Fiscal Decentralization in Support of Devolution

KENYA ECONOMIC REPORT 2016

KENYA VISION 2030

To create a globally competitive and prosperous nation with a high quality of life by 2030

KIPPRA
The KENYA INSTITUTE for PUBLIC POLICY RESEARCH and ANALYSIS

Kenya Economic Report 2016

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Nairobi, Kenya
2016

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Foreword

The general elections held in 2013 were the first under the Constitution of Kenya 2010 and ushered in a major transformative devolved governance system of 47 county governments. Since then, the government has been putting in place various legal, regulatory frameworks and the relevant supporting institutions aimed at implementing the constitutional provisions for successful implementation of devolution. Through devolution, the Government is committed to promoting social and economic development and the provision of proximate, easily accessible services throughout the country, and other objectives of devolution as outlined in Article 174.

The Second Medium Term Plan (2013-2017) whose theme is *Transforming Kenya: Pathways to devolution, socio-economic development, equity and national unity*, has clearly prioritized devolution under the cross-cutting theme 'Making Devolution Work'. The MTP outlines policies designed to implement devolution, accelerate growth, reduce poverty, and transform the structure of the economy in consistent with Vision 2030 goals. In this regard, the amount of resources allocated to county governments, including conditional transfers increased from Ksh 197.8 billion in 2013/14 to Ksh 284.4 billion in 2014/15. This resource allocation is above the Constitutional requirement of 15 per cent. The Ministry recognizes the importance of effective planning and has supported county governments to develop frameworks for the preparation of County Integrated Development Plans and by extension Annual Development Plans and Sector Plans.

The transfer of functions to county governments has been successfully completed. Priority will continue to be given to the development of the capacity for implementation, improvement of policy coordination, and implementation in order to enhance public service and economic transformation.

The Kenya Economic Report 2016, whose theme is 'Fiscal Decentralization in Support of Devolution' is timely in that it provides a deeper look at the status of the economy and how fiscal decentralization can be deepened for improved service delivery. The report notes that there are regional disparities in development outcomes and challenges to effective utilization and allocation of public resources that require coherent policy coordination between the national and county governments, as well as addressing existing capacity gaps. This report draws on quality domestic and international research and is thus significant in informing and shaping the policy debate on devolution.

Let this report serve as an important reference for key stakeholders, including public policy practitioners, development partners, civil society, academia, private sector and other decision makers.

Hon. Mwangi Kiunjuri, MGH
Cabinet Secretary
Ministry of State for Devolution and Planning

Message from the Chairman of the Board

This is the 8th Report in an annual series of economic reports on the status of the Kenyan economy. The reports are prepared pursuant to KIPPRA Act 2006, and basically provide an in-depth assessment of the status of the various sectors of the economy, as well as providing economic prospects in the medium term. The thematic area of analysis for this year's report is *Fiscal Decentralization in Support of Devolution*. This is timely within the context of the Constitution of Kenya 2010, where devolution is one of the key governance reforms being implemented since 2013.

Since the general elections in 2013, the government has continued to put in place the necessary legal, regulatory and supporting institutions for successful implementation of devolution. However, as this report argues, fiscal discipline, efficient allocation and utilization of public resources, coherence in policy coordination between the national and county governments, and adherence to the constitutional fiscal principles of transparency, inclusiveness, accountability, predictability and participation are critical in realizing the goals of devolution.

Over time, KIPPRA has recorded exemplary performance by contributing to public policy, winning various awards and also ranking among the Top Think Thanks in the World. In 2014 and 2015, the Institute was ranked top among Sub-Saharan Africa think tanks. The Board, management and staff are committed to KIPPRA's vision as an international centre of excellence in public policy research and analysis and it is hoped that this report, among others, will inform and contribute to public policy debate.

KIPPRA is grateful for the significant financial support it receives from the Government of Kenya, the Africa Capacity Building Foundation, and the Think Tank Initiative of IDRC, among others. Strong partnerships and networks have also helped the Institute enhance its role in research and capacity building. I wish to acknowledge and thank KIPPRA staff, Board of Directors, Management, and all other stakeholders that were involved in the preparation of this report. KIPPRA is committed to work with the Government and other stakeholders to realize the goals of devolution.

Prof. M. S. Mukras
Chairman, KIPPRA Board
2016

Preface

The Kenya Economic Report 2016 is the eighth in a series of annual reports on the Kenyan economy prepared by the Kenya Institute for Public Policy Research and Analysis (KIPPRA). The report reviews Kenya's recent economic performance and provides an outlook for the medium term. The focus of this report is 'Fiscal Decentralization in Support of Devolution'. This is highly relevant and timely within the context of our current development challenges and potential opportunities and gains associated with devolution.

Kenya's devolution is among the most rapid and ambitious devolution processes, whose implementation started with the 2013 general elections. Over the last three years, various achievements have been made in terms of establishing the necessary legal, regulatory and administrative units to support devolution. The relevant functions have also been devolved and resource allocation to County governments exceed the constitutional minimum of 15 per cent. Overall, county resource allocation as a percentage of total revenue increased from 19.94 per cent in 2013/14 to 24.18 per cent in 2014/15. County expenditure as a percentage of Gross Domestic Product (GDP) and total government outlays are estimated at 5.6 per cent and 18.9 per cent, respectively. The county governments are raising own resources to supplement the vertical allocation from the national government. Overall, this is estimated at about 11 per cent of total county revenue. However, there are inter-county variations, with most counties are over-relying on the equitable share transfers. Based on the 2014/15 fiscal data, only about 70 per cent of the counties raised locally less than ten (10) per cent of their total revenue.

This report argues that while important achievements have been made in laying the foundation for effective fiscal decentralization, there is need to entrench key principles and practices for effective public resource utilization and service delivery. These include strengthening the regulatory framework for public finance management by enhancing compliance with public finance management regulations, enhancing the link between planning and budgeting, addressing human capacity gaps, enhancing own county resource efforts without undermining the business environment, strengthening public procurement, and further strengthening inter-governmental fiscal relations and policy coherence and coordination.

The report underscores the recent positive economic trends and projects an economic growth of 5.9 per cent in 2016, and a further improvement to 6.2 per cent in 2017. This is predicated on a stable macroeconomic environment, political stability, structural reforms aimed at improving the business environment, and continued investment in infrastructure. However, there are downside risks associated with external shocks such as slow-down in global economic performance.

The report is organized in four parts. Part I analyses Kenya's recent macroeconomic performance, governance and social-economic performance. While the economy has recorded improved macroeconomic stability, the report underscores the need for fiscal prudence, sustained investment in infrastructure, improved business environment and stability. While Kenya's governance performance based on the MoIbrahim index improved in 2015, corruption remains a major challenge and the report calls for implementation of the recommendations of the taskforce on the review of the legal, policy and institutional framework for fighting corruption.The report, in Part II, also discusses key underlying policy issues in agriculture, extractives sector, tourism, manufacturing, micro and small enterprises, trade, financial services, building and construction, and information and communication technology.

Part III explores the medium term prospects under different assumptions. The report notes that growth performance remains below the Vision 2030 and MTP targets and calls for improvements in governance and deepening of reforms as outlined in the MTP II.

In part IV, the report focuses on decentralization. According to the report, there have been improvements in functional allocation of resources at the county level. The report advocates for building on the gains made by strengthening public financial management, including policy, planning, budget execution, institutional capacity and systems for monitoring and evaluation of development outcomes.

This Kenya Economic Report 2016 was prepared by the staff of the Kenya Institute for Public Policy Research and Analysis under the overall supervision of the Executive Director. The report was prepared in consultation with the KIPPRA Board of Directors, Central Bank of Kenya, National Treasury, Ministry of Devolution and Planning, Kenya National Bureau of Statistics, the National Economic and Social Council Secretariat, among other stakeholders.

The Institute would like to sincerely thank all those who were involved in one way or the other in the review of the various drafts of this report, more so during the stakeholders consultative workshop. We do hope we have adequately taken on board your suggestions towards improving the quality of the report.

While all effort has been made to ensure that all data and analysis is accurate, the Institute takes responsibility for any errors of data, analysis or presentation that may have passed unnoticed.

Dr Dickson O. Khainga
Ag. Executive Director, KIPPRA
2016

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Abbreviations and Acronyms

ACHPR	African Charter on Human and People's Rights
AFIDEP	African Institute for Development Policy
AG	Attorney General
AgGDP	Agrucultural Gross Domestic Product
AGOA	Africa Growth and Opportunity Act
AMISOM	African Mission in Somalia
AMV	African Mining Vision
ANC	ante-natal care
ART	Antiretroviral Therapy
ASALs	Arid and Semi-arid Lands
ASCAs	Accumulating Savings and Credit Associations
ASF	African Standby Force
CBEF	County Budget Economics Forums
CBK	Central Bank of Kenya
CBRIS	Companies and Business Registration Integrated System
CEC	County Executive Committee
CFAs	Community Forest Associations
CIC	Commission for the Implementation of the Constitution
CIDPs	County Integrated Development plans
CIRTs	Computer Incident Response Teams
CMA	Capital Markets Authority
COMESA	Common Market for Eastern and Southern Africa
CPI	Consumer Price Index
CRA	Commission on Revenue Allocation
CRBs	Credit Reference Bureaus
CRF	County Revenue Fund
DSA	Drug and Substance Abuse
EAC	East African Community
EACC	Ethics and Anticorruption Commission
EACC	Ethics and Anti-Corruption Commission
EASF	Eastern African Standby Force
ECDE	Early Childhood Development Education
ECDE	Early Childhood Development Education
EITI	Extractive Industries Transparency Initiative
EPAs	Economic Partnership Agreements
EPZs	Export Processing Zones
EU	European Union
FBOs	Faith-Based Organizations
FDSE	Free Day Secondary Education
FOCAC	Forum on China Africa Cooperation
FSD	Fiancial Sector Deepening
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GER	Gross Enrolment Rate
GES	Global Entrepreneurship Summit
GFCF	Gross Fixed Capital Formation
GoK	Government of Kenya
GST	Goods and Services Tax
HIV/AIDS	Human Immunodeficiency Virus /Acquired Immune Deficiency Syndrome
ICESCR	International Covenant on Economic Social and Cultural Rights
ICT	Information and Communication

	Technology
IEA	Institute of Economic Affairs
IFC	International Finance Corporation
IGAD	Inter-Governmental Authority on Development
ILO	International Labour Organization
IMF	International Monetary Fund
JKIA	Jomo Kenyatta International Airport
KBRR	Kenya Bank's Reference Rate
KDHS	Kenya Demographic and Health Survey
KIHBS	Kenya Integrated Household Budget Survey
KIPPRA	Kenya Institute for Public Policy Research and Analysis
KNBS	Kenya National Bureau of Statistics
KOSF	Kipevu Oil Storage Facility
KPRL	Kenya Petroleum Refineries Limited
KTMM	KIPPRA Treasury Macro Model
LAPSSET	Lamu Port South Sudan-Ethiopia-Transport
LCOE	Levelized Cost of Electricity
MEWNR	Ministry of Environment, Water and Natural Resources
MINUSCA	Multidimensional Integrated Stabilization Mission in the Central African Republic
MMDAs	Metropolitan, Municipal and District Assemblies
MMR	Maternal Mortality Ratio
MSEs	Micro and Small Enterprises
MTEF	Medium Term Expenditure Framework
MTP	Medium Term Plan
MW	Megawatts
MWI	Ministry of Water and Irrigation
NAAIAP	National Accelerated Agricultural Inputs Access Programme
NACCSC	National Anti-Corruption Campaign Steering Committee
NCA	National Construction Authority
NCA	National Construction Authority
NCDs	Non-Communicable Diseases
NCIP	Northern Corridor Integration Projects
NCTTCA	Northern Corridor Transit and Transport Coordination Authority
NEMA	National Environmental Management Authority
NER	Net Enrolment Rate
NSE	Nairobi Securities Exchange
NSSF	National Social Security Fund
NTBs	Non-Tariff Barriers
NTSA	National Transport and Safety Authority
OCOB	Office of Controller of Budget
OMO	Open Market Operations
PFM	Participatory Forest Programme
PRT	Pupil Teacher Ration
REA	Rural Electrification Authority
REITs	Real Estate Investment Trusts
REP	Rural Electrification Programme
RMLF	Road Maintenance Levy Fund
ROSCAs	Rotating Savings and Credit Associations
RSIP	Roads Sector Investment Programme
RTGS	Real Time Gross Settlement Systems
SACCOs	Savings and Credit Cooperative Societies
SADC	Southern Africa Development Cooperation
SASRA	Sacco Societies Regulatory Authority
SCT	Single Customs Territory
SDGs	Sustainable Development Goals
SEZs	Special Economic Zones
SID	Society for International Development
SMEs	Small and Micro Enterprises
SMS	Short Message Test
SSA	Sub-Sahara Africa
SSM	Special Safeguard Mechanism
THVC	Traditional High Value Crops
TICAD	International Conference on African Development
TVET	Technical, Vocational and Entrepreneurship Training
UNAMID	United Nations-African Union Mission in Darfur
UNCTAD	United Nations Conference on Trade and Development
UNEA	United Nations Environmental Assembly
UNECA	United Nations Economic Commission for Africa
UNHCR	United Nations High Commission for Refugees
UNICEF	United Nations Children's Funds
UNMISS	United Nations Mission in South Sudan
VAT	Value Added Tax
WARIS	Water Regulatory Integrated System
WASREB	Water Services Regulatory Board
WEF	World Economic Forum
WHO	World Health Organization
WTO	World Trade Organization
WTTC	World Travel and Tourism Centre

Executive Summary

This *Kenya Economic Report* focuses on recent performance of Kenya's economy, medium term prospects, and how fiscal decentralization can support the realization of the goals of devolution, especially, socio-economic development. The theme of fiscal decentralization is a highly relevant one within our current policy context due to the challenges and opportunities arising from implementation of devolution since 2013. Over the last three years, Kenya has been building the foundation for an effective devolved governance system putting in place the legal and regulatory framework, together with institutions to operationalize the provisions and principles in Chapter 11 and 12 of the Constitution of Kenya 2010.

The report notes that the share of resources allocated to county governments as a proportion of total revenue increased from 19.9 per cent in 2013/14 to 24.2 per cent in 2014/15. There has also been a notable improvement in functional and economic allocation of resources at the county level, with notable increases in resources allocated to health, education, agriculture and other devolved functions. At the same time, the share of resources going to compensation of employees declined from 39.8 per cent in 2013/14 to 33.5 per cent in 2014/15. Despite these improvements, most counties are yet to comply with fiscal responsibility principles on operationalization of the Public Finance Management (PFM) Act; the Auditor General's reports on financial operations point to an urgent need to strengthen financial management. Other priority areas include enhancing county own-resource administration, strengthening inter-governmental relations relating to implementation of functions and budgeting, strengthening institutional capacity, and improving transparency and participation in budget formulation and execution.

According to the report, Kenya's growth prospects remain positive and robust. The economy is projected to expand at a rate of 5.9 per cent in 2016 and further to 6.2 percent in 2017. This is predicated on a stable macroeconomic environment, improved security environment, and structural reforms that enhance the business environment in the various sectors of the economy.

Macroeconomic Performance

The slowdown in economic growth that was experienced in 2014 was reversed in 2015, which recorded a growth rate of 5.6 per cent compared to 5.3 per cent in 2014. Kenya's economy is projected to grow at a rate higher than the Sub-Saharan Africa (SSA) average. Growth is expected to continue to be driven by investment and household consumption, and a stable macroeconomic environment through prudent fiscal and monetary policy.

An assessment of fiscal performance reveals that, in recent years, public expenditure has grown faster than revenue, and thus public debt has notably increased. While Kenya's public debt remains sustainable, there are concerns over the need to maintain fiscal sustainability because the current account deficit is comparatively high at about 10 per cent of GDP in 2014, though it improved to 6.8 per cent in 2015. Budget absorption also needs to be enhanced.

Governance

Based on the Mo Ibrahim indicators, Kenya's overall governance performance has improved. Notable achievements include the institutionalization of performance contract system and innovative service delivery initiatives such as Huduma Centres. Such improvements notwithstanding, the fight against corruption, and inability to meet the Constitution imperative of gender representation remain areas of concern. The taskforce on the review of the legal, policy and institutional framework for fighting corruption has made important recommendations on a coordinated approach to fight corruption, which should be implemented. Moreover, concerted efforts should be made to ensure that Kenya meets the gender representation requirement.

Socio-economic Performance

The Constitution of Kenya provides for free and compulsory basic education. It also institutionalizes devolution of governance and service delivery to the counties. Article 187 of the Constitution specifies that pre-primary education, village polytechnics, home craft centres and childcare facilities will be devolved to county level governments. While there have been improvements in performance, the net enrolment rates (71.8% for ECDE, 88.2% for primary and 47.4% for secondary) imply that close to 28.2 per cent of ECDE eligible children, 22.9 per cent of the primary school going age population, and 52.6 percent of secondary school age children are not enrolled in school. Urban informal settlements and arid and semi-arid lands are most affected with low enrolment rates, and there are also regional disparities.

There is need for initiatives targeting marginalized groups, institutionalizing capacity development programmes, developing and monitoring standards, and revitalizing the tertiary sector of education.

The health sector has recorded improved performance on key indicators such as infant and child mortality, maternal healthcare, and HIV/AIDS prevalence. However, there is need for strategic interventions to address the double burden of communicable and non-communicable diseases, and enhance the link between policy, planning and budget, and also coordination between national level and policy implementation at the county level. Funding HIV/AIDS programmes still remains largely donor-dependent.

Agriculture

In 2015, the agriculture sector grew by 5.6 per cent compared to 3.5 per cent in 2014. The sector accounted for about 30.0 per cent of GDP and 22.0 per cent of growth in GDP in 2015.

However, performance has been complicated by the teething problems associated with implementation of devolution. There is need to reduce the duplication of functions between national and county governments, and increase investment in research, science and technology, as well as rural infrastructure development.

Extractives Sector

The Kenyan mining sector is small and under-developed, contributing about one percent to GDP, but the recent discovery of mineral deposits and oil reserves presents considerable untapped potential of the sector. The sector registered the highest percentage growth of 14.2 per cent between 2013 and 2014, mainly attributed to the commencement of titanium ore mining in Kwale. The sector has great potential and the government should focus on putting in place a strong legal and institutional framework, as well as local capacity to support the development of the industry.

Manufacturing

Manufacturing in Kenya accounts for 65 per cent of the industrial sector real GDP. While the sector is improving in absolute terms with regard to indicators such as sector value added (Ksh 425.5 billion in 2014/15 compared to Ksh 417.7 billion in 2013/14) and formal employment (287,400 jobs in 2014/15 compared to 279,400 jobs in 2013/14), its contributions to GDP and employment are marginally declining as a result of both internal and external factors. Key challenges include high production costs, and competition from cheap imports especially from China and India, among other challenges.

To address high production costs, the Government has embarked on key energy and infrastructural projects that are yielding positive results; Kenya's ranking in the World Bank's doing business ranking improved from position 129 in 2015 to 108 in 2016. More reforms are, however, required to realize the top 50 position envisaged in the Industrial Transformation Programme launched in 2015. Progress towards second Medium Term Plan has been hampered by various challenges, including lengthy process of land identification and transfer, delays resulting from stakeholder consultations, funding constraints, and inadequate training facilities for industrial skills.

With regard to policy developments, the Sustainable Development Goals (SDGs) launched in 2015 underscore the prioritization of labour-intensive sectors, efficient use of resources and doubling of industrial sector contribution to employment and GDP in developing countries. Domestically, two notable policy developments include the enactment of the Special Economic Zones Act No. 15 of 2015, and the launch of the industrial transformation programme. The congruence between SDGs and Vision 2030 in industrialization agenda and poverty reduction provides Kenya with an opportunity to concurrently implement the two agendas.

Overall, revitalization of the manufacturing sector will entail reduction of production costs, as well as ensuring easy access to factors of production such as land. Second, there is need to diversify exports destination for manufactured goods, while the country maintains a stable exchange rate regime to ensure importation of intermediate goods. Third, development of Special Economic Zone regulations will help attract investments, promote technology transfer, and reduce informality.

Micro and Small Enterprises

The Micro and Small Enterprise (MSE) sector is a critical pillar of the economy because majority (75%) of all modern establishments in Kenya are MSEs. The sector, however, is faced with the challenge of informality. Tackling informality therefore forms a critical policy priority.

The Government should use the existing platform of the Registrar of MSEs, as well as the MSEs Association, to provide incentives that can lead to formalization of most these enterprises.

