the banks were requested to check the reason for re-exchange if it occurred within 48 hours. - EC 22/1970.

The purchase of Kenya securities from a recognized stock exchange by non-residents is freely approved, provided payment is made in foreign exchange. The income from such securities is remittable, but proceeds on resale must normally be credited to a Blocked Account.

In contrast to foreign receipts (credit side of the balance of payments) where the functions of the exchange control administration are limited to supervision, it can play a decisive role in allocating payments and transfers abroad (debit side of the balance of payments) which involves the distribution of foreign exchange according to priorities.

2. Debits (Payments)

According to the aim of the Kenyan exchange control system - to preserve foreign exchange - the bulk of exchange control notices cover payments and transfers of Kenya residents to persons living outside the Scheduled Territories. Primarily exchange control exists to prevent the export of capital. However, in order to detect the movement of capital disguised as payments in the current account a close supervision of the latter is necessary. Generally speaking most current payments are permitted upon documentary proof or within specified limits. Due to the great variety of current payments²⁴ most of the exchange control notices (Ec) deal with this group of payments. Analogous to the discussion of receipts, payments are divided in those for goods, for services and for capital transfers.

a. Merchandise transactions: Imports. Prior to 1972 the importation of goods into Kenya was regulated solely according to the objectives of the licensing policy of the government as administered by the Department of trade and Supplies. Its aims are to protect local industry, aid the Africanization of import trade and maintain or increase the efficiency of local business.²⁵ The role of exchange control is to regulate the method of payment without interfering with the licensing policy or impeding the importation of goods and to check upon hidden capital exports through overinvoicing of imports. Due to the favourable overall position of foreign exchange holdings of the Kenya banking system exchange control considerations did not influence import licensing.

24. A list of payments defined as current payments is in Annex VII of the Treaty for East African Co-operation, Govt. Printer, Nairobi 1967

25. M.G. Phelps, Import Licensing in Kenya, May 1970, p. 13/14

With the deterioration of the balance of payments and the large trade deficit in 1971 a fourth object of the licensing policy was added in January 1972: the government found it "necessary to restrict the availability of foreign exchange in payment of certain imports".²⁶ New regulations were introduced for certain categories of imports for which foreign exchange will be restricted, irrespective of whether the import is subject to the requirements of specific licensing or open general license. Under these regulations imports for a variety of goods are frozen to 50% of average imports for the years 1970/71 - Schedule A, C, and D - and others, mainly those that are produced in Kenya, can no longer be imported - Schedule B and E - .²⁷ It is expected that these measures will result in a foreign exchange saving of about £ 10 mill annually which amounts to around 5% of 1971 imports.²⁸

Once an importer has obtained an individual license or imports are covered by an open general license²⁹ and has exchange control permission, exchange is provided automatically by commercial bank upon application and submission of the necessary documentary evidence.

As long as the balance of payments situation did not deteriorate the problem of invoice falsification was largely ignored by Exchange Control. In the future, however, it is planned to collect information from abroad to check on quoted prices in order to discourage this practice.

b. Services. Payments for invisibles to all countries outside the Scheduled Territories need Exchange Control approval. Authorized banks can approve specified categories of current payments without limitation or up to established limits. Amounts above these limits as well as non-specified current payments have to be approved by the exchange control administration. Generally speaking most current payments are granted.

Following the balance of payments presentation the first item concerning exchange control is freight and insurance, which primarily involves payments incurred abroad in the course of operation of locally owned shipping and airline companies. These are granted the foreign exchange needed for normal operations of ships and aircraft and agent's charges incurred in the process of transport provided documentary evidence is submitted.³⁰

26. Ec 1/1972

27. Ibid.

28. E.A. Standard 18 Jan. 1972 p.1 and p. 4; Daily Nation 19. Jan 1972, p.1

29. Specific import licenses are required for all commodities originating in some communist countries - Albania, Bulgaria, China, East Germany, Hungary, Rumania, North Vietnam - and from Iran and Iraq. A number of commodities may be imported only by or to the order of the Kenya National Trading Corporation.

The item other transportation involving passenger fares of Kenyans using foreign sea and air carriers, is handled through the control of the Special Resident Account. Shipping and airline companies owned by non-residents with offices or agencies in Kenya must maintain such a special account with a local bank at which they credit their earnings from residents, normally paid in shillings, and from non-residents, normally paid in foreign exchange, and from which they defray their local expenses such as office rent, salary of local staff, use of airport facilities etc.

