REPUBLIC OF KENYA

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GOVERNMENT GUARANTEE IN RESPECT OF AN I.B.R.D. LOAN TO THE EAST AFRICAN RAILWAYS CORPORATION

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SESSIONAL PAPER No. 1 of 1970

Government Guarantee for a Loan to the East African Railways Corporation by the International Bank for Reconstruction and Development

THE GUARANTEE (LOANS) ACT 1966

In accordance with section 5 of the Guarantee (Loans) Act 1966, the following information is laid before the National Assembly in connexion with a proposed guarantee by the Government (jointly and severally with the Governments of Tanzania and Uganda) of the obligations of the East African Railways Corporation in respect of a loan of the equivalent of approximately K£15,130,000 to the Corporation by the International Bank for Reconstruction and Development (World Bank).

2. To obtain the finance necessary for full implementation of the 1969-72 railways development programme as approved by the three Partner States, the East African Railways Corporation has asked the International Bank for Reconstruction and Development for a loan in various foreign currencies equivalent to 42,400,000 U.S. dollars or approximately K£15.13 million. This is the amount by which the Corporation's own resources and borrowings from other sources are estimated to fall short of its expenditure during the programme period and will provide most of the necessary foreign exchange content of this expenditure.

3. The development programme was evolved after careful evaluation of essential needs in full consultation with the three Governments and having regard to the financial position of the Corporation and its ability to service further borrowings. It aims primarily at modernizing the railway system and equipping it with the additional wagons, diesel locomotives and other facilities necessary to ensure that it will be able to provide economically and efficiently the services required to match the growth evident in the economies of each of the Partner States.

4. Principal among the items to be financed with the proceeds of the loans are:—

(*a*) the construction of new marshalling yards at Changamwe (Mombasa) and Makadara (Nairobi) and the improvement of various other marshalling yards; loop lengthening at existing stations and the construction of additional crossing stations; the renewal of worn out rails and track fittings, the welding of rails and the ballasting of track; and the improvement of signalling and communications and of terminal facilities. All these items are designed to keep the track in good repair; to make more intensive use of the existing system by increasing the number of trains that can run over various sections of the line and, by reducing the time spent by trains at crossing stations and by wagons in marshalling yards and at terminals, to obtain a more efficient and intensive use of rolling stock, thereby reducing operational costs;

(*b*) the acquisition of goods wagons, service vehicles and spare component parts for diesel locomotives, the construction of diesel locomotive sheds in Morogoro and Kampala, and the acquisition of workshop machinery and equipment. These items will ensure that a sufficient number of wagons, etc., are available for the anticipated volumes of traffic and that the diesel locomotive fleet—additions to which are to be financed from other sources—is properly serviced and maintained in sound condition. The provision of diesel locomotive sheds at Morogoro and Kampala is in accordance with the Treaty for East African Co-operation Annex XIV Part B 1 (*b*) and (*c*);

(*c*) the construction of a wagon ferry terminal at Bukoba, modification of two wagon ferries and replacement of two other lake vessels, the rehabilitation of piers on Lake Victoria and the replacement of machinery at Kisumu dockyard. These items reflect a comprehensive plan to ensure on Lake Victoria and on Lake Tanganyika efficient marine services at least cost, having regard to the fact that certain ships there are now at the end of their useful life and will shortly have to be withdrawn from service;

(*d*) the renewal of road transport vehicles in Tanzania. This is to enable the Corporation to maintain its existing road services where no alternate rail services are available;

(*e*) the construction of regional office buildings and staff housing. Annex XVI Part B 1 (*a*) of the Treaty for East African Co-operation requires that strong and functionally comparable regional railways headquarters, including revenue and accounting services, shall be established in Dar es Salaam, Kampala and Nairobi. Existing accommodation is inadequate for this and new offices are required. Some additional housing is also required in this connexion and at other railway centres where activities are increasing;

(*f*) studies of the economic feasibility of certain railway lines and services. It is intended that independent Consultants shall be engaged to carry out economic studies of those sections of the line and services which prima facie appear to be loss-making and adversely affecting the viability of the Corporation. The studies will be carried out in the context of expected development over a 20-year period to determine the least cost solution to the transport requirements of the areas concerned. Short- and long-term remedial measures will be identified and discussed by the Consultants with each Partner State and by the latter with the World Bank with a view to implementation.

5. It is to be noted that it is only the foreign exchange content of these items which is to be financed out of the loan proceeds, local costs being met from the Corporation's own resources. Certain lesser items will be financed wholly by the Corporation. It is expected that the further stages of dieselization within the development programme, costing approximately K£5.5 million, which will follow the purchase of the 70 diesel locomotives in respect of which orders will be placed in 1970, will be financed from bilateral sources.

6. The amortization schedule for the loan provides that the first repayment of principal shall be made on 15th June 1975 and the final payment on 15th June 1995. Effectively, then, the loan is for a period of approximately 25 years from the expected date of signing, with an initial grace period of some 5 years during

which there will be no repayment of principal. The rate of interest applicable, in accordance with the unvarying practice of the World Bank, will be the Bank's ruling rate at the time the loan agreement and guarantees are signed: currently this is seven per cent. The payment of the principal and interest charges are so arranged as to spread the burden of the loan as evenly as possible over the life of the loan, excluding the grace period during which interest only is payable.