Secondly, a one-stop shop and single registration form could help simplify the business registration, licensing and statutory requirements and thus limit rent seeking opportunities which have been identified as a key constraint to the sector. Moreover, the issue of multiple fees payments in county governments needs to be addressed.

Thirdly, alternative credit solutions that cater to the needs and requirements of MSEs should be explored. The two which have been explored so far are credit guarantee funds to lend to start-ups, and invoice discounting. They provide opportunities for MSEs to borrow in times of cash flow shortfalls.

Trade and Foreign Policy

The domestic retail and wholesale trade sector has been evolving with greater concentration of firms as well as developments in electronic commerce, making Kenya a regional business hub. However, there is need to strengthen and rationalize the regulatory framework, taking into account the roles of the national and county governments in order to increase the sector's contribution to GDP and wage employment. To expand trade, there is need to improve the commercial environment by addressing domestic constraints to international business development, and through projects that could facilitate regional sharing of production, as well as diversification into new export lines.

Financial Services

As at June 2015, the sector recorded an increased growth of 8.1 per cent compared to a growth of 7.2 per cent in June 2014. In the same period, the sector's contribution to the GDP increased marginally from 6.8 per cent to 6.9 per cent, although the structure of the sector remained fairly unchanged. A number of policy changes were witnessed in the sector, key among them being the launch of Kenya's first mobile-based Treasury bond dubbed M-Akiba bond. The bond with a minimum investment level of Ksh 3,000, will enable many Kenyans to access government debt securities through their mobile phones and at low amounts. It will increase competitiveness, and democratize the government securities market by reaching the 26.5 million users of mobile phone financial services.

Commercial banks registered improved growth in assets of 21.4 per cent. Loans and advances grew by 20.5 per cent and, on liabilities, the deposit base increased by 20.3 per cent. Commercial banks pre-tax profits increased by 8 per cent from Ksh 71 billion in 2014 to Ksh 76.7 billion in 2015. The factors driving growth were branch expansion, remittances and agency banking. In the case of MFBs, loans increased by 31.6 per cent and the deposit base by 0.8 per cent. The capital market performance also continued to improve in 2015. High investors' gains especially in the stock market are likely to have been the driving factor. On the bonds' market, the local investors' confidence in economic prospects of the economy and the East African region led to several corporate bond issues. Though there was improved performance of the insurance industry, insurance penetration in the country remains low, with non-life business accounting for 66 per cent of total premiums in the industry.

On cost of credit, though the interest rates remained stable, the interest spread was 8.8 per cent against the Vision 2013 target of 6.0 per cent. Despite this, private sector credit grew by 20.5 per cent as a result of increased demand for credit from private households, trade, manufacturing, transport and communication, and real estate. In 2015, the stock of gross non-performing loans grew by 21.8 per cent, with highest growth recorded in the mining and quarrying, transport and communication, building and construction, real estate, and trade. Policy reform considerations should aim at increasing competition in order to lower the cost of credit, deepen the capital markets, and expand on the tradable securities, and reduce non-performing loans.

Building and Construction

The building and construction sector is critical in creating a platform for the realization of the country's Vision 2030. The contribution of the construction industry to GDP stood at about 4.8 per cent in 2015, and it recorded a growth of 13.6 per cent. Of policy concern in the sector is the unmet demand for low income housing; escalating cost of land; multiplicity of costs coupled by lengthy development approval procedures; quality control in the sector in view of collapsing buildings; and high cost of financing. There is need to strengthen public-private partnerships (PPPs) especially in the supply of affordable housing be strengthened; harmonize the costs and processes for development control (one-stop-shop); develop a National Housing Price Index as a tool for regulating housing price; and expedite the completion of the National Spatial Plan and the Urban Development Policy.

Transport

The sector's performance improved in 2015, registering a growth of 7.1 per cent compared to 4.6 per cent in 2014. Such improvement is attributable to increased investment in transport infrastructure and services, including an increase of the Road Maintenance Fuel Levy. Some policy and legal developments that will likely impact the sector include introduction of increased fuel levy; revision of exercise duty on motor vehicles; and constitutional institutionalization of classification, management and maintenance of public roads. One of the challenges that face the sector include conflict over the responsibilities of national and county governments, which need to be clarified through consultation and participation. Moreover, to mitigate the high costs of construction, there is need to embrace and promote public-private partnerships (PPPs). As more projects come on board, such as the Standard Gauge Railway, there is need to enhance local content.

Energy

The Sustainable Development Goal for energy aims to enhance access to affordable, reliable, sustainable and modern energy for all. Kenya consumes a mix of renewable energy (hydro, wind, solar, geothermal and cogeneration) and non-renewable energy (coal and petroleum products). The expenditure on energy and petroleum has been increasing, as the absorption capacity is declining. Rural electrification initiative has notably boosted electricity accessibility, which is complemented by massive government investment in renewable energy. Such connectivity notwithstanding, prices of electricity are higher compared to other countries lsuch as Ghana. Seemingly, Kenya has excess supply of electricity, but this is likely to be outstripped by 65 per cent potential demand. Thus the government needs to enhance the implementation of the 5,000+ MW power plan to meet this potential demand. In terms of petroleum consumption, the formula used to calculate prices has not been reviewed since it was enacted. It is important to review this because aspects such as charges for refining remain even after the only local refinery was closed. Finally, Kenya depends heavily on petroleum products. Attempts to substitute petroleum fuels with biofuels will require a delicate balance between production of food and that of fuel.

Water and Sanitation

The population of Kenyans' accessing improved water sources was 63.2 per cent in 2015, reflecting an improvement of 0.1 per cent. Land under irrigation increased by 12,917 hectares and water storage capacity increased by 14 million cubic metres. However, the sector's contribution to GDP declined by 0.1 per cent to reach 0.8 per cent. Water utilities improved accessibility by 2.6 per cent, and also registered progress in hours of supply, metering ratio, revenue collection efficiency, production, turnover, non-revenue water, personnel expenditure and employment. However, the utilities registered negative progress in drinking water quality, coverage of operations and maintenance costs, sewerage coverage, and compliance with data submission.

Accessibility to improved sanitation is estimated at 30.2 per cent. Coverage of the population within the service area of the water and sanitation utilities increased by 1.9 per cent to reach 68.6 per cent in 2015 up from 66.7 per cent in 2014. Urban and rural water utilities increased their coverage from 70.6 percent to 72.2 per cent and 63.8 per cent to 66.0 per cent, respectively. Sewerage coverage, which is only applicable to urban areas, increased by 1.6 per cent from 20.6 per cent to 22.2 per cent.

Budget allocation for the water sector reduced in the year 2014. Actual receipts reduced from Ksh 29.9 billion in 2014 to Ksh 21.4 billion. The level of effort by government and donors towards funding the sector in 2014 was relatively the same as 2013, with government to donor funding ratio being 50:50. Recurrent expenditure to development expenditure ratio was 1:4.

The government has initiated several bills to enhance service delivery, strengthen management of sector resources, and improve interactions among various stakeholders. There is need to improve the mobilization of water and sanitation resources, strengthen management of water and sanitation resources, and finalize the bills, policies and strategies that are pending.

Information and Communication Technology

The information and communication sector is a key enabler in transforming Kenya into a knowledge-based economy. The sector grew by 7.3 per cent in 2015. It has made significant growth both in public and private sectors as reflected by various indicators, such as mobile cellular subscriptions, mobile money transfer services, and Internet usage. The areas where policy requires attention include cyber insecurity, sharing of key ICT infrastructure, the ever growing digital divide, and the need to promote and streamline the growth of the sector.

PART I

MACRO AND SOCIO-ECONOMIC PERFORMANCE

This part reviews Kenya's macroeconomic performance especially in terms of overall economic growth, fiscal and revenue performance, government expenditure, and overall public debt. It also provides a comparison of key fiscal indicators across selected African countries, and raises important fiscal policy issues and options.

The part also reviews two key governance indicators, namely corruption and gender representation in Kenya's National Assembly and Senate.

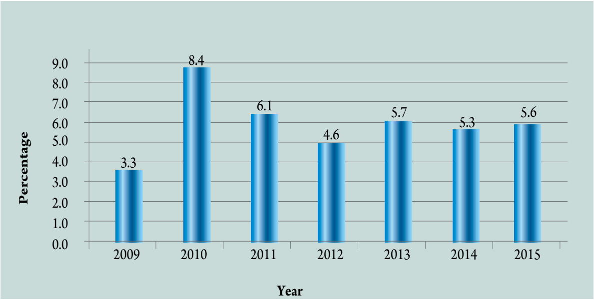
Chapter 1

Macroeconomic Performance

1.1 Introduction

This chapter reviews the performance of Kenya's economic growth up to 2015, fiscal and revenue performance, government expenditure, and overall public debt. The chapter also compares a number of fiscal performance indicators across selected African countries, and raises important fiscal policy issues and options for Kenya.

Figure 1.1: GDP growth rates, 2009-2015



Source: KNBS (2014, 2015 and 2016)

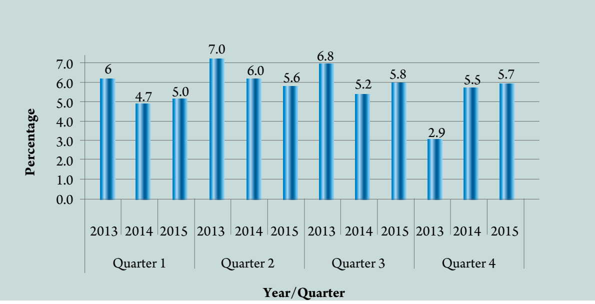
1.2 Economic Growth Performance

Following the rebasing of the national accounts in 2014, statistics indicate that the Kenyan economy grew by 4.6 per cent, 5.7 per cent, 5.3 per cent and 5.6 per cent in 2012, 2013 ,2014 and 2015, respectively (Figure 1.1). Growth in 2015 was mainly driven by a stable macroeconomic environment and improvements agriculture, construction, finance, insurance and real estate sectors (KNBS, 2016). However, growth in real gross fixed capital formation declined from 14.8 per cent in 2014 to 5.2 per cent in 2015. Growth in the exports of goods and services also declined from a growth rate of 5.3 per cent in 2014 to -0.9 per cent in 2015. The growth in imports of goods and services also declined from 10.6 per cent in 2014 to -1.2 per cent in 2015.

Quarterly GDP estimates indicate that the Kenyan economy expanded by 5.0 per cent, 5.9 per cent, 6.0 per cent and 5.7 per cent during the first, second, third and fourth quarters of 2015 (Figure 1.2). Growth in the fourth quarter was higher than growth in the fourth quarter of 2014, which was 5.5 per cent. Also, third quarter growth was higher than the same period in 2014, which was 5.2 per cent. The strong growth in the third quarter of 2015 was mainly supported by stable macroeconomic indicators and expansion of activities in agriculture, mining and quarrying, construction, accommodation and restaurant, finance and insurance, wholesale and retail trade, and transport and storage.

In terms of sources of growth, accommodation and restaurants, mining and quarrying, construction and agriculture, forestry and fishing registered higher growth rates during the fourth quarter of 2015 (grew at 21.2%, 16.3%, 14.9% and 11.8%, respectively), as compared to the fourth quarter of 2014 (grew at -15.5%, 22.4%, 19.4%, and 3.8%, respectively) – Table 1.1. All sectors recorded higher growth in the

Figure 1.2: Quarterly GDP growth rates



Source: KNBS(Quarterly GDP releases, 2015)

third quarter of 2015 compared to the third quarter of 2014, except for agriculture, communication, education, health and other services.

In general, growth in most African countries has been strong, with growth in low income countries averaging 6.6 per cent and 5.7 per cent in 2014 and 2015, respectively (IMF, 2016). Growth in middle income countries (where Kenya now falls after rebasing its GDP, excluding South Africa and Nigeria) averaged 4.6 per cent and 2.6 per cent in 2014 and 2015, respectively, which was much lower than growth in the low income countries. Growth in middle income countries is projected at 2.5 per cent and 3.4 per cent in 2016 and 2017, respectively. Comparatively, Tanzania and Rwanda recorded the highest growth rates in the East African region, with growth rates of 7.0 per cent and 6.9 per cent, respectively, in 2015 (Table 1.2). Ethiopia recorded the highest growth rate among the low income countries, averaging 10.2 per cent in 2015. Among the selected middle income countries, Kenya recorded the highest growth rates in 2015, with a growth rate of 5.6 per cent. In general, growth in Sub-Saharan Africa is projected to decline in 2016 and 2017, while East African countries are projected to record slightly higher growth rates in 2016 and 2017. Botswana recorded negative growth rate in 2015, but is expected to pick up in 2016 with a growth rate of 3.7 per cent. South Africa and Zambia are expected to slow down in 2016, with their economies expected to grow at a slower pace. Even though the Sub-Saharan growth momentum seems to have slowed, largely attributed to the sharp decline in commodity prices, ebola outbreak and drought. The medium term growth prospects, however, are still favourable (IMF, 2016). The

Table 1.1: Sectoral sources of growth

	2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Agriculture and forestry	2.2	2.1	6.8	3.8	4.4	5.6	5.5	11.8
Mining and quarrying	10.5	26.9	1.5	22	4.6	7.5	13.7	16.3
Manufacturing	6.4	8.3	1.5	-2.3	3.5	4.6	3.3	1.2
Electricity and water	3.9	4.6	7.2	7.3	8.4	10.2	10.0	1.8
Construction	7.6	16.6	8.8	19.4	11.3	9.7	15.6	14.9
Wholesale and retail trade, and repairs	9.7	5.2	5.3	7.9	6.7	5.5	6.2	6.0
Accommodation and restaurants	-14.1	-19.3	-20.5	-16	-7.5	-0.8	-6.5	21.2
Transport	3.8	5.7	7.8	2.8	6.0	6.1	9.4	5.5
Communication	12.7	8.1	16.1	15.8	9.4	7.7	8.2	5.9
Financial services	8.3	7.9	7.1	10	9.1	7.6	10.3	6.5
Professional services	3.0	2.5	1.9	3.3	4.4	5.8	1.9	-0.1
Real estate, renting and business services	6.3	6.7	6.2	3.2	2	4.2	11.4	-4.9
Public administration	-4.2	16.2	0.4	10.9	8.4	5.9	3.7	3.7
Education	6.6	8.2	7.5	7.2	3.3	3.5	5.7	4.2
Health	5.1	7.5	7.8	8.3	7.4	8.1	3.2	10.6
Other services	5.5	4.4	4.1	3.0	3.0	1.7	3.8	4.1

Source: KNBS (2015c)

Table 1.2: GDP Growth in selected African countries

	2012	2013	2014	2015	2016	2017
Sub-Saharan Africa	4.3	5.2	5.1	3.4	3.0	4.0
Kenya	**4.6**	**5.7**	**5.3**	**5.6**	**6.0**	**6.1**
Uganda	2.6	4.0	4.9	5.0	5.3	5.7
Tanzania	5.1	7.3	7.0	7.0	6.9	5.2
Rwanda	8.8	4.7	7.0	6.9	6.3	6.7
Burundi	4.4	4.5	4.7	-4.1	3.4	3.9
Ethiopia	8.7	9.9	10.3	10.2	4.5	7.0
Botswana	4.5	9.9	3.2	-0.3	3.7	4.3
Ghana	9.3	7.3	4.0	3.5	4.5	7.7
South Africa	2.2	2.2	1.5	1.3	0.6	1.2
Zambia	7.6	5.1	5.0	3.6	3.4	4.8

Source: IMF (2015)

favourable prospects are largely due to improved business environment and favourable demographics, even though the external environment still poses significant downward risks mainly due to terms of trade shocks and tighter external financing.

1.3 Fiscal Sector Performance

Following the rebasing of GDP, fiscal outturn indicators as a proportion of GDP reduced in magnitude. For instance, total revenue was 24 per cent of GDP in 2013/14 before rebasing, but declined to 19.32 per cent of GDP rebasing. The ratio declined further to 18.9 per cent of GDP in 2014/15 and 8.8 per cent for the first half of 2015/16 (Table 1.3). Ordinary revenue also declined from 18.2 per cent of GDP in 2013/14 to 18.0 per cent of GDP in 2014/15 and 8.5 per cent in the first half of 2015/16. Despite the effect of rebasing, expenditure and net lending increased from 25.7 per cent of GDP in 2013/14 to 28.3 per cent of GDP in 2014/15, mostly due to increased government spending especially towards funding of the devolution process and implementation of the flagship projects under Vision 2030. In the first half of 2015/16, expenditure and net lending amounted to 11.3 per cent of GDP.

As a result, deficit excluding grants increased from -5.71 per cent of GDP in 2013/14 to -9.35 per cent of GDP in 2014/15 while deficit, including grants, (commitment basis) increased from -5.17 per cent of GDP in 2013/14 to -8.86 per cent of GDP in 2014/15. In the first half of 2015/16, deficit excluding grants, and deficit including grants (commitment basis), were -2.46 per cent and -2.27 per cent of GDP, respectively. Deficit including grants (cash basis) increased from -5.43 per cent of GDP in 2013/14 to -8.25 per cent of GDP in 2014/15. The deficit was largely financed by foreign financing, which increased from 2.1 per cent of GDP in 2013/14 to 3.81 per cent of GDP in 2014/15. Domestic financing marginally increased from 4.00 per cent of GDP in 2013/14 to 4.39 per cent of GDP in 2014/15. In the first half of 2015/16, deficit including grants (cash basis) was -2.56 per cent of GDP. The deficit was mainly financed through foreign financing (2.12% of GDP), with only 0.43 per cent of GDP of domestic financing.

Table 1.3: Fiscal outturn (% of GDP)

	2013/14	2014/15	First half 2015/16
Total revenue	19.3	18.9	8.8
Revenue	18.2	18.0	8.5
A-I-A	0.3	0.3	0.1
Expenditure and net lending	25.7	28.3	11.3

Recurrent expenditure	14.9	15.3	6.6
Development expenditure	6.3	8.4	3.2
Deficit excluding grants (commitment basis)	-5.7	-9.4	-2.5
Grants	0.5	0.5	0.2
Deficit including grants (commitment basis)	-5.2	-8.9	-2.3
Deficit including grants (cash basis)	-5.4	-8.3	-2.6
Financing	6.1	8.3	2.6
Foreign financing	2.1	3.8	2.1
Domestic financing	4.0	4.4	0.4

Source: National Treasury (2015), Quarterly Economic and Budget Review (2014/15 for the period ending 30th June 2015

1.4 Revenue Performance

Total cumulative revenue (including A-I-A) over the first half of 2015/16 amounted to Ksh 581.1 billion against a target of Ksh 678 billion, compared to Ksh 1,081.2 billion in 2014/15 against a target of Ksh 1,170.5 billion (Table 1.4). Thus, total revenue over the first half of 2015/16 was below target by Ksh 96.9 billion. Ordinary revenue amounted to Ksh 544.2 billion in the first half of 2015/16, against a target of Ksh 591.8 billion. Thus, total revenue fell below the target by 17.0 per cent, while ordinary revenue also fell below target by 8.7 per cent.

A review of the performance of tax handles also shows that only Value Added Tax (local) surpassed its target by 0.9 per cent in 2014/15. Other income tax (mainly corporate tax) and PAYE were below target by 7.7 per cent and 1.6 per cent, respectively in 2014/15 (Table 1.4). VAT imports were also below the target in 2014/15 by 8.0 per cent while import duty and excise duty were below the target by 3.5 per cent and 3.1 per cent, respectively. A-I-A funds were below target by 48.0 per cent, which has been attributed to under-reporting especially by universities. External grants were below target by 58.0 per cent. In the first half of 2015/16, income tax and VAT were below their target by 10.0 per cent and 9.0 per cent, respectively. Excise and import duties were also below target by 6.0 percent and 5.0 percent, respectively. A-I-A were also below target by 108.0 per cent.