In contrast to the above payments which are approved upon documentary evidence, the items summarized under foreign travel, mainly travel expenses of Kenyans abroad, home leave of expatriates and expenses of Kenyan students abroad, are limited by quantitative restrictions. In the case of travel the banks grant every second year a basic allowance of upto K/sh 4000/- per adult and K/sh 2000/- for every child between 3 and 12 years upon presentation of the passport and a valid travel ticket.³¹ Mecca pilgrims who have not been in Mecca before, may receive an additional allowance upon application if the basic allowance is already exhausted.³² Special travel allotments are granted for bona-fide business travel. At present the amount available for such journeys is K/sh. 450/- per day for the USA and Canada and K/sh 300/- per day for all other overseas countries for a maximum period of 25 days.³³ Special regulations apply for travel to neighbouring countries.³⁴ Allowance for health journeys and other special reasons are granted upon individual considerations.

Expatriates working in Kenya who are eligible for leave outside East Africa can transfer their leave pay within specified limits. If leave pay is granted in foreign exchange, no basic travel allowance is allotted.

30. Unless the source is another than the Exchange Control Administrative Notices and Instructions (1966 Edition) no footnote is given in the following description.

31. The basic allowance is not available for travel to Rhodesia and South Africa and for emigrants.

32. Ec 2/1970

33. Ec 18/1970

34. Banks are not permitted without approval to sell exchange in excess of K/sh 200/- per day - upto a maximum of K/sh 3000/- for a stay of not less than 15 days - for travel to Burundi, Democratic Republic Congo, Ethiopia, Malawi, Mozambique, Rwanda, Somali, South Yemen and Zambia.

An allowance for education up to a maximum of K/sh 14,000/- is provided per scholastic year upon presentation of supporting evidence. Of this amount fees are paid directly to the school; board and lodging up to K/sh 800/- per month may be paid directly to the pupil. For correspondence courses the allowance is up to K/sh 2400/- per completed course.

The item International Investment Income covers interest on foreign private loans and profits of foreign owned enterprises. Since local companies are not allowed to borrow abroad, interest payments cover only loans of foreign owned companies for investment in Kenya. These loans are covered by the Certificate of Approved Enterprise, which allows free transfer of interest payments. Foreign controlled companies wishing to pay dividends or profits to non-residents including parent companies must seek permission from Exchange Control. The application must be accompanied by the relevant balance sheet, profit and loss account and the addresses of all non-resident shareholders. At present any "reasonable" dividend from genuine profits will be approved.³⁵ If the dividend proposal appears too high the company might be requested to reduce the dividend and increase its equity.

Rents from property in Kenya owned by non-residents could be transferred upon examination of the rental agreement whenever the rent was properly due. In September 1970 the maximum net rent - after deduction of repairs, renewals, taxes etc. - transferable, was limited to £ 1000 p.a. irrespective of the number of properties from which the rent is derived. With the introduction of this limit the owner of the property had to open a Special Non-Resident Rent Receivable Account to which the rent has to be credited and from which current expenses are met and the transferable allowance is deducted. At the end of each 12 month period any balance left on the account will be transferred to a Blocked Account used for investment in prescribed securities. Subject to Exchange Control approval funds in a Blocked Account may, however, be used to make up the transferable sum of £1000 or to meet extra-ordinary local expenses in a subsequent year. The same limit of K/Sh 20,000/- applies on transfers of dividends due to non-resident shareholders, that are derived in whole or in part from rents. Any amount in excess of this sum has to be credited to a Blocked Account.³⁶ This restriction does not, however, apply to investments covered by a Certificate of Approved Enterprise.

35. The Revised Investments Protection Act (1967), Section 7, allows transfer of "the profits, after taxation, of his investment of foreign assets"

36. Ec 16/1970

The item other services covers a great variety of payments. Those arising from foreign investment such as director's fees, management fees, royalties, architect's and consultant fees, engineering fees and general administrative expenditures are approved upon documentary evidence. Others may be limited in amount. For example commissions to agents resulting from imports into and exports from Kenya to agents outside the Scheduled Territories may be granted up to K/sh 10,000/-. Payment upon documentary evidence is normally approved for books and periodicals ordered from abroad, for advertising placed outside East Africa, for tourist agency fees and for royalties of films shown in Kenya. In all these cases the amount due must appear reasonable. The same applies to various sundry payments such as repairs that cannot be done locally, legal fees, cost of medicine imported directly and others.

Payments for insurance premiums can be transferred through the banks if the policy was in existence prior to June 1965 or upon the holder's arrival in Kenya and if the policy holder has no foreign assets in his possession. Local insurance premiums received by foreign companies operating in Kenya are not transferable and should be invested in the country.