7. The general terms of the loan and the various convenants required of the Corporation as borrower and of the Partner States as guarantors are in accordance with the normal practices of the International Bank for Reconstruction and Development and are on similar lines to those applicable to loans made in the past and guaranteed by Kenya, most recently that made to the East African Harbours Corporation. They provide *inter alia* that the loan is made specifically in respect of the Corporation's Development Programme 1969-72 as agreed by the Partner States and the Bank and that the proceeds of the loan shall be applied solely for the purpose of its implementation. The programme is to be carried out with due diligence and efficiency and in accordance with sound engineering, financial and railways management principles and practices, competent and experienced consultants and contractors where necessary being employed for this purpose. The Corporation is required to manage its affairs, plan the development of its properties and maintain its financial position all in accordance with sound engineering, railways management, financial and business principles and practices and under the supervision of experienced and competent management and is required also to maintain soundly its plant, equipment and properties and where necessary effect renewals. The Corporation is to establish a cost accounting system and retain the services of experts in railway marketing, traffic costing, train operation and yard working. The Corporation is required to achieve improvement in the utilization of manpower to reflect the savings inherent in better equipment and more scientific management and by 1976 and thereafter to achieve a six per cent return on its net fixed assets in operation. These requirements are directed at ensuring the continuance of the East African Railways Corporation as an efficient and viable transport undertaking geared to meet the needs of the vigorous, expanding economies of East Africa. As such, it is in Kenya's interest that they should be honourably fulfilled.

8. In addition to these general terms and convenants required of the Corporation and of the Partner States as guarantors of the loan there are certain particular convenants which require special mention. It is a particular condition of the loan that the services provided by the Corporation shall not by design be protected from road competition and that in consequence the railway tariff shall be re-cast to enable the railway to compete effectively with efficient road transport, whilst ensuring that overall the revenues of the Corporation are adequate to cover all out-goings and to give the stipulated return of six per cent per annum on the net fixed assets in operation by 1976 and thereafter. No rate is to be applied which will result in net loss to the Corporation. This is a realistic approach to the problem of rail-road competition and one which will result in transport users having a free choice of both rail and road services with price and quality of service being the demand criteria. Kenya will remain free to exercise such control over road operations as it seems necessary in the national interest but will not restrict road operations specifically to protect the services of the Corporation from competition.

9. Having regard to the importance to the Corporation of the net revenue it derives from the transport of oil products all three Partner States are required not to construct or permit to be constructed any oil pipe-line which might compete with the oil transport operations of the Corporation until a feasibility study for

such oil pipe-line has been carried out and the Partner States and the Bank is satisfied that the oil pipe-line in question would be economically justified. No developing country with many competing calls on the scarce capital available to it can afford a mis-allocation of its resources and Kenya is no exception to this. It would be damaging to the national interest to invest or allow investment in a competing mode of transport which was not economically justified. There is no intrinsic merit in oil pipe-lines; they must stand or fall on their ability to transport the oil cheaper than by any other means having regard to all the economic factors involved. It is this that the feasibility studies, when they are carried out will seek to establish.

10. One other important condition attached to the loan is that Consultants shall be engaged to complete within two years of the date of the Loan Agreement and the Guarantees studies on the economic feasibility of certain sections of the railway and certain services. There is prima facie evidence that persistently certain sections of the railway and certain services are loss-making and in total seriously affect the viability of the Corporation. It is in respect of these, using a common determinant, that studies will be carried out in order to estimate the total demand for transport on the existing and potential transport services for twenty years. Account will be taken of planned development likely to generate additional traffics and the economically appropriate division of total traffic between the alternative modes of transport will be determined. The studies are intended to indentify both short- and long-term measures which might reduce or even eliminate the losses believed to be incurred and these will be discussed with the World Bank to determine which of them should be implemented. Since the Corporation is required by statute to operate on sound business lines and in accordance with commercial principles it is very desirable that all aspects of its operations where losses appear to be incurred should be investigated and the causes identified. Only in this way can sensible remedial measures be planned and implemented at the appropriate time. The studies therefore are to be welcomed.

11. The payment of the loan principal, interest and other charges under the Loan Agreement or under any Bonus given pursuant thereto, and the performance of all the other convenants and obligations of the Corporation under the Loan Agreement and Bonds, are, as a requirement of the loan, to be guaranteed jointly and severally by the Governments of Kenya, Tanzania and Uganda.

12. The East African Railways Corporation is an instrument of the three Governments and plays an essential role in the economies of all three countries. It is in their best interest that it remains an operationally sound, well-managed and viable undertaking and that its operational efficiency is improved. This the loan is intended to ensure and Kenya, therefore, along with the other two Partner States of Tanzania and Uganda should enter into this Guarantee with the International Bank for Reconstruction and Development, as they have done with the loan recently made to the sister East African Harbours Corporation and with previous loans to the Community's predecessor services.

13. The current total contingent liabilities of Kenya Government in respect of guarantees given under the Guarantee (Loans) Act (other than those specified in the Schedule to the Act) amount to the equivalent of K£37,432,255. With the proposed loan guarantee of K£15,130,000 above mentioned, and with further proposed loan guarantees of K£3,713,000 and K£250,000 referred to in Sessional Papers No. 3 and 4 of 1970, the aggregate will be increased to K£56,525,255, of which K£16,582,255 will fall within paragraph (*a*) and K£39,943,000 within paragraph (*b*) of section 3 (3) of the Act.

The guarantee limits imposed by paragraphs (*a*) and (*b*) of section 3 (3) are the subject of the Guarantee (Loans) (Amendment) Bill 1970 now before the Assembly.

Ministry of Power and Communications,
NAIROBI.
10th February 1970

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