Table 1.4: Government revenue and grants (Ksh billions)

	2013/14	2014/15		Half of 2015/16	
	Actual	Actual	Target	Actual	Target
Total revenue	974.4	1,081.2	1,170.5	568.8	642.9
Total ordinary revenue	919.0	1,029.3	1,070.5	544.2	591.8
Import duty	67.6	74.0	76.7	39.2	41.3
Excise duty	102.0	115.9	119.6	64.7	68.3
PAYE	249.9	279.8	284.4	262.2[a]	288.7[a]
Other income tax	199.7	228.8	248.0		
VAT local	107.8	127.9	126.8	138.0[b]	149.8[b]
VAT imports	124.9	131.8	143.3		
Other revenue	57.2	71.1	71.7	40.1	43.6
A-I-A	55.4	51.9	100.0	24.6	51.1
External grants	27.0	28.1	66.4	12.3	35.1
Total revenue and grants	1,001.4	1,109.0	1,236.9	581.1	678.0

Source: National Treasury (2015), Quarterly Economic and Budget Review (2014/15 for the period ending 30th June 2015; a includes all income tax revenue; b includes all VAT revenue

1.5 Government Expenditure

Total government expenditure and net lending for the first half of 2015/16 amounted to Ksh 727.4 billion compared to Ksh 1,616 billion in 2014/15 and Ksh 1,297.8 billion in 2013/14 (Table 1.5). Recurrent expenditure accounted for 58.0 per cent of total expenditure in 2014/15 and first half of 2015/16, respectively. Development expenditure, on the other hand, accounted for 31.0 per cent and 28.0 per cent of total expenditure in 2014/15 and first half of 2015/16, respectively. Wages and salaries accounted for 18.0 per cent and 20.0 per cent of recurrent expenditure in 2015/15 and the first half of 2015/16, respectively. Operations and Maintenance accounted for 21.0 per cent and 20.5 per cent of total expenditure in 2015/15 and first half of 2015/16, respectively.

Allocations to county governments were 15.0 per cent in 2013/14, 14.0 per cent in 2014/15 and 14.0 per cent over half of 2015/16. In 2015/16, aggregate approved budget estimates for the county governments amounted to Ksh 362.76 billion and comprised Ksh 200.57 billion (55.3%) allocation for recurrent expenditure and Ksh 162.19 billion (44.7%) for development expenditure (Office of the Controller of Budget, County Governments Budget Implementation Review Report for the first half of 2015/16). Actual expenditure during the first half of 2015/16 amounted to Ksh 113.43 billion, which consisted of Ksh 81.08 billion for recurrent activities (71.5% of the total expenditure) and Ksh 32.35 billion (28.5% of total expenditure) for development projects. The aggregate expenditure represented an absorption rate of 31.3 per cent of the annual budget. The cumulative spending on development activities did not conform to the public financial management requirement that at least 30 per cent of budget must be allocated for development programmes. In 2014/15, cumulative spending conformed to the public financial management of at least 30 per cent spending on development activities (35.1%), even though several counties (such as Nakuru, Nairobi, Kisumu, Nyeri, Embu and Kajiado) did not meet the 30 per cent threshold.

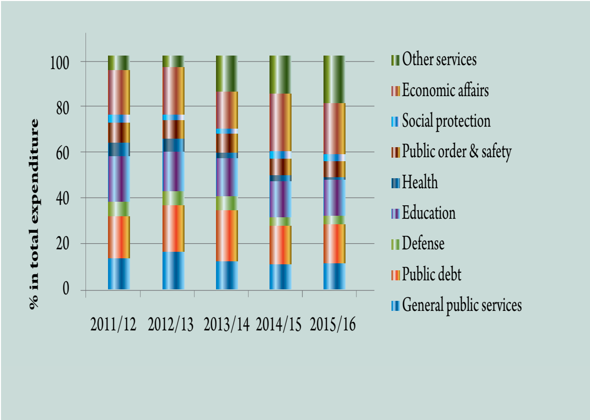
Figure 1.3 shows the proportion of spending by functions of government over the past five years. The proportion of spending on economic affairs was 19 per cent in 2011/12 compared to 16 per cent in 2015/16. The proportion of spending on general public services increased from 13 per cent in 2011/12 to 17 per cent in 2014/15, before declining

Table 1.5: Government expenditure and net lending (Ksh billions)

	2013/14		2014/15	Half of 2015/16	
		Actual	Target	Actual	Target
Recurrent	749.6	839.0	907.4	423.8	512.8
Domestic interest	119.2	139.7	136.2	85.7	77.7
Foreign interest	12.8	32.3	29.0	17.4	15.1
Pensions	30.2	37.5	39.4	22.8	22.0
Wages and salaries	281.2	293.1	298.0	148.7	166.8
Operation and maintenance	306.3	336.4	404.8	149.1	231.3
Development	319.3	508.1	636.4	204.4	329.2
County governments	193.4	229.3	229.3	99.2	149.7
Parliamentary service	22.5	22.9	26.5		
Judicial service	13.0	11.7	13.8		
Equalization fund	0.0	0.4	3.4		
Civil contingency fund	0.0	5.0	5.0		
Total expenditure	1,297.8	1,616.0	1,821.8	727.4	997.2

Source: National Treasury (2015), Quarterly Economic and Budget Review (2014/15 for the period ending 30th June 2015

Figure 1.3: Classification of expenditures by functions of government



Source: KNBS (2016)

to 11 per cent in 2015/16. Spending on education also declined from 20 per cent of total spending in 2011/12 to 17 per cent in 2015/16, while health sector spending declined from 5 per cent in 2011/12 to 2 per cent of total spending in 2015/16.

1.6 Fiscal Deficit and its Financing

In 2014/15, the overall fiscal balance on commitment basis (including grants) amounted to Ksh 506.7 billion (8.9% of GDP against a target of Ksh 584.9 billion (10.2% of GDP) – Table 1.6. For half of 2015/16, the overall fiscal balance on commitment basis (including grants) amounted to Ksh 146.2 billion against an annual target of Ksh 319.2 billion. Overall fiscal deficit, including grants, on a cash basis amounted to Ksh 471.9 billion (8.3% of GDP) compared to a target of Ksh 584.9 billion (10.2% of GDP). For half of 2015/16, the overall fiscal balance on cash basis (including grants) amounted to Ksh 165.3 billion against an annual target of Ksh 319.2 billion. In 2014/15, deficit financing was largely from domestic sources, amounting to Ksh 251.1 billion compared to the first half of 2015/16 where deficit financing was mainly foreign, amounting to Ksh 136.8 billion (83% of the deficit financing over the same period). This represented domestic financing and external financing of 0.43 per cent and 2.12 per cent of GDP in the first half of 2015/16, respectively, as compared to domestic financing of 4.4 per cent of GDP and external financing of 3.81 per cent in 2014/15.

1.7 Overall Public Debt

Total public debt was Ksh 2,844 billion (about 49.7% of GDP) at the end of December 2015 compared to Ksh 2,276 billion at the end of December 2014– Figure 1.4 (Quarterly Economic and Budget Review, First half of 215/). The total external debt stock, including the International Sovereign Bond, stood at Ksh 1,615 billion at the period ending December 2015, accounting for 51 per cent of total gross public debt. The external debt stock comprised of multilateral debt (47%), bilateral debt (30%), export credit debt (1%) and commercial banks' debt (23% including the International Sovereign Bond). Most of Kenya's external debt remains on concessional terms, although its commercial component has increased.

The stock of domestic debt increased from Ksh 1,308 billion in December 2014 to Ksh 1,540 billion in December 2015, accounting for 49 per cent of total gross public debt.

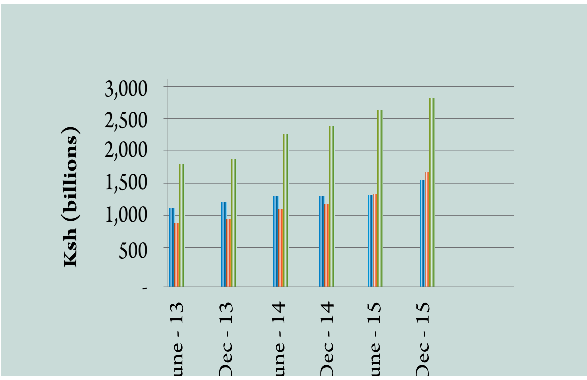
Table 1.6: Fiscal deficit and financing (Ksh billions)

	2013/14	2014/15		Half of 2015/16	
		Actual	Target	Actual	Target
Deficit excluding grants (commitment basis)	-287.9	-534.8	-651.3	-158.6	-354.3
Deficit including grants (commitment basis)	-261.0	-506.7	-584.9	-146.2	-319.2
Deficit including grants (cash basis)	-273.7	-471.9	-584.9	-165.3	-319.2
Financing	309.1	471.9	584.9	165.3	319.2
Foreign financing	106.1	217.8	261.2	136.8	211.5
Domestic financing	201.7	251.1	172.9	27.7	106.6

Source: National Treasury (2015), Quarterly Economic and Budget Review (2014/15 for the period ending 30th June 2015

The total cumulative debt service payments to external creditors amounted to Ksh 33.8 billion by December 2015, which comprised Ksh 16.4 billion principal repayments and Ksh 17.4 billion interest payment.

Figure 1.4: Public debt



Source: National Treasury (2015), Quarterly Economic and Budget Review (2014/15 for the period ending 30th June 2015

1.8 Comparison of Key Fiscal Indicators Across Selected African Countries

A comparison of fiscal indicators across selected African countries for 2015 is shown in Table 1.7. Kenya has the highest revenue to GDP ratio of 19.8 per cent in 2015 among the EAC countries, with Uganda, Tanzania, Rwanda and Burundi having revenue to GDP ratios of 13.7 per cent, 13.9 per cent, 17.6 per cent and 10.3 per cent, respectively. Kenya, Rwanda and Burundi have higher expenditure to GDP ratios amounting to 28.6 per cent for Kenya, 27.2 per cent for Rwanda and 29.9 per cent for Burundi. Consequently, Kenya, Rwanda and Burundi have the highest fiscal deficits as a ratio of GDP among the EAC countries. Among the selected countries, Botswana has the highest revenue and expenditure to GDP ratios (37.9% revenue to GDP ratio and 39.7% expenditure to GDP ratio). In terms of debt, Kenya has the highest debt to GDP ratio in the EAC, estimated at 52.7 per cent to GDP compared to Uganda's 35.4 per cent, Tanzania's 40.5 per cent, Rwanda's 34.6 per cent, and Burundi's 38.4 per cent. Ghana has the highest debt to GDP ratio among the selected countries, estimated at 73.3 per cent of GDP.

1.9 Underlying Fiscal Policy Issues and Options

1.9.1 Fiscal space and public financial management

Fiscal space can be defined as the availability of budgetary room that allows a government to provide resources for a desired purpose without

Table 1.7: Fiscal indicators for selected African countries (2015)

	Revenue to GDP (%)	Expenditure to GDP (%)	Fiscal deficit to GDP including grants (%)	Fiscal deficit to GDP excluding grants (%)	Debt to GDP (%)
Sub-Saharan Africa	17.9	22.6	-4.1	-4.8	36.4
Kenya	**19.8**	**28.6**	**-8.4**	**-8.8**	**52.7**
Uganda	13.7	18.0	-2.9	-4.3	35.4
Tanzania	13.9	18.8	-3.7	-4.9	40.5
Rwanda	17.6	27.2	-2.8	-9.6	34.6
Burundi	10.3	29.9	-6.9	-19.6	38.4
Ethiopia	15.1	18.6	-2.5	-3.6	48.6
Botswana	37.9	39.7	-1.6	-1.8	17.8
Ghana	18.0	24.4	-5.0	-6.3	73.3
South Africa	29.7	33.7	-4.0	-4.0	50.1
Zambia	17.3	25.6	-8.1	-8.3	52.9

Source: IMF (April, 2016), Regional Economic Outlook, Sub-Sharan Africa any prejudice to the sustainability of a government's financial position (Heller, 2005). Creation of fiscal space enables the country to generate additional resources to increase government spending or reduce taxation on an activity that is deemed important. At the national level, a review of trends reveals that government expenditure has increased at a faster rate than government revenue. Additional fiscal space can be generated through three key areas. First, additional revenue can be generated by broadening the tax base (through tax reforms (VAT and Excise tax), taxation of SMEs, taxation of real estate sector, capital gains tax, etc) and through enhancing tax administration to enhance compliance. Second, fiscal space can be created at the national level through reallocation of resources across sectors, depending on sectoral priorities. This requires rationalization of expenditure through curtailing of less productive expenditures and reallocation of more resources towards more efficient sectoral priorities. Third, the government can borrow additional resources, especially through cheaper foreign concessional loans, but only within sustainable limits.

At county level, several challenges have continued to hamper budget execution (Office of the Controller of Budget, County Governments Budget Implementation Review Report for the Financial Year 2014/15 and half year of 2015/16). These include: cash payment and manual revenue systems; under-performance of local revenue systems; weak internal controls; and weak public financial management systems (especially budgetary reallocations according to exchequer issues and priority levels; inflated expenditures; borrowing from commercial banks without guarantee from national government or county assembly; use of locally generated revenues at source; etc). There are several measures that counties are putting in place to enhance revenue generation and enhance their public financial management systems, key among them: automation of revenue generation systems; rationalization of existing taxes; updating of taxpayers' databases; drafting of relevant legislations; capacity building for staff; improved audits and internal controls; and identification of new tax bases. Some of the potential sources of additional revenue for counties include: taxation of property, liquor licensing, levies on tourism activities, and mining levies/cess.

At county level, several challenges have continued to hamper budget execution (Office of the Controller of Budget, 2015). These include: cash payment and manual revenue systems; under-performance of revenue systems; weak internal controls and; weak public financial management systems (especially budgetary reallocations according to exchequer issues and priority levels; inflated expenditures etc). There are several measures that counties are putting in place to enhance revenue generation and public financial management, key among them being automation of revenue generation systems; rationalization of existing taxes; updating of taxpayers' databases; drafting of relevant legislations; capacity building for staff; improved audits and internal controls and; and identification of new tax bases. Some of the potential sources of additional revenue for counties include: taxation of property, liquor licensing, levies on tourism activities, and mining levies/cess.

1.9.2 Debt sustainability

Statistics on central government's debt show that total debt more than quadrupled between 2000 and 2014. Thus, the issue of debt sustainability should be a concern given the increasing debt levels. The government acknowledges that pursuance of a sustainable debt level is important, given the effect of the stability of key macroeconomic variables (stability of inflation, interest rates and exchange rates) on private sector participation in the economy (Budget Policy statement, 2013). One simple way of assessing whether debt is sustainable is by looking at the relationship between central government revenue and expenditure over time. Debt will be sustainable if government revenue and expenditure move in a similar manner, which would imply that the government will be able to finance its expenditure from its own revenues. The analysis of growth in total revenue and total expenditure shows that the growth in expenditure has over time mirrored the growth in revenue, except for increased expenditure during election years and also after 2012 (Figure 1.5). After 2012, total expenditure increased at a higher rate than total revenue, while total revenue grew at a declining rate. In 2015, total revenue grew at a faster rate than total expenditure. Even though previous analysis by IMF (IMF, 2013) showed that Kenya faced a low risk of external debt distress as all external public debt indicators were found to be below the relevant country-specific debt burden thresholds (for Kenya, a threshold of 40% of GDP and 150% of exports), persistence in recent trends could signal fiscal distress. The biggest risks to Kenya's fiscal position are: (i) fluctuations in the exchange rate; (ii) less favourable terms of payment on new loans; (iii) slower economic growth rate; and (iv) widening current account deficit. Maintenance of a favourable debt position requires: (i) slower increases in fiscal and current account deficits; (ii) faster growth, at the long-term projected rate of 6 per cent; (iii) stability in macroeconomic fundamentals, especially inflation; and (iv) growth in exports beyond the medium term projection of 7 per cent.

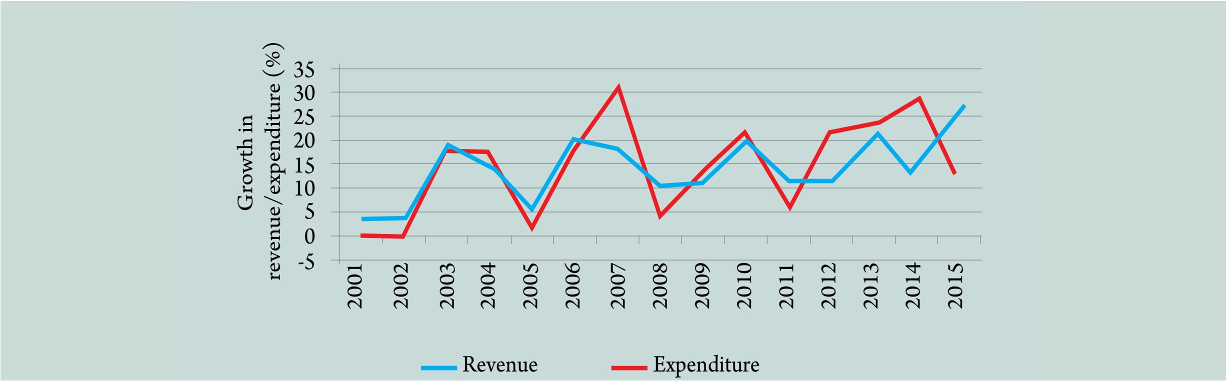
1.9.3 Savings and investment

The gross fixed capital formation (GFCF) in Kenya has experienced a high growth during the period 2012-2015 (registering a 48% increase). Particularly, GFCF increased to Ksh 1.34 trillion in 2015 from Ksh 1.24 trillion in 2013, representing about 8 per cent growth (KNBS, 2016). This implies that Kenyans devote about 21 per cent of their national output to investment. The impressive growth in investment spending has been driven by a number of infrastructural projects that the government has initiated in recent years. A further analysis of capital spending in Kenya reveals that the increase in gross terms diverges widely from real terms. For instance, between 2013 and 2014, the capital formation rate at constant prices increased by far less than in current prices. This big divergence (Figure 1.6) points to an increased inflation on new capital acquisition, which can be a financial strain to the economy in case GDP does not expand at a similar rate.

With regard to gross savings (as a percent of GDP), data for the first 8 months of 2015 reveals an encouraging development. Having nearly stagnated between 2011 and 2014, gross savings increased from 11 per cent in 2014 to 14.1 per cent in 2015, reflecting about 28 per cent growth (Table 1.8).

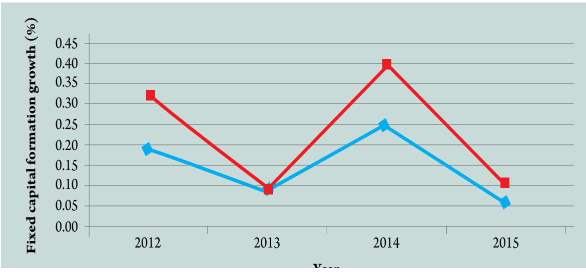
A simple comparative analysis of average gross investment and savings among some selected countries in Sub-Saharan Africa indicates that Kenya lags behind almost all the selected countries. For instance, Kenya's average gross savings between 2012 and 2015 were 13.5 per cent, while the average for the East African regional block was 16.9 per cent. Additionally, while the EAC bloc registered

Figure 1.5: Growth in government revenue and expenditure



Source: Own computation using data from KNBS (Various), Economic Survey

Figure 1.6: Gross versus real fixed capital formation growth (2010-2015)



Source: KNBS (2016)

an average gross investment of 26.7 per cent, Kenya achieved an average of 21.7 per cent. Clearly, policy makers in Kenya need to pursue policies that will promote both savings and investment to achieve the growth rates envisaged in the Vision 2030. Specifically, closing the human development and governance gaps seems to hold promise for higher national savings and investment (Caceres and Caceres, 2015). Caceres and Caceres (2015) found out (in their study of 24 countries in Sub-Saharan Africa) that positive shocks to human development indicators (such as education and health) as well as the rule of law lead to increase in national savings and investment. We therefore suggest (in view of the

Table 1.8: Gross savings and investment in some selected Sub-Saharan African countries

Gross Investment (% of GDP)					
	2012	2013	2014	2015a	2012-2015 average
Kenya	21.5	20.1	21.4	23.8	21.7
Uganda	29.5	29.2	30.2	33.4	30.6
Tanzania	28.5	30.3	31.0	30.9	30.2
Rwanda	25.9	26.5	26.3	25.3	26.0
Ethiopia	30.8	35.8	36.8	39.5	35.7
Botswana	38.5	33.4	31.5	32.8	34.1
Ghana	32.0	23.5	24.8	23.8	26.0
Zambia	34.2	33.6	31.1	30.9	32.5
Mauritius	24.8	25.1	22.9	25.4	24.6
Namibia	26.9	24.9	28.0	29.6	27.4
EAC	25.8	25.9	26.8	28.2	26.7
Gross Savings (Percent of GDP)					
	2012	2013	2014	2015*	2012-2015 average
Kenya	13.1	11.2	11.0	14.1	12.4
Uganda	21.5	22.0	20.6	22.8	21.7
Tanzania	19.3	15.1	21.9	22.7	19.8
Rwanda	14.7	19.1	14.4	14.7	15.7
Ethiopia	31.2	29.7	28.8	27.0	29.2
Botswana	39.9	42.3	47.6	35.6	41.4
Ghana	16.8	13.5	15.2	15.4	15.2
Zambia	39.7	33	29.7	29.5	33.0
Mauritius	18.4	19.7	18.3	20.3	19.2
Namibia	21.2	20.9	18.0	17.5	19.4
EAC	16.8	15.0	16.8	18.8	16.9

IMF (2015)
* data is up to September 2015

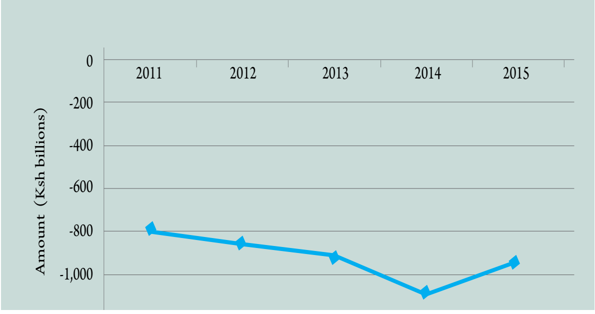
findings of Caceres and Caceres, 2015) that, for the Kenyan government to positively impact the current low levels of savings and investment, it should pursue human development and institutional quality as part of a national macroeconomic policy.