The item private transfers also covers assorted headings. For example cash gifts to individuals or organizations are approved upon application up to K/sh 200/- per adult. If granted, the sum is entered in the applicant's passport. A similar procedure is applied to compassionate remittances by residents which may be allowed up to K/sh 400/- for the support of one person and K/sh 600/- for two persons per month for a maximum of 12 months upon documentary evidence of hardship. Remittances to South Africa other than for certain pensions are not permitted.

Non-residents other than those from Uganda and Tanzania who work in Kenya as employed persons as well as specified categories of self-employed such as doctors and dentists, may transfer personal savings abroad of up to one third of their monthly salaries, but not more than K/Sh 3000/- per month. In addition they are allowed to remit funds for family maintenance, education expenses etc, but their total remittance including savings may not exceed 50% of total monthly salary, which has to be proved by details of salary earned. Expatriates who stay more than four years in Kenya may continue to effect remittances from salaries as outlined above, but if they do so, they are not entitled to the exchange facilities provided for emigrants.

Residents leaving Kenya permanently - except those who opted for the transfer from salaries - must give a statement of total assets together with a tax clearance certificate to Exchange Control prior to departure. Personal belongings, household effects and cash totalling a value up to K/sh 50,000/- per family unit - formerly K/sh 100,000/- may be transferred from the emigrants declared assets as a settling in allowance to his new country of residence, which must be outside East Africa.³⁷ Assets exceeding this limit must be paid into a Blocked Account. For the next five years however, a total of K/sh 100,000/- or a maximum of K/sh 20,000/- annually can also be transferred. Assets exceeding K/sh 150,000/- remain in the Blocked Account, though they may be invested in approved securities. Their redemption proceeds will be authorized for transfer to the country of residence of the emigrant concerned.

The main difficulty facing funds in a Blocked Account is, however, not the time delay of at least five years if invested in securities, but the limited amount of approved securities available. But even of those, the share offered to non-residents is small, residents and security funds having preference. Thus funds presently in a Blocked Account, i.e. those not investable in securities, remain inaccessible to the non-resident owner, except for local consumption.

c. Long term capital movements: The export of capital - including Kenya currency notes - is strictly forbidden under Kenya law. The only exceptions are capital transfers in respect of legacies and inheritances outside East Africa, which are approved by the Banks. All other capital transfers require individual application to Exchange Control. The only transfers approved are capital repayments of locally owned companies to non-residents, repayment of private loans contracted abroad by foreign owned companies operating in Kenya and the repatriation of direct foreign investment of these companies. Both cases involving foreign owned companies are regulated under the terms of the Foreign Investments Protection Act which allows repayment of foreign loans and grants and a repatriation concession to all foreign capital invested in an approved enterprise.

In theory the repatriation of capital of non-resident owned companies is approved upon application supported by a current balance sheet and a statement of accounts, a reference to the Certificate of Approved Enterprise issued when the capital was originally invested and a declaration that all local debts are repaid. The difficulty in practice results from the definition of "invested capital". The Foreign Investments Protection Act is here ambiguous with its definition or rather the lack of one. It does not define that not only the capital originally brought into Kenya in

37. Exchange Restrictions (1971): Kenya

foreign currency is transferable but also reinvested profits formally eligible for transfer as dividends. Where such a case of interpretation arose in the past Exchange Control decided "on the merits of the case involved". This probably meant, that in order not to disturb any incoming foreign investment, the investor had his way.

Portfolio investments made in Kenya do not fall under the Foreign Investments Protection Act. Their proceeds on resale are not transferable and are to be credited to a Blocked Account³⁹

IV EXCHANGE CONTROL MEASURES WITHIN THE EAST AFRICAN COMMUNITY.

In the presentation above only exchange control measures affecting countries outside the East African Community were discussed. When the exchange control system of Kenya was set up, it was harmonized with that of the two neighbour countries and the free movement of funds was allowed within the Community. However, in order to protect themselves against loss of foreign exchange, the exchange control laws of the three countries had similar enabling statutes aimed at stopping the export of capital from partner states to the rest of the world. Since free movement of capital inside the three states existed, co-operation in the field of exchange control was vital. In May 1970 the free movement of funds within East Africa was for the first time restricted, when Uganda introduced exchange control measures in respect to transactions with Kenya and Tanzania.⁴⁰ The latter introduced similar restrictions on March 17th, 1971, when capital transfers to Uganda and Kenya were made subject to control and a total ban on the export of Tanzania currency was imposed.⁴¹ On March 22, 1971 Kenya introduced "as a precautionary measure aimed at frustrating speculators" a ban on the export and import of Kenya currency notes covering also Uganda and Tanzania.⁴² An exception was made for travellers going from Kenya to Uganda and Tanzania who can take up to K/sh 100/- along to meet expenses enroute. Also the EA Airways and EA Railways have been authorized to accept Kenya currency for goods and services on interstate lines.⁴³ No restrictions were introduced by Kenya on payments or transfers made to Uganda and Tanzania, if these are transacted through the banking system.⁴⁴ As far as Kenya is concerned the pre-1970