1.9.4 Current account

Kenya's current account has been trending downwards for the last four years, although it mildy improved in 2015. Particularly, the balance of trade recorded a deficit of Ksh 997 billion by the end of 2015, which was an improvement from a deficit of Ksh 1081 billion recorded in 2014.

The current account balance has been on a downward trend for the past five years, although there was an improvement in 2015 (Figure 1.7). This improvement was largely driven by a decline in imports (of 9.6%), particularly oil imports, which decreased by 34 per cent on a year to year basis. Even though there was a marginal reduction in imports between October 2014 and September 2015, the gap between imports and exports still remained wide (Figure 1.8). Reviving the manufacturing industry and promoting local products, coupled with quality assurance, are some of the ways of tackling the persistent trade deficit.

Figure 1.7: Kenya's balance of trade

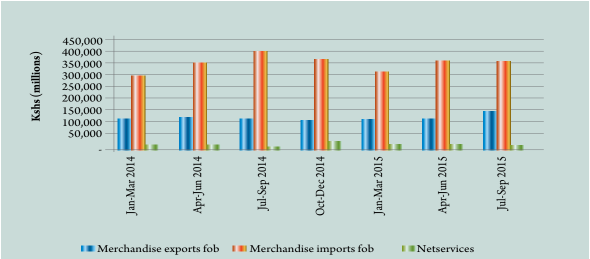


Source: KNBS (2015)

1.9.5 Monetary policy and inflation

The key aim of monetary policy is to maintain price stability by keeping inflation at a low level, normally within the target range of 5±2 per cent. In

Figure 1.8: Kenya's exports versus imports

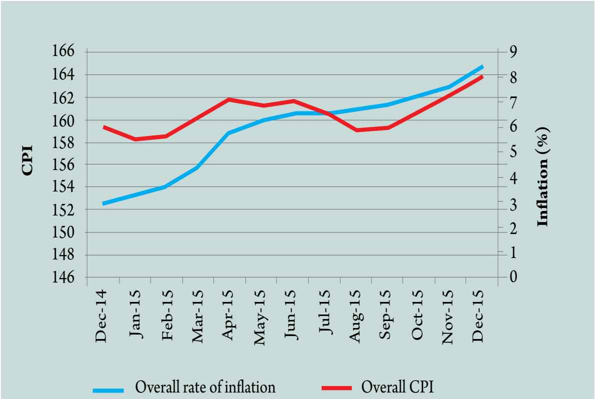


Source: National Treasury (2015), Quarterly Economic and Budget Review (2014/15 for the period ending 30th June 2015

December 2015, the overall inflation had risen to 8.0 per cent, which surpassed the target bounds set by the National Treasury (Figure 1.9). The average annual consumer price index (CPI) increased from 140.11 in 2013 and 149.74 in 2014 to 164.72 in December 2015. It resulted in a modest increase in the rate of inflation. This was attributed to increase in the cost of several food and non-food items, which outweighed the significant decrease in the cost of electricity and petroleum products, such as petrol, kerosene and diesel.

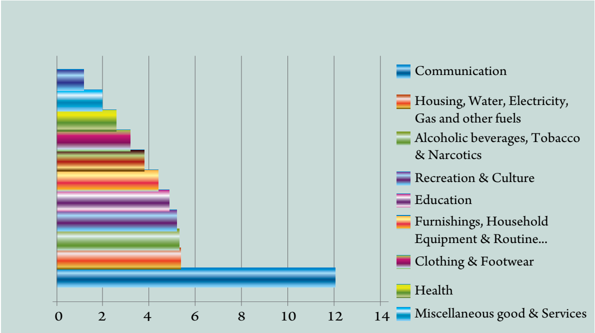
Non-food non-fuel inflation rose by 88 basis points to 5.6 per cent following a revision in excise duty in December 2015. This was also attributed to higher prices in the following categories of goods and services: alcoholic beverages, tobacco and narcotics, communication, clothing and footwear, health, miscellaneous goods and services and furnishings, household equipment, and routine consumption baskets (Figure 1.10). The inflation pressure in most of non-food and non-fuel was attributed to imported inflation arising from exchange rate depreciation during the period under review. A review of inflation by income group shows that the lower income group is disadvantaged compared to other categories (Figure 1.10). This is attributed to the fact that lower income group inflation is sensitive to changes in food prices, given that food carries the highest weight in compilation of the lower income CPI, reflecting the fact that lower income groups spend the highest share of their income on food.

Figure 1.9: Overall Consumer Price Index (CPI) and inflation, 2015



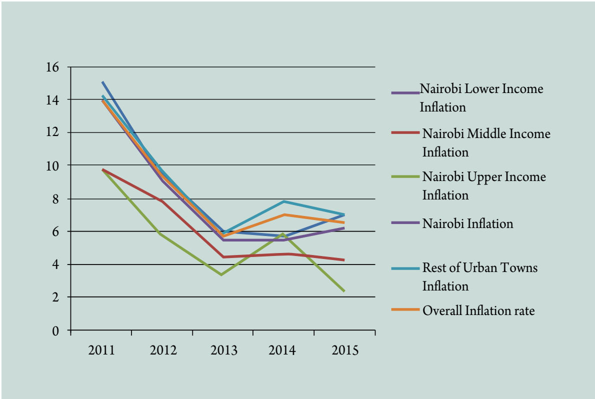
Source: KNBS (2015)

Figure 1.10: Month inflation across the CPI categories of goods and services, June 2015



Source: National Treasury (2015), Quarterly Economic and Budget Review (2014/15 for the period ending 30th June 2015

Figure 1.11: Overall 12 months inflation by income groups (%)



Source: Central Bank of Kenya (2015), Monthly Economic Review

Figure 1.12: Inflation trends across some Sub-Saharan African countries

Source: World Bank

Table 1.9: Developments in inflation rates, 2015

		12-month inflation	Average Annual	Food inflation	Fuel inflation	Non-food non-fuel inflation
2015	Jan	5.5	6.7	7.4	4.5	3.5
	Feb	5.6	6.6	8.3	3.3	3.4
	Mar	6.3	6.6	10.3	2.9	3.2
	Apr	7.1	6.7	12.5	1.5	3.5
	May	6.9	6.7	12.4	0.3	4.2
	Jun	7.0	6.6	12.6	0.2	4.6
	Jul	6.6	6.5	11.4	0.6	4.7
	Aug	5.8	6.3	9.4	1.1	4.6
	Sept	6.0	6.3	9.4	1.5	4.7
	Oct	6.7	6.3	10.6	2.1	4.8
	Nov	7.3	6.4	11.8	2.3	4.8
	Dec	8.0	6.6	12.4	2.9	5.6

Source: KNBS (2015)

1.9.6 Diaspora remittances

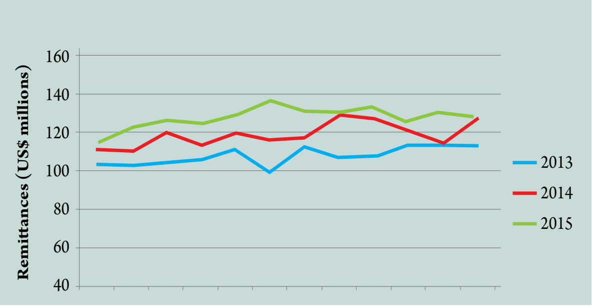
Diaspora remittances to Kenya increased by 19.9 per cent from US$ 114.6 million in January 2015 to US$ 137.5 million in January 2016. It increased by 2.6 per cent when compared to inflows in December 2015. The increase was attributed to improvement in inflows from North America and Europe. Inflows in the 12 months to January 2016 cumulatively increased by 9.7 per cent from US$ 1,432 million in the year to January 2015 to US$ 5,171 million in 2016 (Table 1.10). The rest of the world, despite accounting for the least amount by volume and market share, greatly contributed to increase in remittances in January 2016 and fully counterbalanced the decline recorded from North America and Europe.

Table 1.10: Remittance inflows by source (US$ millions)

	North America	Europe	Rest of the World
Jun-2015	67.1	37.3	31.6
Sept-2015	61.9	37.4	29.2
Nov-2015	60.3	37.4	33.0
Dec-2015	66.4	43.2	33.3
Jan-2016	63.5	40.6	33.3
Percentage share of total inflows			
	North America	Europe	Rest of the World
Jun-2015	49.3	27.4	23.2
Sept-2015	48.2	29.1	22.7
Nov-2015	46.2	28.6	25.2
Dec-2015	49.6	32.2	18.2
Jan-2016	46.2	29.6	24.3

Source: Central Bank of Kenya (2015), Monthly Economic Review

Figure 1.13: Diaspora remittances inflows to Kenya



Source: Central Bank of Kenya (2015), Monthly Economic Review

1.9.7 Exchange rate

During the period ending June 2015, the Kenya shilling depreciated against major world currencies. The depreciation with respect to the US dollar was reflected across the major international currencies, including the South African Rand, Ugandan Shilling and Tanzanian Shilling. Except for the Kenya Shilling, these currencies depreciated faster and were more volatile against the US dollar (Central Bank of Kenya, 2015).

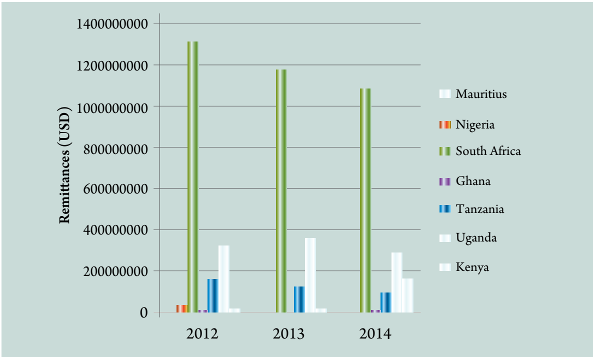
A strong recovery of the US economy bolstered the demand of the dollar denominated assets, which strengthened the US dollar against world major currencies. This was further attributed to lower interest rate expectations in the Eurozone after the adoption of Quantitative Easing (QE) by the European Central Bank (ECB) in January 2015. This was in addition to weak growth recovery in the Eurozone.

The Kenya shilling exchange rate is continuously being supported by resilient foreign exchange inflows via Diaspora remittances. The Central Bank of Kenya interventions, by mopping up liquidity through direct sales of foreign exchange to commercial banks, led to short-term volatility in the foreign exchange market during the period (Central Bank of Kenya, 2015).

According to the Central Bank of Kenya (2015), the level of foreign exchange reserves stood at US$ 6,859.58 million. This equates to 4.40 months of import cover as of April 2015. This level of reserve was increased by the precautionary access under a blended standby arrangement and a standby credit facility that was negotiated by the Kenyan government and approved by the IMF in January 2015. The aim was to mitigate any balance of payment shocks, which boosted the bank's capacity to curtail short-term volatility in the foreign exchange market.

The Kenya shilling exchange rate movement against the US dollar during the period September-

Figure 1.14: Cross-country comparisons for remittance inflows

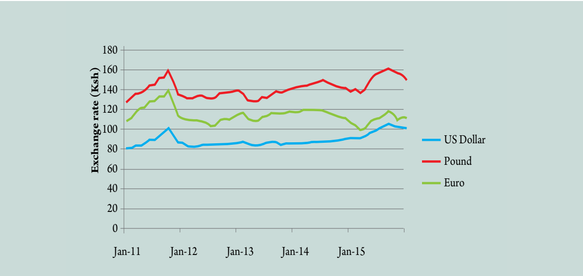


Source: World Bank

December 2015 reflected a higher demand for the dollar, resulting from heightened economic activity that led to increased imports and slowed exports, especially in leading Kenya's foreign exchange earners such as tea and tourism, which declined on account of weak global demand and lower tea prices. The chart below illustrates the exchange rate movement for the Kenya shilling against the world major currencies.

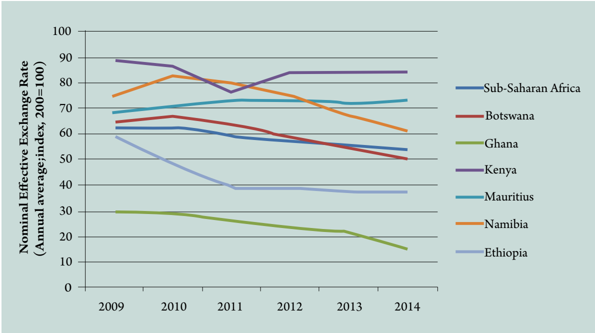
The large majority of frontier market economies' currencies experienced depreciations of higher magnitude, including in Ghana, South Africa, Kenya, Tanzania, Uganda, and Zambia, reflecting existing or rising domestic vulnerabilities in some cases (Ghana, South Africa, Zambia), but also increasing overall risk aversion as in many other frontier and emerging market economies around the world (Figure 1.15).This could have been caused by volatile capital movements following market expectation changes about the likely evolution of monetary

Figure 1.15: Kenya shilling exchange rate



Source: Central Bank of Kenya (2015), Monthly Economic Review

Figure 1.16: Nominal effective exchange rates for selected Sub-Saharan African countries (annual average index 2000=100)

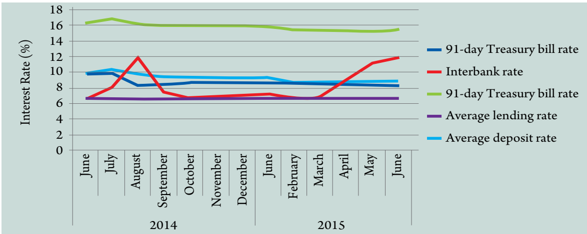


policies stance in key countries, notably the United States (IMF, 2015). In some other countries in the region, severe pressures on the exchange rates have also been triggered by growing macroeconomic imbalances, exacerbated by lower tourism receipts (Kenya and Gambia) or a poor harvest (Malawi). The central banks in these countries responded by tightening policies to stabilize exchange rates and to counter inflation.

1.9.8 Interest Rates

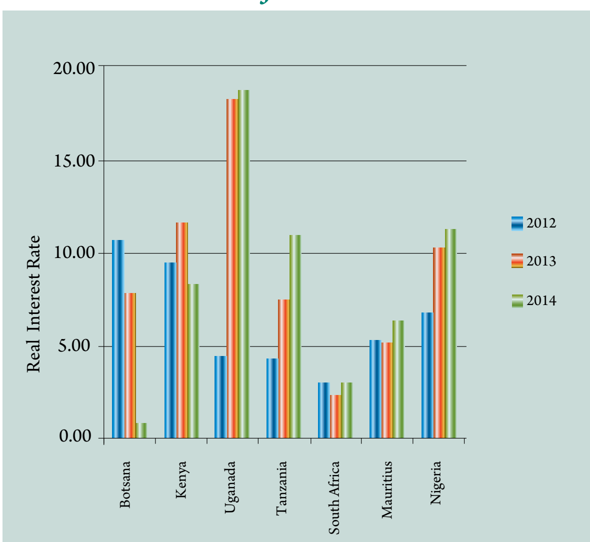
There was a mixed performance of rise and falls in most of the nominal interest rates during 2015 (Figure 1.16). To mitigate the surging demand associated with the weakening of the Kenya shilling against the US dollar, the Monetary Policy Committee (MPC) raised CBR rate in June 2015. The Central Bank Rate (CBR) was also revised upwards twice during the year. The rate increased from 8.5 per cent in December 2014 to 10.0 per cent in June and to 11.5 percent in December 2015. There was a drop in 91-day Treasury bill rate from 8.58 per cent in December 2014 to 8.26 per cent in June 2015 and further rose to 9.81 per cent in December 2015. Central Bank of Kenya maintained sustained liquidity management through Open Market Operations. Nevertheless, interbank rate spiked to 11.78 in June 2015 from 6.91 per cent and finally dropped to 7.27 per cent in December 2015. There was also an accumulation of government deposits at the CBK, and OMO activity intensified to mob

Figure 1.17: Trends in nominal interest rates, 2011-2015



Source: KNBS (2015)

Figure 1.18: Trends in real interest rates for selected Sub-Saharn African countries



Source: World Bank

up excess liquidity following tightening of monetary policy to anchor inflationary expectations. This saw interbank rate rising above the CBR in December 2015.

1.10 Emerging Policy Issues and Recommendations

Macroeconomic risks emanating from foreign exchange market volatility and fiscal policy concerns could feed into inflation (and inflationary expectations). If inflation rises, the CBK could decide to raise the central bank rate again to calm the market. A yield on government securities and lending rates is likely to rise in tandem, increasing returns on shilling-denominated assets, making them attractive. A steep rise in interest rates would dampen aggregate demand, as both consumption and investment spending would slow down and hinder growth (World Bank, 2015). Continued weak demand for Kenya's export following deflation in the Euro could slow down overall growth, since Europe is a leading destination for merchandise exports and also a main tourist destination for Kenya.

Kenyan interest rates are sticky downwards; they rise quickly but take long before they fall. To prevent real interest rates from rising prematurely, monetary policy must stay accommodative. It is also important, however, that the overall policy mix be supportive. Monetary policy efforts should be accompanied by efforts to strengthen balance sheets and the credit supply channel, and by the active use of macro prudential policies to address financial stability risks. The recent Central Bank action to publish the average bank lending rates has been lauded as a move to promote completion and transparency in pricing of loans and thus reign in on high interest rates.

Chapter 2

Governance

2.1 Introduction

Good governance reforms enhance constitutionalism, respect for human rights, democracy, transparency, accountability and economic development. Article 10 of the Constitution of Kenya 2010 provides for the entrenchment of national values and principles of governance in the country. These national values and principles of governance bind all State organs, State officers, public officers and all persons. They include:

(i) Patriotism, national unity, sharing and devolution of power;
(ii) The rule of law, democracy and participation of the people;
(iii) Human dignity, equity, social justice, inclusiveness, equality;
(iv) Human rights, non-discrimination and protection of the marginalized;
(v) Good governance, integrity, transparency and accountability; and
(vi) Sustainable development.

Kenya is governed through three Arms of Government: Executive, Legislature and the Judiciary. The executive implements government laws and policies, and exists both at the national government and county government levels. The National Executive comprises the President, the Deputy President, the Attorney General, Cabinet Secretaries, Principal Secretaries and the entire civil service. At the county level, the Executive comprise of the Governor, Deputy Governor and the entire County Executive.

The Constitution establishes a legislature that is fundamentally different, existing at both the national and county levels. At the national level, there are two chambers of Parliament consisting of the National Assembly and the Senate.

The Judiciary has a four tier structure with the Supreme Court being the top most tier. The other tiers are the Court of Appeal, the High Court, and the Subordinate Courts.

2.2 Performance Analysis

The three arms of government seek to:

- Enhance accountability by building accountable and transparent governance systems;
- Elevate civic education by providing citizens with the necessary information;
- Inspire good governance by building the capacity of civil society organizations working in the counties to enhance good governance and improve service delivery; and

- Support and develop programmes that stimulate community development and increase citizen participation

Good governance is at the core of sustainable development. The four key components of governance are accountability, transparency, predictability, and participation - these being universally applicable regardless of the economic orientation, strategic priorities, or policy pursued by government. In the 2015 MoIbrahim Index of governance, Kenya improved in its ranking (Table 2.1) from position 17 in 2014 to position 14 in 2015.

Table 2.1: Selected countries (2012/2013 to 2015/2016) MoIbrahim Index of Governance

Country		2013	2014	2015
1	Mauritius	1	1	1
2	Cape Verde	3	2	2
3	Botswana	2	3	3
4	Rwanda	15	11	11
5	Kenya	21	17	14
6	Tanzania	17	15	18
7	Uganda	18	19	19
8	Burundi	40	38	38

Source: MoIbrahim (2015)

Kenya's ranking improved probably due to the government adhering strictly to a code of governance and performance contracting of all State corporations. However, Article 10 of the Constitution also largely contributed to this improvement because it aims to entrench values and principles of governance in the civil service. Moreover, Article 73 of the Constitution has put emphasis on public trust, honor and dignity of all public offices and their holders.