38. The Act allows in Sect. 7th transfer of "the approved portion of net proceeds of sale of all or any part of the approved enterprise."

39. Central Bank of Kenya, First Annual Report (1967), p. 18

40. Central Bank of Kenya, Fourth Annual Report (1970), p.17

41. Central Bank of Kenya, Fifth Annual Report (1971), p.10

42. Ibid, p.10

43. Ec 11/1971

44. Central Bank of Kenya, Fifth Annual Report (1971), p.10

situation allowing free capital movement within the community still exists; the exchange control administration is only concerned with transactions with countries outside the community.

V EXCHANGE CONTROL STATISTICS

To complete the presentation of the Kenyan exchange control system a few comments on the compilation of exchange control statistics. The use of the authorized dealer - the commercial banks - as agent of the Central Bank to affect all transactions in foreign exchange, removed from the latter the need to keep separate statistics. The commercial banks were required to file a monthly report which spelled out foreign exchange receipts and payments. The latter included those whose approval was delegated to the banks as well as those individually granted by the exchange control administration.

Prior to September 1971 these reports were not analysed but simply filed. With the deficit beginning to emerge in 1971 a new statistical form was drawn up and introduced in September of the same year, which covered receipts and payments in more detail and also included balances held in External or Sterling Accounts.⁴⁵ The evaluation of the reports filed by the commercial banks after September 1971 showed that the figures supplied were totally unrealistic and unreliable. From September to December 1971 the banks reported a large outflow of foreign exchange without a corresponding increase in receipts and without drawing on the Central Bank for funds. According to the statistics filed, their reserves were not large enough to cover this outflow. In May 1972 a revised statistical form was therefore introduced and the banks instructed in accurate reporting.⁴⁶

In addition the Central Bank introduced two new statistical series to have better figures on receipts. The first aims to check on export proceeds by analysing the CD 3 forms for the four principal agricultural crops - coffee, tea, pyrethrum, sisal - which in the past accounted for approximately 50% of total exports. The second tries to control tourist receipts by requiring hotels and lodges to file a monthly report covering total bednights supplied to foreigners, including those provided via tour operators, and receipts in foreign exchange.⁴⁷

45. Ec 21/1971

46. Ec 6/1972

47. Ec 30/04 5 July 1972

This improved statistical coverage of receipts and payments together with an adequate evaluation method should reveal information upon which to base future adjustments of the exchange control system.

B. EXCHANGE CONTROL IN KENYA - A COMMENTARY

The above summary of the exchange control system of Kenya indicates that payments for current account transactions are usually granted. Only occasionally are they checked to prevent hidden capital outflows. As long as the balance of payments showed a surplus and the small deficit of 1967 was more than offset in subsequent years,⁴⁸ little thought was given to improve the system. The activities of the exchange control administration concentrated largely on emigration allowances and on suspected illegal capital transfers of the Asian community. Consequently the emigration transfer was reduced and rent payments to non-resident owners restricted. However, the balance of payments deficit of £ 31,5 mill. in 1971 raised the question whether the exchange control is doing what it is supposed to. In the following the weak points of the system will be discussed and ways of improving the present system suggested.

1. IMPORTS

In 1970 imports accounted for 68% of total payments in the current account. Excluding government transactions, the share of imports increased to 73%. Imports for 1971 reveal a rise in both figures to 73% and 77% respectively.⁴⁹

The allocation of foreign exchange for import payments is determined largely by criteria set outside the jurisdiction of Exchange Control. The recent inclusion of exchange consideration as criteria for import licensing will undoubtedly result in a foreign exchange saving. However, the method used here - the application of reference periods - will close the market to newcomers, which seems contrary to another aim of import licensing, namely the Africanization of the import trade. The inclusion of foreign exchange considerations as import criteria seems only to complicate the licensing system. Consideration such as the protection of local industry together with tariff adjustments such as implemented in the 1972/73 budget, should suffice to control excessive imports in unwanted categories.

48. Balance of Payments Surplus/Deficit 1964 - 1971 (current Account + Long Term Capital Account: in £ mill)

| 1964 | 1965 | 1966 | 1967 | 1968 | 1969 | 1970 | 1971 |
|--------|--------|--------|--------|--------|---------|---------|---------|
| 2,7(D) | 8,3(S) | 8,1(S) | 5,4(D) | 2,0(S) | 18,3(S) | 12,6(S) | 31,5(D) |

Source: Economic Survey

49. Calculated from Economic Survey 1972, p. 20

The main problem arising under any system of exchange control is that of over/ or underinvoicing of imports by either adding to or subtracting from the actual invoice value, a fictitious amount.⁵⁰

The aim of overinvoicing of imports is either to transfer funds abroad or to reduce the costs of goods imported by selling the illegally acquired foreign exchange at a higher "black" market rate. The transfer of funds through overinvoicing does not require the existence of an unofficial exchange rate. For one reason or another the importer wants to have funds abroad or the seller wants a higher profit. Especially in connection with the establishment of large engineering works there is a tendency to over-invoice, because it is virtually impossible to detect and to prove this practice. The same applies to cases where vertically integrated international oligopolies are involved. Here international trade consists of a transfer of partly processed products from the "extraction/cultivation country" to the "processing country". In this case neither a proper market or price exists and it is impossible to determine the amount of profits realized in the primary activity. Where the international company wants its profits to be realized is a function of the tax policies of the two countries concerned and the international strategy of the firm and the industry.⁵¹

Quite often overinvoicing is practiced with the aim of reducing the cost of imported goods by selling illegally acquired foreign exchange at a premium in the domestic market. The profit of overinvoicing is here a function of the amount of the invoice that is fictitious, the rate of import tariff applied to this amount and the difference between the black market rate and the official rate of exchange. Generally speaking the importer makes a profit when the rate of the ad valorem tariff applied is lower than the premium paid for foreign exchange at the black market.⁵²

Underinvoicing of imports cannot be used to transfer funds abroad. It is profitable if a high tariff rate is levied on imported goods or imports are strictly controlled and thus command a premium on the domestic market. When underinvoicing the importer has to purchase foreign exchange

50. Jagdish Bhagwati, "Fiscal Policies"; J. Bhagwati, "On the underinvoicing of imports", Bulletin-Oxford University Institute of Economics and Statistics, vol 26 (Nov. 1964) p.389-397; Gordon C. Winston, "Overinvoicing, Underutilization and Distorted Industrial Growth", Pakistan Development Review, vol X (Winter 1970) p. 405-421

51. An example of the international vertically integrated oligopoly case is the oil industry. see: E. Penrose, "Middle East Oil: The international distribution of profits and Income taxes. "Economica(NS), vol XXVII(1960) p.203-213.

52. Winston, p. 407

on the black market in order to pay the invoice amount to the foreign seller. This practice becomes profitable as soon as the tariff rate exceeds the premium charged for foreign exchange on the black market and/or if the premium paid for the imported commodity prevailing in the domestic market is larger than the premium demanded for illegal exchange.⁵³ In the Kenya context the problem of invoice falsification through under-invoicing can be ignored. The only relevant case is overinvoicing to transfer funds abroad. In most cases the inputs in manufacturing do not come under the oligopoly case mentioned above, which is extremely difficult to detect and to prove.

For most imported raw materials or intermediates used in production as well as for finished standard products, import prices can be compared with prices quoted on the "open market" of the industrialized countries.⁵⁴ Here occasional random checks might be useful. If the variance between the two prices is considerable - allowing for cif costs - and collusion between the supplier and importer is suspected, the latter should explain the difference to Exchange Control. If overpricing can be proved, heavy fines and/or the withdrawal of licences are the only deterrents possible.

How important the control of prices is to any effective system of exchange control can be shown by the fact that overpricing of inputs of an industry using primarily imported raw materials by one or two percent might result in larger outflows than that of profits actually repatriated.

A recent study⁵⁵ tried to estimate the outflow of resources due to overpricing imports as multiples of profits actually repatriated. Under the realistic assumption that foreign companies use around 60% imported intermediates and that the firm earns 45% profit before tax on foreign equity of which, after tax deductions, 35% was repatriated in 1968 and 46% in 1969, it was estimated, that only slight overpricing of imported inputs would result in a large addition to funds transferred through profits. For example, if overpricing of only 1% of all imported inputs in manufacturing took place, the total outflow of resources in 1968 would have been 1.4 times as great as profit outflow. Assuming a hypothetical overpricing of 5% and 10%, the outflow rose to 3.9 times and 4.4 times the profit outflow. Due to the higher

53. Bhagwati, Underinvoicing, p.389

54. For machinery and transport equipment a comparison between export statistics of the seller country and import statistics of the buyer country might reveal the practice of faking import declarations. For the application of this method see the articles by Bhagwati.