Chapter 6 of the Constitution on leadership and integrity requires that public officers conduct themselves with decorum and those with tainted past are not allowed to occupy public offices. This is complemented by Article 232 of the Constitution on values and principles of public service.

The government has developed a code of conduct for state corporations (Mwongozo), which allocates responsibilities for supervision, implementation and enforcement of public service provisions so as to improve service delivery. The role of oversight institutions has been enhanced to monitor, consolidate and ensure free flow of information from the government to citizens. This will help enhance quality service delivery to citizens, and hence improved ranking of the country.

Service delivery is at the core of the government. Initiatives such as the Huduma centres across the country are meant to bring government services closer to the people. This will enable citizens get services in a one-stop service centre. However, even with such radical measures taken by the government to enhance service delivery, some services such as national registration are still experiencing some challenges; the National Registration Bureau, for example, can hardly meet demand for identity cards in Kenya as shown in Table 2.2.

From 2010 onwards, the Bureau has been carrying over the processing of identity cards to the next year. This has meant that some citizens are denied some critical services such as access to credit due to lack of national identification card. Another worrying concern is the large number of uncollected identity cards that have already been processed. The National

Table 2.2: Identity card applications made, processed and collected, 2009-2014

Service	2010	2011	2012	2013	2014
No. of applications made	976,971	1,190,570	2,475,183	843,642	915,101
No. of applications processed	632,219	1,413,842	2,282,378	956,230	740,078
No. of identity cards collected from districts	639,344	645,516	2,183,520	901,468	711,587

Source: KNBS (2015)

Registration Bureau should partner with officers from the Ministry of Interior and Coordination of National government and county governments to ensure that applicants collect their identity cards.

2.2.1 Control of corruption

Corruption is a challenge that is undermining the authority and effectiveness of the Executive. The Ethics and Anti-Corruption Commission is at the moment dealing with several reported cases of corruption. The number of cases handled by the commission is shown in Table 23.

From Table 2.3, it is evident that the number of corruption cases reported for investigation to the commission increased from 1,424 cases in 2011/2012 to 1,950 cases in 2013/2014. Likewise, the number of cases forwarded to the office of Director of Public Prosecutions (DPP) were 70 in 2011/2012, 49 in 2012/2013 and 70 in 2013/2014. Out of these cases, EACC was able to obtain eight convictions in 2011/2012, one conviction in 2012/2013 and three convictions in 2013/2014. The number of convictions within the three year period has dropped. The Commission should work with the DPP to ensure that cases forwarded to it are dealt with expeditiously. EACC referred 681 cases to other investigative agencies in 2013/14 compared to 111 cases in the previous year and had 65 cases pending for more information. The number of complaints advised on the right authority to report to dropped by 3.2 per cent from 1,170 cases in 2012/13 to 1,132 in 2013/14.

The EACC has a special role in the justice chain because it is the lead investigator in most corruption cases, and has recorded increase in the number of cases being handled by the commission (Table 2.3).

Corruption in Kenya is affecting service delivery in many public sectors. In addition to backlog of cases, corruption has contributed to lack of confidence in the Judiciary by the public. The Afrobarometer 2014 report indicates that about 30 per cent of Kenyans do not trust the court system at all. The East Africa Bribery Index 2014 also indicates that despite the police being the most corrupt institution, the judiciary leads in the size of bribe, with an average of Ksh 7,885 as at 2014. This was, however, a decrease in the average amount of bribe in 2013, which stood at Ksh 8,390 (Table 2.4).

A 2015 report of the task force on the review of the legal, policy and institutional framework for fighting corruption in Kenya made the following recommendations to enhance the fight against corruption:

(i) Establish a legal framework to facilitate the transmission of Auditor-General's reports directly to EACC for timely investigations, and eventual prosecutions by the Director of Public Prosecution.

(ii) The public be actively involved in the fight against corruption.

(iii) Professional organizations should be involved in the fight against corruption.

(iv) Integration of Information, Communication Technology (ICT) in the fight against corruption through the rendition of diverse government services through ICT-based platforms, such as E-Citizen, should be supported and mainstreamed.

(v) The Government should provide adequate resources for the conduct of civic education on the Constitution, governance, anti-corruption and national values to be undertaken by the Presidency (National Cohesion Directorate), EACC, National Anti-Corruption Campaign Steering Committee (NACCSC) and other stakeholders targeting members of the public and select groups to promote a culture of constitutionalism, rule of law, respect for human rights, adherence to national values and

Table 2.3: Number of cases handled by EACC, 2009/10-2013/14

Number					
Action taken	2009/10	2010/11	2011/12	2012/13	2013/14*
Corruption cases for investigation	1,796	2,816	1,424	1,423	1,950
Criminal cases referred to other investigative agencies	196	314	82	111	681
Cases referred to public service organizations for administrative intervention	813	987	31	506	841
Pending more information	59	43	25	18	65
Complainant's advised on the right authority to report	2025	2,050	1,050	1,170	1,132
Complainants advised to seek civil redress	950	869	301	0	0
No further action	179	247	65	127	178
Total	6,018	7,326	2,978	3,355	4,006
Cases forwarded to Attorney General (AG)/DPP	104	136	70	49	70
Convictions obtained	34	25	8	1	3

Source: KNBS (2015)
* Provisional

Table 2.4: Average size of bribe in public sector

Sector	Average size of bribe 2014	Average size of bribe (Ksh) 2013	Difference
Judiciary	7,885	8,390	-505
Land services	7,219	8,949	-1,730
Tax services	6,815	3,986	2,829
County administration	4,942	5,637	-695
Police	4,821	4,411	410
Utilities (Water and Electricity)	2,121	1,553	568
Educational institutions	2,095	4,378	-2,283

Source: TI (2014)

principles of governance, and the promotion of ethics and integrity.

(vi) Ensure effective collaboration in fighting corruption by preventing and combating money laundering by strengthening coordination among law enforcement institutions in the investigation and prosecution of corruption cases and further strengthening of cooperation with interested agencies.

(vii) Mainstream anti-corruption, ethics and integrity training into the formal system Early Childhood Education Development, primary, secondary, tertiary and university levels.

(viii) Formulate and implement county government specific anti-corruption, ethics and integrity training programmes.

These recommendations underscore the need to streamline the fight against corruption by bringing on board other government agencies to tackle corruption in a focused coordinated approach.

In the 2015 Corruption Perception Index report released by Transparency International, Kenya appears not to have made any meaningful progress in the fight against corruption (Table 2.5)

Table 2.5: Corruption Perception Index 2015 scores for selected countries

Rank out of 168	Country	Score (%)
28	Botswana	63
40	Cape Verde	55
40	Seychelles	55
44	Rwanda	54
45	Mauritius	53
117	Tanzania	30
139	Kenya	25
139	Uganda	25
150	Burundi	21
163	South Sudan	15
167	Somalia	08

Source: Transparency International (2016)
0-Highly corrupt; 100-Very clean

Out of the 168 countries surveyed, Kenya was position 139 with a score of 25 per cent. Rwanda is less corrupt in the region, coming at position 44 with a score of 54 per cent. Tanzania was at position 117 with a score of 30 per cent, being the second best country in the East African Community. The Rwandese government has undertaken a number of anti-corruption measures and these, coupled with immense political will and public support, have led to a low impunity environment where corruption is shunned. In Rwanda corruption prevention is the responsibility of every citizen, including public institutions and the political leadership. The Rwandese experiences in the zero tolerance against corruption is that political leadership. and political will matters; independent and credible institutions are important; and citizens' mobilization and support is central in fighting corruption. It is mandatory for all government officers to declare their assets before, during, and after, leaving office.

Under the Rwandese law for preventing and suppressing corruption, both public and private institutions are required to set up mechanisms for preventing and fighting corruption. The private sector too plays a critical role in fighting corruption through various codes that the sector is expected to come up with. This is because the contribution of the private sector in fuelling corruption cannot be ignored.

2.2.2 Gender Representation

Kenya is a party to the African Charter on Human and People's Rights (ACHPR), whose key principle is the recognition that "Every citizen (both women and men) shall have the right to participate freely in the government of their country, either directly or through freely chosen representatives in accordance with the provisions of the law". The Protocol to the African Charter on Human and People's Rights on the Rights of Women in Africa (Maputo Protocol) also seeks to ensure participation of women in the political and decision making processes in the country.

Secondly, the Constitution of Kenya enshrines the importance of equitable gender representation in Article 81(b): the two-thirds requirement for the National Assembly and Senate. Following the Attorney General's request for an advisory opinion on the minimum one-third gender requirement in the National Assembly and the Senate, the Supreme Court of Kenya on 11th December 2012 ruled that gender equity as an affirmative action for women is progressive in nature and not an immediate realization. The Court gave Kenya's Parliament up to 26th August 2015 to come up with legislation on how the one third gender rule will be met in the 2017 General Election.

Thirdly, the Kenya Vision 2030 seeks to institutionalize genuinely competitive and issue-based politics. The electoral and political processes strategy, which is under the political pillar, seeks to promote inclusion of women and disadvantaged groups in electoral and political processes.

Out of the 349 members of the National Assembly, 68 are women and 281 men. The envisaged constitutional requirement is that the majority gender will be 232 and minority gender

117. Therefore, there is no equitable gender representation in the National Assembly at the moment. Women are also under-represented in the Senate. In fact, there is no elected female in Kenya's Senate. However, 18 female Senators were nominated to the Senate to represent special interest groups and political parties. The constitutional requirement is for 44 majority gender and 23 minority gender in the Senate.

Kenya is the only country in East Africa that has not achieved gender equity in its legislature, measured by women comprising at least one third of its national legislators (Table 2.8).

Table 2.8: Representation of women in parliaments in East Africa in 2015

	Men (%)	Women (%)	Difference (%)
Kenya	79	21	58
Uganda	65	35	30
Tanzania	64	36	28
Rwanda	42	58	16
Burundi	65	35	30

Source: Institute of Economic Affairs (2015)

A realization of women's representation is not only good for democracy, but also in bringing in women's perspectives to bear upon Kenya's political decision making. In the absence of such equity, women will continue to be politically marginalized.

2.3 Conclusion and Policy Recommendations

Although Kenya is implementing various reforms in government to entrench good governance at all levels of government, corruption and unequal gender representation are among the critical challenges.

Presently, the Ethics and Anti-Corruption Commission (EACC) appears to be overwhelmed with cases of corruption. The Executive should empower other state institutions such as the Directorate of Criminal Investigations, National Intelligence Service, Efficiency Monitoring Unit, and office of the Director of Public Prosecutions, among others, to partner with EACC and tackle corruption. Moreover, there is need for capacity building (strengthening investigations) in the Ethics and Anti-Corruption Commission to ensure that it is able to fight corruption.

The Judiciary and Parliament should develop a framework working with the EACC and the office of Director of Public Prosecutions (DPP) to strengthen the fight against corruption. Often, when EACC forwards investigation files for cases it has investigated, the DPP returns them back to the Commission due to weak investigations or lack of sufficient evidence for successful prosecution of corruption suspects.

The services offered under Huduma centres should be expanded to cover all the 47 counties and to include a wider scope of services such as issuance of birth certificates, death certificates, and identity cards. Expansion of Huduma centres to all counties would reduce the tendency of public servants soliciting for bribes from citizens, especially if all services are digitalized (E-service).

The Executive and National Assembly should partner with the Senate to put in place legislation and measures that will enable the country realize the one-third minimum gender representation as stipulated in the Constitution. Political parties could, for instance, be compelled to reserve women seats in their respective party strongholds. This will be a meaningful step towards realizing the one-third minimum gender constitutional requirement. The National Assembly should partner with other stakeholders to enact a bill on gender quotas as one of the ways towards realizing the one-third minimum gender representation. Political parties should provide for specific affirmative action that increases women's participation within their parties, and thus increased candidacy of women in elections.

Chapter 3

Social-Economic Performance

3.1 Overview

Kenya is currently implementing Vision 2030 and its Medium Term Plan II. In these policy documents, the social pillar is one of the critical foundations for sustainable development. Further, the target of Vision 2030 is to transform the Kenyan economy to an industrialized economy by 2030. In order to fulfil this target, the quality of human capital, including education and health, will need to improve significantly among the Kenyan population. The government has also implemented various policy initiatives to meet the social capital targets. In the education sector, recent policy interventions include Free Primary Education, Free Day Secondary Education, revitalization of technical education, and expansion of university education. In the health sector, the government has implemented various policy reforms, including devolution of primary healthcare. However, emerging issues in the education sector relate to human resource development, including equity, quality and access to education, and ensuring all eligible children access education at various levels as a human right. For the health sector, areas of concern relate to sustainable financing of healthcare and effective service delivery within the devolved system.

This chapter focuses on socio-economic performance of the Kenya economy with specific focus on education and health sectors. The social-economic indicators are majorly anchored on the Sustainable Development Goals (SDGs), which builds on the MDGs, and emphasizes that the global community must improve on the their development goals and go beyond meeting basic human needs to promote dynamic, inclusive and sustainable development.

3.2 Education and Skills Development

3.2.1 Introduction

The education sector plays a key role in development of skills required in actualizing the economic and social goals of Vision 2030, and transforming Kenya to a globally competitive country. Kenya's Constitution underscores education as a social and economic right, and government efforts to increase resource allocation and provide incentives for investment in education are indications of the importance of the sector. The Vision 2030 identifies quality and equitable education service delivery as key enablers for sustainable development. The recently adopted Sustainable Development Goals (SDGs), to which Kenya subscribes focuses on ensuring inclusive and quality education for all and promoting lifelong learning (goal 4). Towards this end, the Government of Kenya has encouraged the growth of the education sector by increasing resource allocation and providing incentives for investment and participation in provision of skills training.

3.2.2 Recent Policy Reforms

A wide range of education policy reforms have been implemented in Kenya in the recent past, notably the introduction of Free Primary Education in 2003 and Free Day Secondary Education in 2008. These reforms were intended to increase access to affordable, relevant and high quality education and skills development. The reforms came in the context of observed inequalities in access to education.

The Constitution of Kenya (Government of Kenya, 2010), Sessional Paper No. 14 of 2012 (Government of Kenya, 2012) and Vision 2030 provide the current policy directions guiding the provision of education and training. The Constitution provides guidance for education policy in several ways. Firstly, it emphasizes the right to education, granting citizens the right to goods and services, education included, of reasonable quality and to information necessary for them to gain full benefit from goods and services. Every child has a right to free and compulsory basic education regardless of social, cultural, religious and physical differences (Government of Kenya, 2010).

Secondly, it recognizes international laws that Kenya is a signatory to. In effect, the International Covenant on Economic Social and Cultural Rights (ICESCR, 1966), which emphasizes the right to the highest standard of education, is applicable to Kenya. The ICESCR stipulates that education at all levels should exhibit four interrelated features: availability, accessibility, acceptability and adaptability.

Thirdly, the Constitution introduced devolution of governance structures and transformation of key education institutions/organizations to ensure that all public services, including education, are accessed in all parts of Kenya. Under the devolved system of government, the national government is responsible for education policy, standards, curricula and examinations. It is also responsible for granting of university charters; and administration of other institutions of research and higher learning, primary schools, secondary schools, and special education institutions. The county government, on the other hand, is responsible for pre-primary education, village polytechnics, home craft centres, and child care facilities. However, there are various gaps in the sector that warrant policy interventions in financing, quality and access.

3.2.3 Financing of Education

Expenditure on education and training by the Government of Kenya has increased over the years. Overall, education expenditure increased by 26.2 per cent from Ksh 244.4 billion in 2013/14 to Ksh 308.4 billion in 2014/15 (Table 3.1). The increase can be attributed to government commitment to provide Free Primary Education, Free Day Secondary Education, and improved teachers' personnel emoluments.

Table 3.1: Public spending in education, 2013/14 and 2014/15 (Ksh millions)

	2013/14	2014/15	% change	% share, 2014/15
Basic Education				
Recurrent	43,631	54,118	24.0	17.6
Development	3,676	22,138	502.2	7.2
Total	47,307	76,256	61.2	24.7
Higher Education, Science and Technology				
Recurrent	36,793	53,782	46.2	17.4
Development	6,266	12,698	102.7	4.1
Total	43,059	66,480	54.4	21.6
Teachers Service Commission				
Recurrent	154,039	165,479	7.4	53.7

	2013/14	2014/15	% change	% share, 2014/15
Development	-	135		0.0
Total	154,039	165,614	7.5	53.7
Grand Total	244,405	308,350	26.2	100.0

Data Source: Ministry of Education (2015)

In 2014/15, the share of teachers' personnel emoluments comprised 53.7 per cent of the total public spending in Kenya. Development spending constituted about 11.3 per cent of education spending. However, the increased spending has not been matched with commensurate improvements in human development outcomes.

3.2.4 Enrolment per level and number of education institutions

The majority of the population in Kenya possesses low levels of education and training. On average, 25 per cent of the population aged 15-64 years has no education, 52 per cent have attained primary education and only 23 percent have attained secondary education and above (KNBS-SID, 2014). The effects of low education attainment are reflected in the labour market, where only 32.7 per cent of workers in formal wage sector have attained secondary education and above (Munga et al., 2014). This low level of outcome is due to unsatisfactory and inequitable access to education at all levels of education.

Early Childhood Development Education

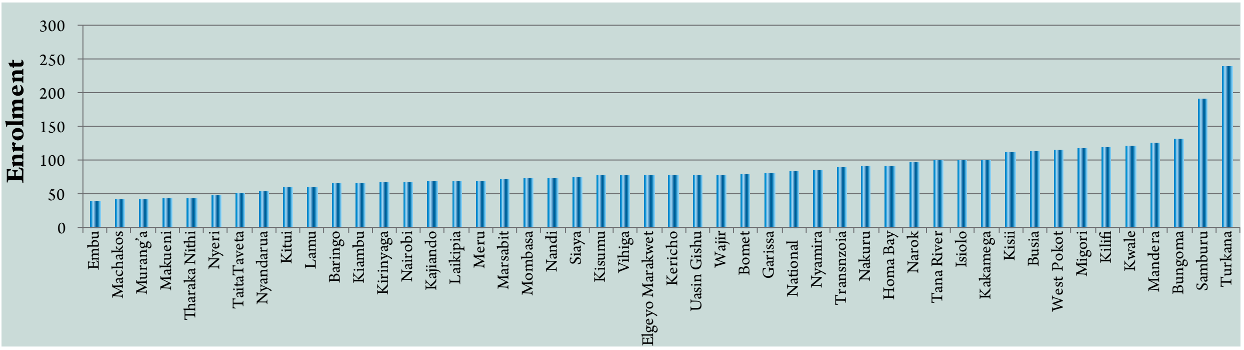
Early Childhood Development Education (ECDE) or pre-primary education saw a steady increase in the number of enrolments in 2014. However, lack of prioritization of ECDE by some counties and weak enforcement of integration of ECDE into basic education, as well as poverty, may have contributed to low ECDE access levels in some counties.

There were 40,211 Early Childhood Development Education (ECDE) or pre-primary education centres in 2014, with an enrolment of 3,019,866 pupils (Ministry of Education, Science and Technology, 2014). Enrolment in ECDE increased from 2.865 million pupils (1.411 million boys and 1.454 million girls) in 2013 to 3.019 million pupils (1.476 million boys and 1.543 million girls) in 2014. The gender parity index between girls and boys at ECDE level has been on the increase from 0.95 in 2009 to 1.05 in 2014. Thus, there were more boys than girls at the beginning of the period, but this changed to having more girls than boys in 2014. The Gross Enrolment Rate (GER) increased from 71.6 per cent in 2013 to 76.6 per cent in 2014. The Net Enrolment Rate (NER) increased from 68.7 per cent in 2013 and 71.8 per cent in 2014. However, there were inequalities in access to ECDE across counties. The National ECDE school size was 84 pupils per school, but varied from a low of 39 pupils for Embu County and a high of 193 learners per school for Samburu County (Figure 3.1).

There is significant likelihood of inequitable outcome across counties. Better-resourced counties have lower school sizes/class size and better enrolment rates, while less-resourced counties have low outcomes (Figure 3.1 and 3.2). About 17 counties recorded an NER of over 80 per cent while the remaining 30 counties recorded a NER of less that 80 per cent. Besides, the national government did not consider treating counties differently in resource allocation, a situation that could worsen the evident inequality among counties.

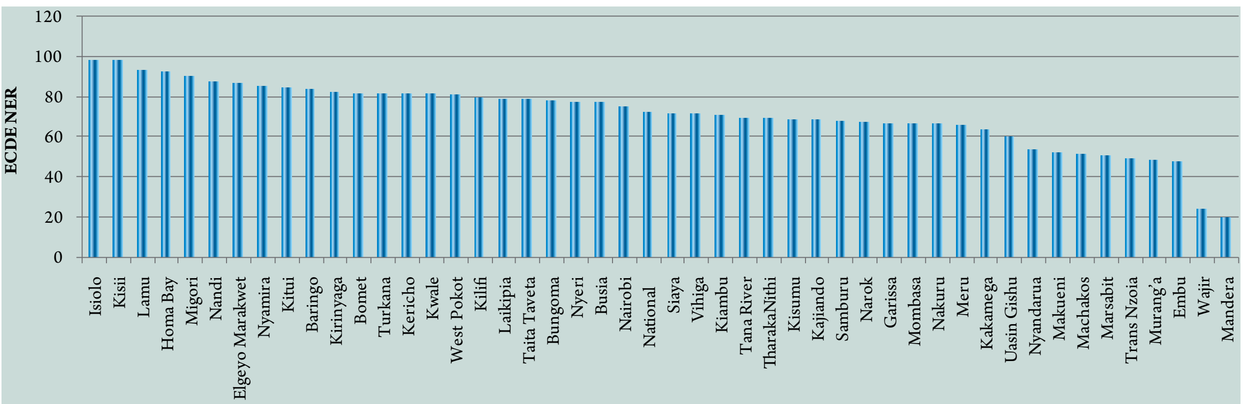
The inequalities in ECDE can be attributed to the fact that the responsibility for ECDE was devolved to counties, but without funding. As an example, the community support grant that was used to finance ECDE teachers in 2012/13 fiscal year alone was discontinued after the devolution of ECDE to counties. Capitation grants for materials and capacity and community support grants for salary top-up by the national government was also stopped in 2013. Although the Constitution stipulates that basic education should be free, and that ECDE is part of basic education (making fees illegal), parents

Figure 3.1: ECDE school size by county, 2014



Source: Ministry of Education, Science and Technology (2015)

Figure 3.2: ECDE NER by county, 2014



Source: Ministry of Education, Science and Technology (2015)

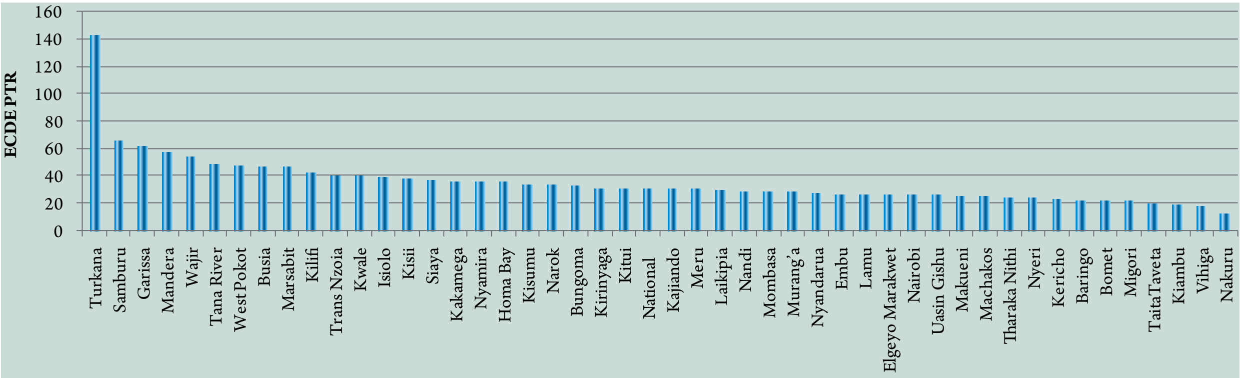
are still required to pay for ECDE, resulting into low access levels observed across some counties.

Although the Constitution stipulates that ECDE should be compulsory, budget allocation from both the national and county governments is relatively small compared to other sectors. Perhaps this can be attributed to the fact that some counties have not prioritized ECDE as one of the key expenditure areas, resulting into low and unsatisfactory access levels.

There is confusion over roles and responsibilities, especially governance and quality assurance across the key education stakeholders. As an example, there is no clarity on the roles and mandates of the Teacher' Service Commission, the national Ministry of Education, and County officials in recruitment of ECDE teachers, and quality assurance. Counties are therefore employing teachers with no clear guidelines on salaries and standards. The situation could have contributed to the inequalities in ECDE pupil teacher ratio (PTR) across counties (Figure 3.3).

About 26 counties recorded a PTR of over 31 pupils per teacher, which is above the national policy target of 30. Personnel emoluments for ECDE teachers across counties are also not based on standard guidelines, resulting into significant variations in ECDE teacher salaries across counties. In most counties, despite ECDE teacher salaries being low compared to primary education teachers, the payment is irregular because it depends on the income and willingness to pay by parents and, for this reason, most pupils do not stay in an ECDE position. Many ECDE teachers move to become primary school educators where salaries are more

Figure 3.3: ECDE PTR by county, 2014



Source: Ministry of Education, Science and Technology (2015)

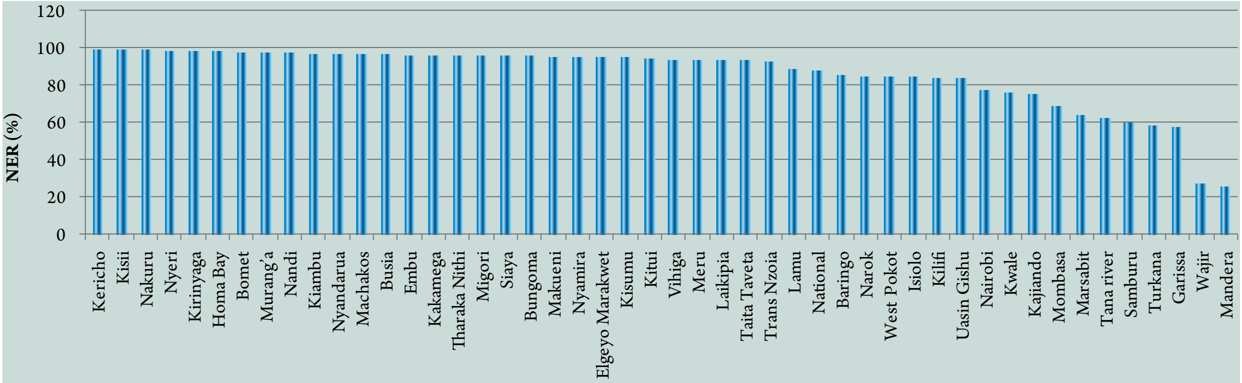
stable and higher. Further, there was no clear indication on integration of key aspects of health and nutrition in ECDE provision. Private sector provision of ECDE is higher in urban areas and informal urban settlements.

Primary education

Kenya has made tremendous effort in expanding access to primary education across the country by providing free primary education since 2003. Primary school enrolment increased from 9,857,600 pupils (5,019,700 boys and 4,837,900 girls) in 2013 to 9,940,800 pupils in 2014 (5,052,400 boys and 4,898,400 girls), with over 80.0 per cent of pupils being enrolled in public schools. During this period, primary schools increased from 28,026 institutions in 2013 to 29,460 in 2014. The Gross Enrolment Rate (GER) decreased from 105 per cent (107.1% for male and 102.9% for female) in 2013 to 103 per cent (105.6% for male and 101.4% for female) in 2014. The Net Enrolment Rate (NER) improved marginally from 88.1 per cent (89.0% for male and 87.4% for female) in 2013 to 88.2 per cent (89.1% for male and 87.4% for female) in 2014 (Figure 3.4, 3.5). The number of candidates sitting for primary school examinations grew by 4.8 per cent from 839,759 candidates in 2013 to 880,486 candidates in 2014.

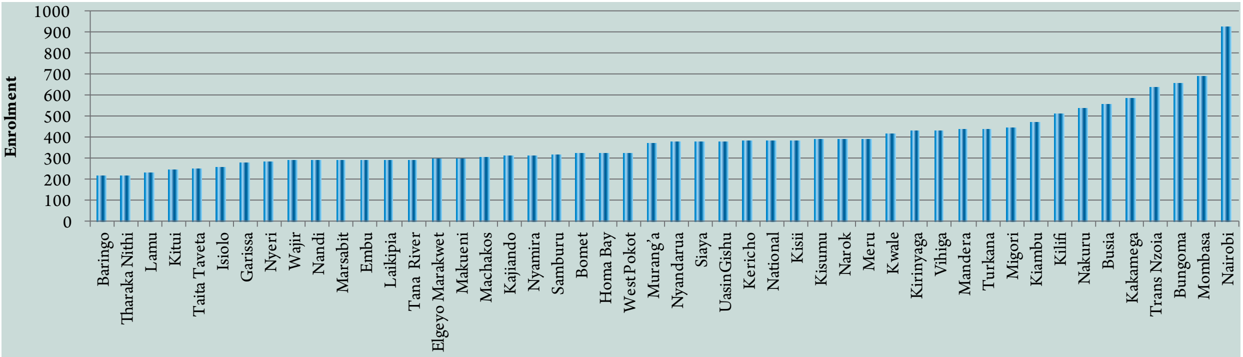
In spite of the notable national figures on GER and NER, there still regional disparities especially in marginal areas of Northern Kenya, with NER slightly increasing from 43.5 per cent (45.3% male and 41.7% female) in 2013 to 44.0 per cent (47.5% for male and 44.2% for female) in 2014 (Figure 3.4). Kericho County recorded the highest primary NER of 99.3 per cent in 2014.

Figure 3.4: Primary Net Enrolment Rate (NER) by county, 2014



Source: Ministry of Education, Science and Technology (2015)

Figure 3.5: Primary school size by county, 2014



Source: Ministry of Education, Science and Technology (2015)

Primary completion rate increased from 83.2 per cent in 2009 to 83.9 per cent (85.8% for boys and 82.0% for girls) in 2013 and dropped to 79.3 per cent in 2014. The reason is that the number of learners in Standard 8 increased less than the population ages 13 that are expected to be at that class.

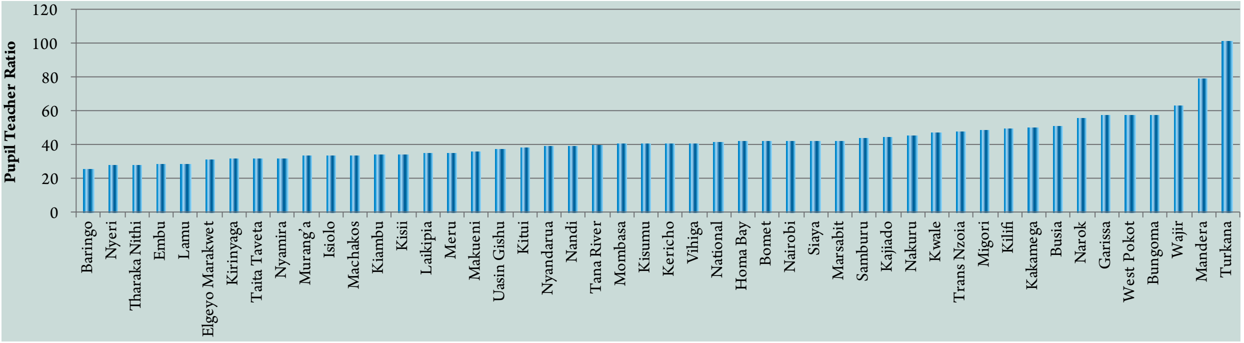
Concerning primary education school size, there are substantial disparities across counties. The primary school size index varied from 926 pupils per school in Nairobi County to a low of 219 pupils in Baringo County. About 21 counties were operating at below optimal capacity of 320 pupils per school, assuming a class size of 40 pupils and eight classes per school.

Figure 3.6 shows regional inequalities in distribution of teachers across primary education schools in the country. About 25 counties that recorded relatively low primary PTR (below 40%) are in the arid and semi-arid lands (ASALs) of the country. About 22 counties had a PTR of between 40 and 101. Thus, although the national public PTR of 41.5 suggests that Kenya is on track to achieve the 40:1 PTR target, most counties will not meet the target unless interventions are put in place to ensure adequate redistribution of teachers across and within all counties.

Secondary

Enrolment in secondary school increased from 2,104,300 (1,127,697 male and 976,565 female) in 2013 to 2,331,700 (1,202,524 male and 1,107,356 female) in 2014 for both public and private schools, with net enrolment of 44.5 per cent (46.2% male and 42.8% female) in 2013 and 47.4 per cent (49.2% male and 45.6% female) in 2014 to 58.2 per cent (60.9% male and 55.5% female) in 2014 (Figure

Figure 3.6: Primary Pupil Teacher Ratio (PTR) by county, 2014



Source: Ministry of Education, Science and Technology (2015)

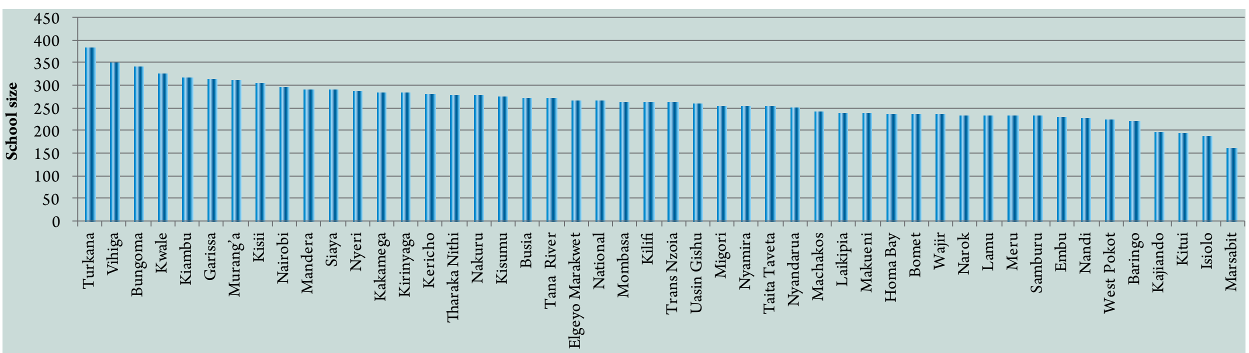
3.7). The average school size ranged from a low of 163 pupils in Marsabit County to a high of 385 in Turkana County. These levels are relatively low when compared to the optimal school size of 480 students, assuming 40 students per class of three streams.

Overall, investment in education expanded during the period between 2012 and 2013, with the number of basic education institutions increasing by 3.2 per cent from 77,197 in 2013 to 79,641 in 2014 (KNBS, 2015). Similarly, the total number of teachers in public primary and secondary schools increased by 0.5 per cent and 20.2 per cent, respectively, in 2014. The total number of teachers at primary school level was 317,477 in 2014. Of these, 76.2 per cent are in public schools while 23.8 per cent are in private schools. Out of all the teachers in public primary schools, 83.3 per cent are employed by the Teachers Service Commission. This represents a pupil teacher ratio of 41.5:1 in 2014. The number of secondary school teachers increased from 59,273 in 2012 to 118,608 in 2014.

At secondary school level, the NER is relatively low and there are regional disparities. Using the most recent available data at county level of 2014, Mandera County had the lowest secondary NER of 7.3 per cent, while Tharaka Nithi County recorded the highest NER (91.4%). In almost three-quarters of the counties, secondary education NER was below 50 per cent (Figure 3.8). The upper proportion of the distribution comprises 17 counties with NER of between 60 per cent and 91 per cent.

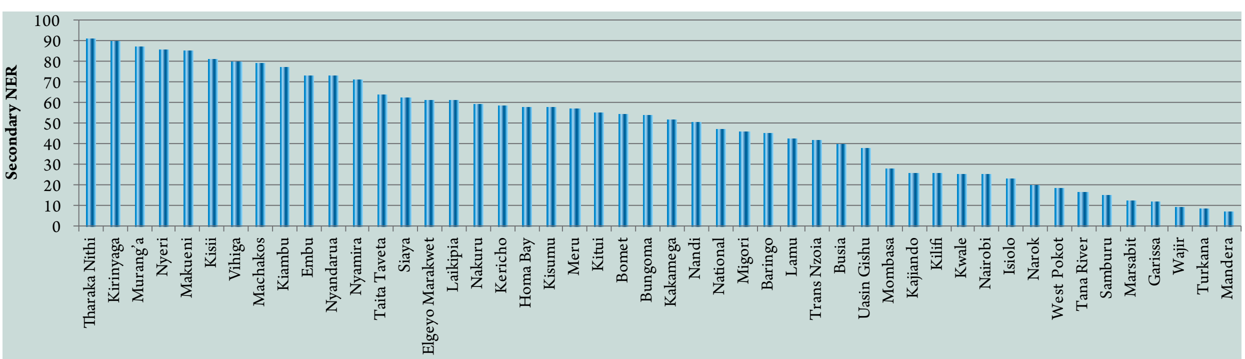
Secondary education PTR is also relatively low. In 2014, about 24 counties recorded a PTR of less than 30:1 relative to a target of 35:1 (Figure 3.9). The average PTR was, however, particularly high

Figure 3.7: Secondary school size by county, 2014



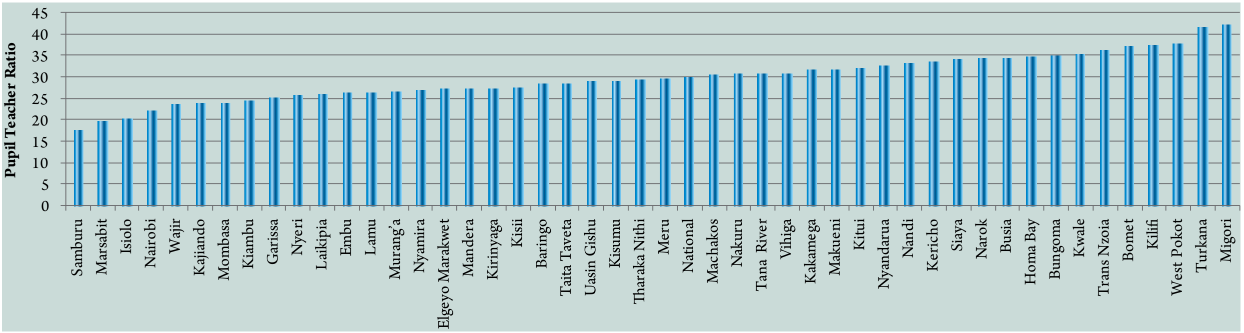
Source: Ministry of Education, Science and Technology (2015)

Figure 3.8: Secondary education Net Enrolment Rates (%), 2014



Data Source: Ministry of Education (2015), EMIS section

Figure 3.9: Secondary pupil teacher ratio by county, 2014



Source: Ministry of Education, Science and Technology (2015)

for Turkana and Migori counties compared to their counterparts.

Tertiary level

At higher education level, the number of teacher training colleges increased to 267 while the number of technical and vocational educational training (TVET) institutions rose marginally to 755 in 2014. TVET in Kenya is provided under various Ministries, Departments, and Agencies (MDAs). The Ministry of Education, Science and Technology operates about 44 public TVET institutions (national polytechnics, technical training colleges, and technical and vocational colleges). This number is set to rise given the current programme of developing 60 new institutions from the proposed 253 to be developed in the current Medium Term Expenditure Framework (MTEF) period. In addition, there are about 700 registered private TVET institutions. The total enrolment in TVET programmes increased from 79,114 in 2010/11 to 100,862 in 2015/2016. The number of students receiving TVET bursary increased from 4,415 in 2013/2014 to 7,071 in 2014/15.

Universities

There are currently 22 accredited public universities, nine public university constituent colleges, 17 chartered private universities, five private university constituent colleges and 13 private universities with Letters of Interim Authority and one private registered institution. The number of students admitted at the university level has continued to increase from 10,632 in 2005/2006 to 52,632 students in 2013/2014.

Admissions for self-sponsored undergraduate students (SSS), as well as all post-graduate students at both public and private universities, are currently handled directly and solely by the individual institutions. The admission process for Joint Admissions Board (JAB) students is currently coordinated through the Kenya Universities and Colleges Central Placement Service (KUCCPS).

There a several challenges currently facing university education in Kenya. These include inadequate capacity to cater for the growing demand for more places in the universities; mismatch between skills acquired by university graduates and the demands of the industry; an imbalance between the number of students studying science and arts-based courses; gender and regional disparities in terms of admissions and in subjects and courses undertaken; and lack of adequate household income as a barrier to students who have qualified and admitted to university.