55. ILO Mission, Technical Paper No. 20, p.22/23

repatriation rate of dividends in 1969 the figures dropped to 1.2, 2.1 and 2.9 in 1969.

Overpricing by 5% is considered common with exceptional cases of 20% and 30% occurring. Since overinvoicing of imported inputs is difficult to prove, it might be useful to investigate only those firms which use a high portion of foreign inputs and do not declare a profit over several subsequent years, which might be an indication of "transfer accounting".

2. SERVICES

The various methods used for the allocation of foreign exchange for invisible payments - either quantitative limits or documentary proof - show the apparent strength of the quantitative system of exchange control used in Kenya. The limits applied can be adjusted to short-run variations in the level of foreign reserves. However the total sum of the invisible payments coming under this category is very small. In 1971 non-government payments and transfers, excluding imports, were around £ 60 mill.⁵⁶ Of these the item International Investment Income, including reinvested profits, accounted for £28 mill. Since these payments are guaranteed under the Investments Protection Act, they cannot be adjusted to the level of reserves. Of the remaining £32 mill, approximately 2/3 - transport, service, business travel etc - contribute directly to the growth of GNP, which means that the exchange control administration has little room to manoeuvre. Only the remaining £10 mill or so, which are allocated to emigration, private travel, educational expenses, remittances of ex-patriate savings et al, can be restricted. Hence exchange control at present has little flexibility should the 1971 deficit repeat itself.

The most glaring fault of the present exchange control system is its concentration on minor aspects of currency outflows for payments and transfers. The most important item for Kenya - International Investment Income - is hardly restricted and exchange policies are totally inadequate. Here the exchange control administration has no power, because the government has placed a high priority on foreign investment, which is reflected in the very liberal guarantees provided in the Foreign Investments Protection Act.

56. Economic Survey 1972 p.20

Once a company has a Certificate of Approved Enterprise it is allowed a great variety of transfers abroad. It can expatriate profits in proportion to the share of foreign equity, payments for interest of foreign loan capital, payments for technical and management services and royalties for the use of a brand name or patented production method. In addition subsidiaries of foreign firms are allowed payments to parent companies abroad for company overheads such as contribution to foreign headquarters (!) and to research and development expenditures.

The size of the first item, repatriation of profits in proportion to the share of foreign equity depends on the size of the equity and the earnings of the company. The determination of the equity, which includes cash, machinery, management service and know how, is the outcome of discussions between the foreign investor and the Ministry of Commerce and Industry perhaps aided by representatives from the Ministry of Finance and Economic Planning and the ICDC. If profits are repatriated or reinvested depends largely on the present level of profits, since it can be assumed that a minimum dividend will be remitted abroad in any case. Hence the lower the profits the lower the amount available for reinvestment. Furthermore the decision to reinvest will be based on an estimate of future earnings which depend on the size and rate of growth of the market and government policies affecting it as well as the foreign firm. Investors wishing to increase their engagement in Kenya may thus reduce profit outflow and/or increase capital inflows, while those who wish to limit their local activities may opt for a large dividend outflow.

At present all foreign private or public companies pay a profit tax of 40% and a withholding tax of 12,5% on dividends.⁵⁷ Branch companies do not pay the latter, since they do not declare dividends; they can transfer their net profits without paying tax.⁵⁸ The application of fiscal levies on dividends encourages the tax department to influence companies to declare dividends. High retention rates have to be justified in terms of future expansion plans.

However the declaration of high dividends, which lead normally to high repatriation rates, seems to be in contradiction to the aim of exchange control, which prefers to limit transfers to a "reasonable" dividend and therefore favours reinvestment of profits.⁵⁹ One problem with

57. Budget Speech 1971/72, p. 14

58. Branch companies are not eligible for ICDC participation.

foreign investment in Kenya is that operations are financed partly by local borrowing, while profits accruing from both local and foreign funds of the firm are exported. In order to prevent this from happening, the exchange control administration restricts the local borrowing rights of foreign firms.

The present regulations limit the borrowing rights of foreign firms to 20% of equity. If the local equity participation is more than 50% the borrowing limit might be increased to 40%.⁶⁰ Both limits apply to private local borrowing only. Companies apparently can borrow from public institutions like the ICDC and DFCK without any foreign equity consideration. The degree to which firms utilize local public and private funds was recently investigated by B. Herman.⁶¹ According to his findings British dominated firms borrowed locally more than four times the amount of their foreign equity, whereas other foreign investors had on the average 67% more local debts incurred than foreign equity.⁶² In this study retained profits, which increase equity, are not included, so that local borrowing ratios are considerably overstated. Nevertheless from these figures it becomes apparent, that local borrowing limits set by Exchange Control are largely ignored. In such cases where they are applied, they should result in higher retention rates.⁶³

The improvement of exchange control measures to restrict local borrowing and limit the actual dividend transfer to a reasonable level still leaves us with a poor measure of total outflows of foreign private enterprise. Should the dividend and profit outflow be effectively limited, the foreign company can use methods of "transfer accounting" to maximise profits while reducing their dividends and hence their tax bill.

59. Reinvestments of profits totalled \$7, 2 mill in 1964, \$ 5,6 mill in 1965, and \$ 7, 9 mill in 1966. - IMF Balance of Payments Yearbook, vol 21 (July 1970), Kenya, p.3

60. EN No 19 (Borrowing by Foreign Controlled Companies)

61. Barry Hermann, Some Basic Data for analysing the political economy of foreign investments in Kenya, IDS Discussion Paper, No. 172

62. Ibid., p.13

63. The reinvestment of profits as alternative to larger outflows leads to a denationalization of existing national industries and/or an increase of new foreign industry relative to national industries.

One of the means open to foreign firms is to increase costs for service payments between the subsidiary and the parent company such as royalty fees for the use of a brand name, technical services, management fees and contribution to headquarters for R & D and overhead expenses.⁶⁴ These payments can result in a large transfer of funds far above the declared dividend.

A sample of ten foreign owned enterprises in Kenya⁶⁵ showed their remittances for 1971 under the various headings as follows:

| Dividends | Management Fees | Technical Services and Consultant Fees | Royalties |
|-----------|-----------------|---|-----------|
| 310 | 136 | 34 | 36 |

This means that non-dividend payments are 67% of dividend payments and 40% of total outflow. But five of the ten firms in the sample, which effected 45% of the non-dividend payments, remitted no dividends abroad and for seven firms non-dividend remittances were larger than dividend remittances.

Since these payments are allowed under the Foreign Investments Protection Act the government has tried since July 1971 to profit from the existing situation by imposing a withholding tax of 20% - i.e. half of the tax on declared dividends.⁶⁶ A better solution would, however, be to limit individual payments and/or the legislation should be amended to eliminate those payments which are hard to justify such as contributions to headquarters for R and D and overhead expenses.⁶⁷ The admittedly difficult task of exchange control here is to sort out those payments which are justifiable as payments for services actually rendered and eliminate those which are disguised profit transfers. In addition the tax on dividends and the tax on "other transfers" as outlined above, should be equal, to remove the incentive to maximize outflows while minimising the tax bill.

Another method to evade exchange control and transfer funds abroad open to the foreign firm is the system of overpricing of imported inputs mentioned above. From the discussion on the role of foreign investment in Kenya it becomes evident, that the financial commitments for remittance of profits,

64. "It is estimated that some K£ 2 million per year leaves Kenya by way of management fees and royalty payments to non-residents". Budget Speech 1971/72 p. 14

65. ILO Mission, Technical Paper No 20, p. 25

66. Budget Speech 1971/72, p.14. "most countries investing here have a double taxation agreement with Kenya under which it will be possible for non-residents to set their withholding taxes they have paid in Kenya against
cont...pg.23

dividends, interest, royalties and administrative and technical services combined with over-pricing can be a serious drain on the foreign exchange reserves of the country.⁶⁸ It goes without saying that exchange control in a larger sense must start with a cost/benefit analysis of the foreign exchange component involved which takes these outflows into account before a foreign firm receives a Certificate of Approved Enterprise. Whether this is done presently may be doubted.