From Table 3.2, there are gender parities in students pursing PhD, Masters and diploma courses, with more female students 15,191 pursuing masters in the year 2014. Patterns of enrolment by level to universities tend to reflect increasing gender, regional and socio-economic differentiation in the country. The existing inequalities in enrolment at

Table 3.2: University enrollment by level of training

Year	2013			2014		
Category	Male	Female	Total	Male	Female	Total
Diploma & Others	19,122	11,160	30,282	20,200	15,350	35,550
Bachelor	110,443	90,123	200,566	153,140	111,213	264,353
Masters	8,980	5,941	14,921	14,412	15,191	29,603
PhD	1,570	755	2,325	1,514	1,484	2,998
Others			3,460			
Total	140,115	107,979	251,554	189,266	143,238	332,504

Source: Ministry of Education, Science and Technology (2015)

basic education levels need critical attention as they tend to be replicated as one goes up the education ladder. Owing to the challenges experienced by the marginalized, the poor, and the disadvantaged, the current environment makes it difficult for such students to participate in university education. Affirmative action should be enforced to ensure increased participation by female students from poor and marginalized areas.

3.2.5 Linking education and the labour market

There is a general concern to promote employability of graduates as well as incorporate the needs of industry and national development priorities especially in the context of the goals delineated in Vision 2030. Universities play a critical role in promoting national development by offering skills required for human capital development. Annually, about 750,000 youth attempt to enter the labour market but only about 15 per cent are absorbed into formal employment (UNDP, 2010). Furthermore, there is a gross mismatch between supply and demand for skilled labour, along with widespread underemployment and low productivity in the informal sector. Pressure to expand and reform post-basic education and government interests in using skills development programmes to help address issues of youth poverty, unemployment and inequality has led to several recent reform efforts intended to provide skills for jobs.

To ensure quality and promote the objectives of university education, the Commission for University Education was established under an Act of Parliament, Universities Act, No. 42 of 2012 to address the need to regulate, coordinate and assure quality in university education as a result of growth and expansion of the university sub-sector in Kenya.

Another emerging challenge affecting the higher education sector relates to skills mismatch with the labour market. The Kenya labour force was expected to reach 14.5 million by the year 2015 (KNBS, 2015), meaning that the Kenyan economy would have to create over 4.5 million additional jobs within that period. If this additional labour force has to contribute effectively to economic development, then there is urgent need to equip the human resource with appropriate skills. Skills development should nurture creativity, critical thinking, and produce innovative and adaptive human resources with appropriate skills, attitudes and values for wealth creation, employment and prosperity.

3.2.6 Conclusions and Recommendations

Conclusions

The Constitution of Kenya provides for free and compulsory basic education. It also institutionalizes devolution of governance and service delivery to local units, notably counties. Article 187 of the Constitution specifies that pre-primary education, village polytechnics, home craft centres and child care facilities will be devolved to county level governments. However, the management of the other levels of education would also be affected by the expected transition from the system of provincial administration, which in this case includes Provincial Education Officers and District Education Officers, to the new governance structure.

Universal access to basic education, in particular, would ensure that relevant education is delivered to all children, including the marginalized and vulnerable groups, while addressing inequality challenges that have affected service delivery in the sector over time. The NER of 71.8 per cent for ECDE, 88.2 per cent for primary and 47.4 per cent for secondary imply that close to 28.2 per cent of ECDE eligible children, 22.9 per cent of the primary school-going age population, and 52.6 per cent of secondary school age children are not enrolled in school. Urban informal settlements and arid and semi-arid lands are most affected by low enrolment rates, and there are also regional disparities. Low access has mainly been attributed to factors such as poverty, insecurity, persistent droughts, and retrogressive cultural and religious beliefs.

Recent reforms in the education sector entail devolution of functions from national to institutional level with the aim of bringing services closer to beneficiaries. Currently, the major interventions include transfer of capitation funds to primary schools to purchase instructional materials, and the subsidized secondary education programme aimed at making secondary education accessible and affordable to households. Other decentralized secondary education programmes include bursary support, whose management was decentralized in 2003/4 to Constituency Bursary Committees. More administrative staff has been deployed from the Ministry of Education to counties to enhance education service delivery at local level. School management committees and boards of management have been given more authority to provide oversight management support to schools and ensure quality service delivery. However, there are access, equity and quality challenges affecting the sector.

Recommendations

(i) Education reforms should include initiatives targeting marginalized groups, and should include grants for hard to reach groups, special education schools, and targeted primary informal schools. To ensure a coherent approach to education and training development, the education organizational and management structure should be reviewed while decentralizing such functions as monitoring and evaluation and quality assurance.

(ii) The government will need to institute capacity building programmes to ensure education personnel and managers handling various responsibilities have adequate capacity in terms of management and facilitation tools to ensure effective service delivery. Quality assurance services will need to be strengthened with a view to ensuring quality in schools.

(iii) Devolution in itself is not necessarily a cure for low access rates and lack of equity in access to education. In fact, devolution may exacerbate inequalities in access if no keen attention is paid to regional differences. The experiences of other countries, including Germany, Argentina and Colombia, indicate that a devolution process that decentralizes to all regions at once is difficult to execute successfully if there are inadequate capacities. This observation is particularly relevant for Kenya, which has regional inequalities in form of unequal distribution of human and material resources, and the existence of both weak and strong regional infrastructure.

It is important to develop clear devolution plans that are linked to national development plans. Other factors that have been found to be important for devolution so that quality, equity in access, and cost of schooling are not compromised are: development of simple and clear decentralization plans; devolution of authority, rather than delegation with experiences across the globe indicating superior performance models that transfer ownership and authority; and provision of specific tools to the central ministry/agency in charge of education to guard against the development of significant regional differences in educational quality, its access and cost.

(iv) Reform of institutions usually results in coordination challenges as roles and responsibilities of players change. An important starting point to promote coordination, accountability and avert conflict is to develop a common vision of reform among potentially competing centres of power. A common vision is essential if collaboration, rather than conflict, is to become the dominant force driving actions. To this end, it is important to initiate an open flow of ideas and information among key actors, including the ministry in charge of education (or relevant sector), Teachers Service Commission, county leaders, political parties, private sector and communities.

v) It will be important to develop and monitor quality standards, including for the devolved functions both at county, sub-county and at national levels; and support community participation, including financial participation, training, or community involvement. Counties should prepare capacity development plans that should be harmonized up to the national level; develop and harmonize national and county government priorities and linkages; and ensure effective coordination between decentralized and central government financing. Financial and data management systems should also be strengthened. Further, most of the decentralized national government functions such as teacher management and quality assurance will need to be deepened for equitable and efficient service delivery.

vi) At tertiary level, it will be important to re-establish mid-level colleges to prepare workers with necessary technical skills; empower youth with relevant skills and connect them to livelihood and employment opportunities; reduce the barriers and costs of education; provide bursaries/scholarships to encourage female participation in science and technical courses; and establish strong linkages between TVET and industry to address issues of relevance of training. This may include attachments, internships, and apprenticeships for both students and teaching staff.

3.3 Health Sector Performance

3.3.1 Introduction

The government commits to improve the quality of life for all Kenyans by ensuring equitable, affordable, and quality healthcare of the highest standard. This is highlighted in Kenya's Vision 2030 for national development under the social pillar. This commitment is also anchored in Kenya's Constitution as a basic right. The Constitution further introduces a two tier health system, where the national government deals with health policies, national referral hospitals, capacity building and technical assistance to counties, while county governments are tasked with county health facilities and pharmacies, ambulance services, promotion of primary healthcare, licensing and control of selling of food in public places, veterinary services, cemeteries, funeral parlors and crematoriums, removal of refuse dumps, and solid waste management. In addition to the Vision and Constitution, health issues in the country are addressed within various legislative and policy frameworks, including the National Adolescent Sexual and Reproductive Health Policy (2015), HIV and AIDS Prevention and Control Act (2006), National Reproductive Health Policy (2007), Kenya Health Policy (2012-2030), Kenya Health Sector Strategic and Investment Plan (2013-2017), Education Sector Policy on HIV and AIDS (2013), and National School Health Policy (2009). Despite the ongoing implementation of these policy provisions, there are gaps in the sector performance.

3.3.2 General Population and Health Sector Profile

Status of key indicators

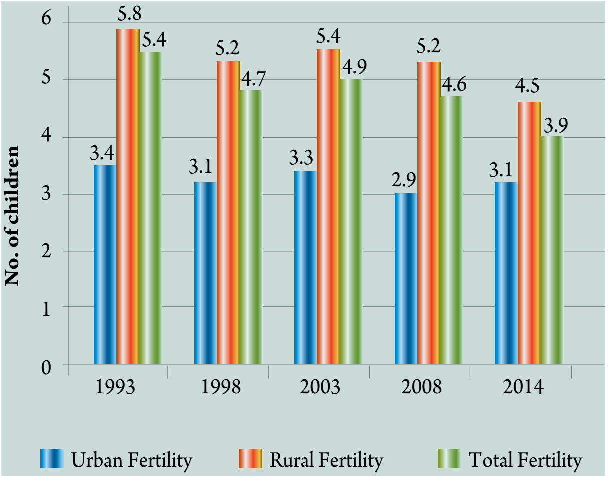
Currently, the population of Kenya is estimated at about 47 million, up from 38 million in 2009 (KNBS, 2015). The population in 2009 by county is presented in Table 3.3, alongside each county's proportion of the total. It also shows the population densities in the counties, county fertility levels and all methods of contraceptive usage.

Population density

The distribution of the country's population across the counties is uneven. As Table 3.3 shows, some counties have a high population density than others, but some expansive counties known to be sparsely populated, such as Garissa, Mandera and Wajir show high densities, surpassing some known high density counties such as Nairobi, Meru, Nyamira and Kisii. These figures are suspect and errors are likely to have occurred during the last census, leading to this scenario. Although the population has changed significantly from 2009, with the 2015 population estimated at about 47 million, the densities must have changed in tandem with each county's fertility trend.

According to the 2009 Kenya population census, fertility in Kenya declined between 1978 and 2009, from 8.1 births to 4.6 births per woman. In 2014, women in Kenya had an average of 3.9 children (KNBS and ICF Macro, 2015). The national figure, however, masks huge regional disparities. Rural fertility is high, with rural women having two children more than their urban counterparts as shown in Figure 3.10. Sub-nationally, fertility ranges from 2.7 children in Nairobi to 6.4 children in North Eastern. In addition, Kenyan women still have one more child than they would like to have. This gap is more pronounced among rural residents and the poor. In 2008, the gap between actual and wanted fertility was 1.5 children in rural areas compared to 0.4 children in urban areas while it was 1.7 children among women from poorest households compared to 0.4 among women from the richest households (KDHS, 2009). Kenya's current population policy of 2012 targets a fertility rate of 2.6 children per woman by 2030.

Figure 3.10: Trends in total fertility by residence, 1989-2014



Source: KDHS (Various)

The relatively arid counties of West Pokot, Wajir, Turkana, Samburu and Narok have some of the highest total fertility rates of above 6.0, which reflects at least six children to a woman. On the other end is Kirinyaga, Nairobi, Kiambu, Murang'a and Nyeri, all with a fertility rate of 3.0 and below or at most three children to a woman. It is worth noting that due to the persistent high fertility, Kenya's population is very youthful. Due to high concentration of young people who are yet to enter their child bearing ages, the country's population is guaranteed to continue growing for many decades, even after fertility declines to the replacement level (2.1 children per woman). The African Institute for Development Policy (AFIDEP, 2012) projections show that for Kenya to attain its replacement fertility level by 2020, its population would continue to grow and stabilize at around 85 million in the year 2100. It further projects that if replacement level fertility is attained by 2060, the population would stabilize at 145 million around 2120.

Contraceptive usage shows that most of those counties with high fertility rates have very low usage of both modern and traditional contraceptive methods. Of all married women in the 15-49 age cohort, the percentages using all contraceptive methods in Mandera (1.9), Wajir (2.3), Garissa (5.5), Turkana (10.3), Marsabit (11.7) and West Pokot (14.2) are the lowest nationally. This may be compared to Makueni (81), Kirinyaga (80), Meru (78), Machakos (76), Kiambu (74), Nyeri (73) and Embu (70), all with over 70 per cent usage. The national usage is 58 per cent, which surpassed the target of 56 per cent by 2015 (AFP, 2014). Despite this achievement at the national level, the counties with low contraceptive usage and consequently high fertility levels must focus keenly on their resource base and assess whether they can continue to sustain the rising population and improve the general welfare of their population. Bearing in mind that poverty levels are relatively high in these counties, they should consider sensitizing the community to adopt family planning, especially through modern contraceptive methods, so as to lower fertility rates and let it go in tandem with development levels of the counties. This must go hand in hand with increased education levels since, according to McCrary and Royer (2011), women fertility and their levels of education have an inverse relationship.

Age distribution

Figure 3.11 compares Kenya and United Kingdom's (UK) population pyramids for 2014. Although Kenya has a wide bottom and a narrow top, which signifies a large dependant population, there are slight signs of a bulging youthful population. This is expected to continue over time until the distribution resembles that of the UK. This would happen as the country's development level improves, leading to better healthcare services, better nutrition and generally higher standards of living. These are expected to lead to longer lives and a higher proportion of the elderly population, coupled with a lower fertility rate that leads to fewer children per woman.

Table 3.3: Kenya's population, fertility and contraceptive use by county

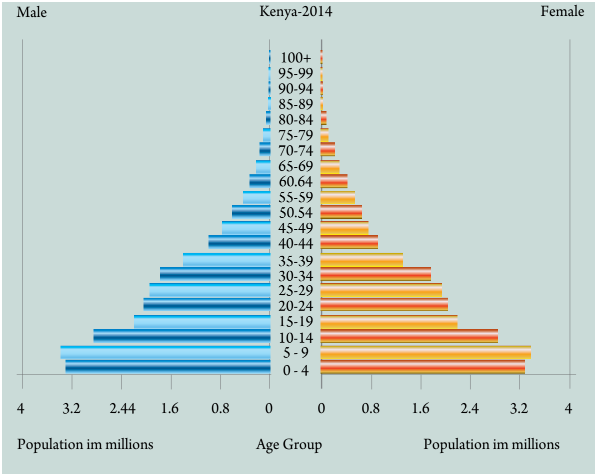
S/ No.	County	Population	Proportion	Density	Total fertility	Use of Contraceptives Method		
						All	Modern	Traditional
1	Baringo	555,561	1.4	282.0	4.8	41.4	33.1	8.3
2	Bomet	724,186	1.9	444.3	4.3	54.8	50.4	4.4
3	Bungoma	1,630,934	4.2	522.2	5.0	55.5	53.9	1.6
4	Busia	488,075	1.3	416.8	4.7	57.5	56.5	0.9
5	Elgeyo Marakwet	369,998	1.0	334.2	4.1	55.2	43.6	11.6
6	Embu	516,212	1.3	398.3	3.1	70.6	67.2	3.4
7	Garissa	623,060	1.6	723.7*	6.1	5.5	5.5	0.0
8	Homa Bay	958,791	2.5	427.2	5.2	46.7	45.5	1.2
9	Isiolo	143,294	0.4	360.9	4.9	27.0	26.3	0.7
10	Kajiado	687,312	1.8	351.6	4.5	54.5	45.2	9.3
11	Kakamega	1,660,651	4.3	496.8	4.4	62.1	60.3	1.7
12	Kericho	758,339	2.0	402.1	4.0	62.9	56.9	6.1
13	Kiambu	1,623,282	4.2	328.2	2.7	74.0	67.8	6.3
14	Kilifi	1,109,735	2.9	473.6	5.1	34.1	32.8	1.3
15	Kirinyaga	528,054	1.4	376.9	2.3	81.0	75.6	5.4
16	Kisii	1,511,422	3.9	445.2	3.7	66.1	62.8	3.4
17	Kisumu	968,909	2.5	402.5	3.6	62.4	59.3	3.1
18	Kitui	1,012,709	2.6	282.3	3.9	57.3	55.1	2.2
19	Kwale	649,931	1.7	513.8	4.7	41.5	38.2	3.3
20	Laikipia	399,227	1.0	390.3	3.7	59.1	51.3	7.8
21	Lamu	101,539	0.3	383.2	4.3	42.2	39.5	2.6
22	Machakos	1,098,584	2.8	360.0	3.4	75.9	67.5	8.3
23	Makueni	884,527	2.3	377.4	3.3	80.3	65.0	15.3
24	Mandera	1,025,756	2.7	988.2*	5.2	1.9	1.9	0.0
25	Marsabit	291,166	0.8	445.9	5.0	11.7	10.9	0.8
26	Meru	1,356,301	3.5	424.4	3.1	78.2	73.2	5.0
27	Migori	563,033	1.5	523.7	5.3	44.6	43.9	0.7
28	Mombasa	939,370	2.4	305.1	3.2	55.0	43.6	11.4
29	Murang'a	942,581	2.4	374.5	3.0	68.9	63.4	5.5
30	Nairobi	3,138,369	8.1	304.0	2.7	62.6	58.3	4.4
31	Nakuru	1,603,325	4.2	344.8	3.7	56.8	53.5	3.2
32	Nandi	752,965	2.0	423.7	4.0	64.5	59.2	5.4
33	Narok	850,920	2.2	459.5	6.0	47.8	38.1	9.7
34	Nyamira	598,252	1.5	463.4	3.5	67.9	64.2	3.7
35	Nyandarua	596,268	1.5	473.6	3.5	65.6	60.4	5.2
36	Nyeri	693,558	1.8	333.9	2.7	73.1	67.1	6.0
37	Samburu	223,947	0.6	413.2	6.3	22.7	20.0	2.7
38	Siaya	842,304	2.2	385.9	4.2	55.0	51.0	4.0
39	Taita Taveta	284,657	0.7	292.2	3.2	68.0	61.3	6.6

S/ No.	County	Population	Proportion	Density	Total fertility	Use of Contraceptives Method		
						All	Modern	Traditional
40	Tana River	240,075	0.6	383.5	5.8	28.7	20.5	8.2
41	Tharaka Nithi	365,330	0.9	331.5	3.4	74.0	67.2	6.8
42	Trans Nzoia	818,757	2.1	508.2	5.2	63.9	56.4	7.5
43	Turkana	855,399	2.2	562.8	6.9	10.4	10.1	0.3
44	Uasin Gishu	894,179	2.3	423.4	3.6	62.6	56.0	6.6
45	Vihiga	554,622	1.4	436.4	4.5	59.5	56.6	2.9
46	Wajir	661,941	1.7	812.2*	7.8	2.3	2.3	0.0
47	West Pokot	512,690	1.3	364.4	7.2	14.2	13.3	0.9
	Total	38,610,097	100	401.1	3.9	58.0	53.2	4.8

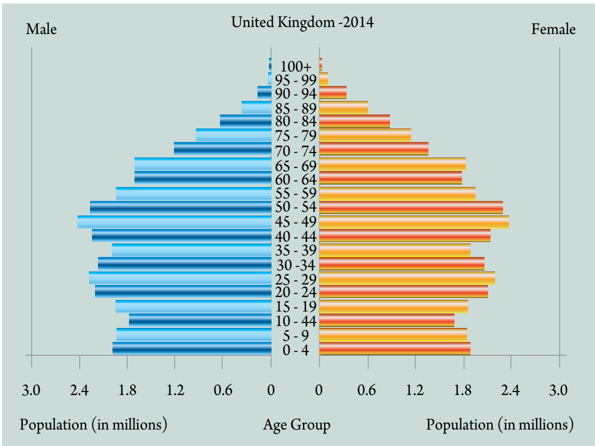
Source: KNBS (2015)

Figure 3.11: Kenya's and UK's population pyramid 2014

a) Kenya



b) United Kingdom



Source: http://www.theodora.com/wfbcurrent/2015/ke_popgraph_2014.bmp

Population, employment and demographic dividend

According to UNECA (2012), Africa has the youngest population, with youth serving as its greatest labour asset. The biggest problem then is to provide employment for this youthful population in the labour force, and this calls for serious measures to create new jobs and curb youth unemployment. Employment creation for the youth is the only sure way for the country to enjoy demographic dividend. This occurs after a country experiences an extended period of fertility and mortality reduction, coupled with employment creation to take advantage of the growing youthful population, which propels increased production and economic growth. The education infrastructure as well as science and technology must improve for skills development alongside job creation to ensure that the human resource capacity of the youth is adequately enhanced to take up new jobs with increased productivity.