For many projects where the foreign investor applies for a Certificate of Approved Enterprise it might even be feasible, to stipulate that a certain percentage of total output must be exported before dividends can be transferred. Through this clause the outflow of foreign exchange resulting from this particular investment can be minimized, offset or even be reversed. An industrialization process which does not create an exportable surplus will lead to a growing imbalance between the inflow of foreign capital and the capacity to service it. So far the transfer of funds has been offset by inflows encouraged by the present easy phase of import substitution. As soon as this period ends in the years ahead the outflow might create a serious foreign exchange problem

3. CAPITAL TRANSFERS

One other important aspect of foreign investments should also be mentioned the repatriation of capital allowed for "Approved Enterprises" in case of termination or sale of local operations. Presently there is a clear tendency of Exchange Control to limit the dividend transfer in favour of reinvestment. This will increase equity far beyond the equity registered at the start of operations. It has been suggested that invested profits should be treated as domestic capital i.e. profits derived from this reinvestment should not be repatriated at any future date nor should these funds be allowed for repatriation should the company end its engagement in Kenya.⁶⁹ At present dividends from reinvested profits are transferable and it is quite unrealistic to assume that this policy will be changed. But a procedure could be devised where

66. pg..22 con./ their tax liability in their own country. Under this agreement a non-resident receiver of dividends and interests derived from Kenya will probably not pay an additional tax in total..... the amount of tax charged and collected by the Foreign Treasury will be reduced and the Kenya treasury will profit by the same extent" Ibid., p. 14

67. The R & D of international corporations invariably is conducted abroad. The result of these efforts, if imported at all by Kenya, have their price in form of royalties, management and consultant fees and similar payments.

by equity created through reinvestment cannot be repatriated at once but should be paid into a Blocked Account subject to the sort of withdrawal regulations applied to emigrants.

That capital is illegally exported is documented by the existence of an official market for Kenya currency abroad and a black market in Kenya.

Dealings in Kenya currency by commercial banks abroad at a discount of about 30% from the official rate quoted in Kenya are quite common in Europe.⁷⁰ The illegal export of a suitcase full of banknotes involves little risk, since no control of the luggage at departure (Embakasi Airport) takes place.⁷¹ The cost of introducing such controls by far outweighs the gains. The same applies to the prevention of imports of Kenya currency notes bought abroad, mostly by tourists coming to Kenya. The refusal of the Central Bank to redeem these notes offered by foreign based banks introduced in March 1971, should reduce the size of this foreign market to the demand of visitors coming to Kenya.

In contrast to these exchange dealings abroad the black market in Kenya, where Kenya shillings are sold with a discount ranging from 10% to 40% against foreign currency,⁷² can be influenced by the activities of Exchange Control. One minor source of supply of foreign exchange is illegal dealings by tourists. The loss of foreign exchange to the Central Bank could here be reduced by making sure that the official rate for foreign exchange is offered to the tourists, thus making black market dealings less attractive. For example tourist hotels quite often charge a discount of up to 20% from the official exchange rate. A margin of 5% should be quite reasonable to cover administrative expenses for this service. The same criteria should apply to commercial banks which are allowed to charge different "discounts" for individual currencies when offered cash or travellers cheques.⁷³

68. Since most of these companies are established under import substitution considerations and therefore do not export, the balance of payments effect might be negative if compared to the import of the article produced locally.

69. J.F. Rweyemamu, "The political Economy of foreign private investment in the underdeveloped countries", The African Review vol I (March 1971) p.117/118

70. The rates quoted by German banks per DM 100. - in K/sh are: selling rate 280/-; buying rate 320/- (Official rate in Kenya 225)

71. See also "Export of Cash big business", Sunday Nation, 4.6.72 p.5

72. E.A. Standard, 18 July 1972, p.5

73. For US Dollars the handling charge is 2%, for German Marks it is almost 12%.

Another source of supply are leakages from Sterling Area or External Accounts. Funds transferred to these accounts can freely be withdrawn in foreign exchange abroad and credited to a foreign account - i.e. they are usually sold against Kenya shillings provided locally. In order to limit this practice, the withdrawals from an External or Sterling Account above a specified amount should be explained to Exchange Control. Also foreign experts, paid abroad as well as technical and voluntary assistance organizations should not be allowed to operate these accounts. Instead they should operate normal local accounts which in the case of foreign experts could be connected with a minimum monthly turnover of 50% of salary received. Foreign payments necessary above a specified limit can then be handled under the normal procedure set up by Exchange Control. The above measures if properly supervised could reduce the supply of foreign exchange for illegal dealings and channel foreign funds to the commercial banks.

Another source of supply prevalent in under-developed countries foreign exchange "earned" through oveinvoicing is of little importance in Kenya.

The prevention of black market dealings in a developing country like Kenya is practically impossible despite exchange control. As long as the motives for illegal capital transfers exist - insecure position of minority groups, fear of nationalization, fear of political instability⁷⁴ - the only hope of the exchange control administration is to limit the size of this black market, so that the loss of foreign exchange is minimized.

74. See: Walter Kraemer, Kapitalflucht aus Entwicklungsländern Bielefeld 1969.