Table 3.4 shows growth in employment numbers by sector for the period 2010 to 2014. Employment in the private sector was increasing by the largest margins, with growth of 106,200 in 2013 being the largest. Growth in self-employment was the smallest but increasing despite the smaller increase in 2012, with the increase in 2014 of 19,200 people being larger than that of the public sector, whose employment grew by 17,500 people. This is an indication that self-employment is gaining momentum, and entrepreneurial skills should be imparted to ensure new enterprises are sustainable.

Table 3.4: Employment growth statistics by sector ('000)

Sector/Year	2010	2011	2012	2013	2014
Private sector	49.4	49.4	52.8	106.2	69.6
Public sector	7.8	23.5	18.8	21.2	17.5
Self-employed	2.3	4.9	3.4	6.9	19.2
Total formal	59.5	71.9	74.7	134.3	106.3

Source: KNBS (2015)

Human capacity development

Many graduates with general degrees are not adequately armed with the skills required in the job market, and therefore retraining may be necessary. Among the skills critically lacking are in sectors of information and communication technology, engineering, agriculture, finance, and entrepreneurship (UNECA, 2012). Universities and other tertiary institutions have the onus of spearheading the development of appropriate skills through research and development, as well as development of both short and long-term courses and academic programmes with the right content, and creation of business incubation centres and business clinics that fill the gap for budding entrepreneurs.

Infant and child mortality

Child health has in the last ten years shown improvements, even though infant and under-five mortality rates have remained relatively high at 39/1000 and 52/1000, respectively (KNBS and ICF Macro, 2015) given the targets in the Medium Term Plan (MTP II) and that the country is now a low middle income country. Infant and childhood mortality indicators are the basic indicators of a country's socio-economic level and quality of life. These indicators are used in identifying the segment of the population that is at a high risk, in order for programmes to be implemented to reduce it. Data from the Kenya Demographic and Household Survey (KDHS) 2014 shows that the level of under-five mortality is 52 deaths per 1,000 births, implying that at least 1 in every 19 children born in Kenya die before reaching their fifth birthday. The infant mortality rate is 39 deaths per 1,000 live births.

Table 3.5: Early childhood mortality rates

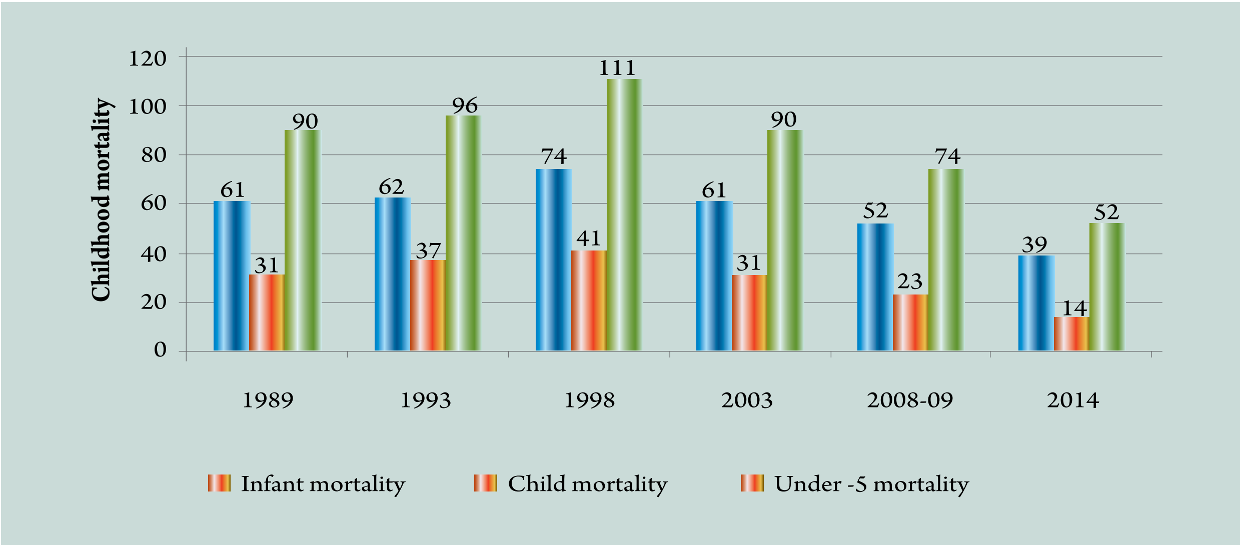
Years	Neonatal Mortality	Post-neonatal Mortality (PNN)	Infant mortality	Child mortality	Under-five mortality
0-4	22	16	39	14	52
5-9	24	19	43	18	60
10-14	26	26	51	30	80

Source: KNBS and ICF Macro (2015)

The rates observed from the KDHS 2014 show a decline in childhood deaths compared with the rates observed in the 2008-09, 2003 and 1998 KDHS. The infant mortality rate decreased to 39 deaths per 1,000 live births in 2014 from 52 in 2008-2009. Similarly, the under-five mortality rate decreased to 52 deaths per 1,000 live births in 2014 from 74 in 2008-09. The trend implies that the increase in mortality seen in the surveys conducted in the 1990s is reversing. The improvement in child survival could be attributed to increased use of mosquito nets among households, improvement in maternal health, increase in the proportion of birth assisted by a skilled provider and delivered in a health facility, and improvement in postnatal care.

Child survival plays an important role in fertility decline because parents can have few children because of the assurance that the few children they have will not die prematurely. Child survival has improved substantially over the past decade. Under-five and infant mortality has declined to 52 per cent and 39 per cent deaths per 1,000 live births as shown in Figure 3.14. The Millennium Development Goals Status Report 2013 attributes this improvement to high impact interventions such as new-born care, immunization, early and exclusive breastfeeding,

Figure 3.12: Trends in childhood mortality



Source: KNBS and ICF Macro (2015)

hand washing with soap and water and appropriate management of common childhood illness, including oral rehydration therapy and zinc for diarrhoea treatment.

3.3.3 Maternal health

Antenatal care

Proper care during pregnancy and delivery is important for the health of both the mother and the infant. According the KDHS (2014), nine in ten mothers reported seeing a skilled provider at least once for antenatal care (ANC). Antenatal care is slightly more common among mothers aged 20-34 compared with those outside this age group. Coverage was slightly higher in urban areas than in rural areas (98% and 94%, respectively).

The World Health Organization (WHO) recommends at least four ANC visits during a woman's pregnancy. About 58 per cent of women reported having more antenatal visits for their most recent birth (KNBS and ICF Macro, 2015). Urban women are more likely to have four or more ANC visits compared with women in rural areas (68% and 51%, respectively). Both education and wealth are positively associated with receiving the recommended number of ANC visits. Forty three (43) per cent of women with no education attended four or more ANC visits compared with 69 per cent of women with secondary or higher education, and 44 per cent of women in the lower quintile attended four or more ANC visits compared with 75 per cent in the highest quintile.

In Mombasa, Embu, Machakos and Nandi counties, ANC from a skilled provider universals (99%) and there are only six counties with less than 90 per cent coverage (Mandera, Wajir, Samburu, Marsabit, West Pokot and Garissa). The percentage of women making four or more ANC visits ranges from a low of 18 per cent in West Pokot to 73 per cent in Nairobi; in 12 counties, less than 50 per cent of women attend the recommended number of ANC visits (Garissa, Wajir, Mandera, Meru, Bomet, Marsabit, Turkana, West Pokot, Trans Nzoia, Elgeyo Marakwet, Narok, and Kakamega) as show in Table 3.6.

Table 3.6: Maternal care indicators by county

Country	% with 4+ ANC visits	% delivered by skilled provider	% delivered in a health facility
Coast	62.3	58.2	57.7
Mombasa	65.0	82.8	81.8
Kwale	60.3	50.1	49.0
Kilifi	64.6	52.3	52.6
Tana River	50.8	32.2	31.6
Lamu	62.2	47.3	43.9
Taita Taveta	58.9	62.5	61.9
North Eastern	36.8	32.4	29.2
Garissa	47.7	39.8	36.7
Wajir	37.7	21.7	18.3
Mandera	20.2	38.7	36.0
Eastern	56.3	63.3	62.7
Marsabit	42.8	25.8	25.8
Isiolo	50.2	43.8	42.1
Meru	45.3	82.8	81.8
Tharaka Nithi	56.1	76.6	77.7
Embu	56.2	81.5	81.5
Kitui	62.2	46.2	45.6
Machakos	60.8	63.4	62.9
Makueni	65.8	54.6	53.3
Central	63.4	89.7	90.2
Nyandarua	58.4	85.3	86.1
Nyeri	61.1	88.1	89.0
Kirinyaga	60.0	92.3	92.5
Murang'a	61.4	85.5	85.0
Kiambu	67.1	92.6	93.4
Rift Valley	51.7	51.3	50.2
Turkana	48.9	22.8	23.1
West Pokot	18.2	27.0	25.8
Samburu	51.9	29.0	24.5
Trans Nzoia	40.6	41.8	41.5
Uasin Gishu	63.0	59.0	57.4
Elgeyo Marakwet	46.8	65.0	64.7
Nandi	56.8	46.8	46.5
Baringo	54.5	53.8	53.5
Laikipia	56.2	49.5	48.1
Nakuru	61.4	69.5	69.7
Narok	46.0	40.3	38.6
Kajiado	66.9	63.2	62.4
Kericho	53.7	64.4	62.2
Bomet	37.2	52.2	49.0
Western	51.3	47.8	47.0
Kakamega	45.0	48.6	47.0
Vihiga	61.3	50.3	50.2
Bungoma	50.0	41.4	40.8
Busia	59.9	58.5	58.4
Nyanza	58.7	65.0	64.8
Siaya	61.1	70.4	69.6
Kisumu	68.1	69.2	69.5
Homa Bay	61.4	60.4	61.9
Migori	56.4	53.4	53.3
Kisii	50.0	72.8	69.3
Nyamira	50.3	74.1	74.3
Nairobi	73.1	89.1	88.7
Total	57.6	61.8	61.2

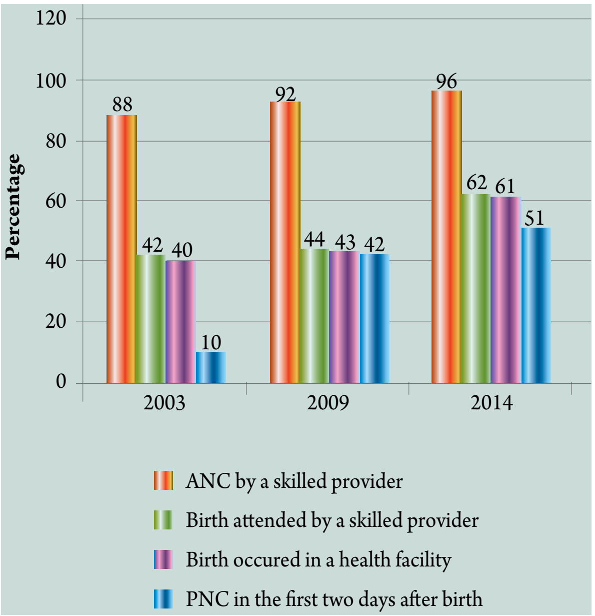
Source: KDHS (2014)

Delivery care

Proper medical condition and hygienic conditions during delivery reduce the risk of complications, infections or death of the mother and baby. Figure 3.13 shows that 62 per cent of births in Kenya are delivered by a skilled provider. A similar proportion of deliveries (61%) take place in health facilities. Across counties, as show in Table 3.6, skilled delivery attendance and delivery in a health facility varies considerably. All counties in the central region achieved a level of at least 85 per cent on both of these indicators, while counties in Nyanza region all achieved at least 53 per cent. In contrast, in six counties, less than one-third of live births in the past five years were attended by a skilled provider or were delivered in a health facility (Tana River, Wajir, Marsabit, Turkana, West Pokot and Samburu counties).

Figure 3.13 shows the trends in key maternity care indicators between 2003 and 2014. The proportion of mothers reporting ANC from a health professional increased between 2003 and 2014, from 88 per cent to 96 per cent. The percentage of births attended by a skilled provider and the percentage occurring in health facilities each increased by similar magnitude, about 20 per cent from 2003 and 2014.

Figure 3.13: Trends in maternal healthcare, 2003-2014



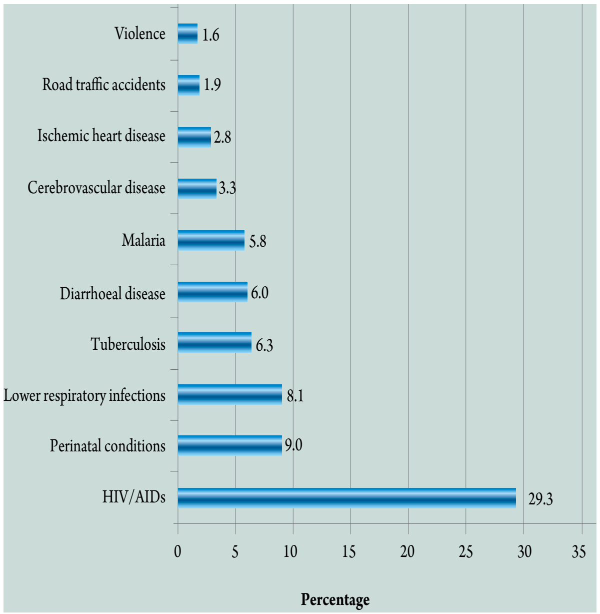
Source: KDHS (2003; 2009 and 2014)

3.3.4 Disease burden

Disease burden remained relatively high in the country, with communicable diseases posing the greatest burden. Despite the significant decrease in HIV prevalence rate, co-infection of HIV/AIDS and TB, coupled with the emergence of drug-resistant TB strains still remains a challenge. HIV/AIDS, prenatal conditions, and malaria account for 24.2, 10.7 and 7.2 per cent causes of disabilities, respectively. The leading causes of death are HIV/AIDS (29.3%), perinatal conditions (9.0%), lower respiratory disease (8.0%), tuberculosis (6.3%) and malaria (5.8%).

The country is in also experiencing rising trends in incidence of non-communicable diseases (NCDs). Cancer cases are on the rise, and this is estimated to cause 21,000 deaths annually. Other NCDs on the rise include hypertension, heart disease and diabetes. Major challenges exist in terms of equipment and experts such as oncologists for cancer.

Figure 3.14: Leading causes of death in the past 20 years for Kenya



Source: Ministry of Health Policy (2014)

The fast rising threat of NCDs is catching up with the population. Communicable and non-communicable diseases dominate the top ten causes of mortality in Kenya for the past 20 years as shown in Figure 3.14. Despite substantial resources directed towards the control and management of HIV/AIDS, it is still the leading cause. The country is increasingly faced with a fast growing burden of NCDs. Changing lifestyle habits linked to increasing urbanization, unhealthy nutrition habits, reduced physical activity, smoking and alcohol consumption are all associated with the rise in NCDs. Even as the burden of NCDs keeps rising, the health system in the country has been slow in upgrading both infrastructure and trained personnel to manage NCDs and provide quality preventive and curative care for the patients.

Table 3.6: Top ten leading causes of death, 2014

Cause	Total	
	%	Number
Malaria	11.6	22,948
Pneumonia	10.9	21,640
HIV/AIDS	7.1	14,175
Other Causes	6.2	12,235
Cancer	5.5	10,986
Tuberculosis	4.3	8,469
Sudden Death	2.4	4,710
Anemia	2.1	4,187
Heart Disease	2.5	5,030
Meningitis	2.3	4,555
All Other Causes	45.2	89,676
Total	100.0	198,611

Source: KNBS (2015)

Mortality data presented in Table 3.6 are based on in-patient data from Civil Registration Department and does not reflect the actual major causes of death and the ranking of the causes of death mortality country wide. Malaria was the leading cause of mortality with 11.6 per cent of the total deaths in 2014. This was closely followed by pneumonia (10.9%, HIV/AIDS (7.1%) cancer (5.5%) and TB (4.3%).

Risk factors to health

Risk factors to good health in Kenya include unsafe sex, sub-optimal breast feeding, under-nutrition, alcohol and tobacco use, obesity and physical inactivity, among others. According to the health sector Medium Term Expenditure Framework (MTEF, 2015) 5.0 per cent of all deaths from non-communicable conditions and 55.0 per cent of deaths from cancers of the trachea, bronchitis and lungs are attributable to tobacco use. These deaths comprise 19.1 per cent males and 4.5 per cent females among the adult population 15 years and above, or about 2.5 million people using tobacco products in 2014.

3.3.5 Health inputs

Expenditure on health

Total health expenditure on health has been increasing, with the latest estimates at US$ 66.6 per person per year. The increases are as a result of donor initiatives to reduce household expenditure, specifically free maternity and primary healthcare services. Nationally, health expenditure as a proportion of the national budget stood at 6.1 per cent in 2013 and rose to 8.8 per cent in 2015/16. The allocations are, however, below the Abuja Declaration of 15 per cent.

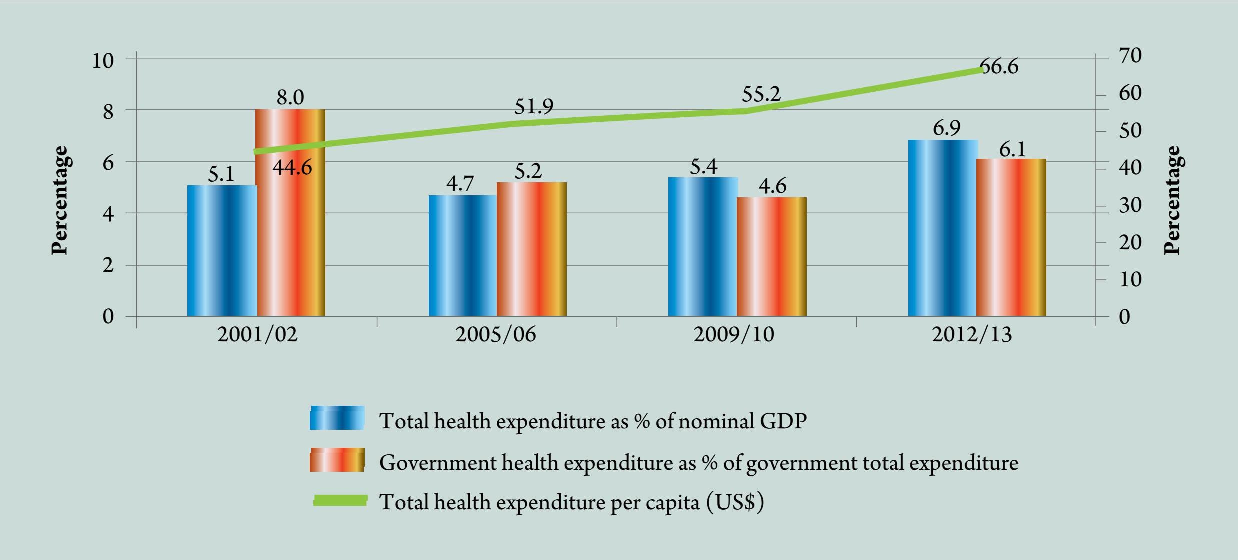
As shown in Table 3.7, more funds have been allocated for recurrent expenditure than for development in the last three year. However, with the onset of devolution and the transfer of significant funds to the county governments, the allocation for both recurrent and development has dropped significantly in absolute terms. As a result of the more significant drop in recurrent expenditure than in development expenditure, the proportion of the total budget allocated to recurrent budget has dropped from about 60 per cent to 51-54 per cent. On the other hand, the proportion allocated to development budget has increased from 40 per cent to 46-49 per cent.

Table 3.7: Ministry of Health budget trends 2012/13–2014/15

Economic Classification	2012/13	2013/14	2014/15
Total recurrent	55,980	18,298	23,932
% of Total	69%	59%	65%
Total Development	25,003	12,777	13,115
% of Total	30.9%	41.1%	35%
Total Expenditure	80,983	31,075	37,048

Source: Ministry of Health (2015)

Figure 3.17: Total health expenditure trends, 2001/2002–2012/13



Source: Government of Kenya (2010;2015)

Analysis of national level health budgetary allocations

The Ministry of Health budget allocation for 2014/15 was Ksh 47.4 billion, constituting 4.0 per cent of the national budget compared to 3.4 per cent in 2013/14. The Ksh 47.4 billion budget allocation included government and development partners' contributions for one year. Overall, the Ministry of Health 2014/15 budget allocations increased by 34.0 per cent from what was reported in 2013/14. The development health budget for 2014/15 accounted for 45.0 per cent of the total Ministry budget, a marginal increase from what was reported in 2013/14 (43.9%). The recurrent health budget in 2014/15 accounted for 55.0 per cent of the total budget compared with 56.1 per cent in 2013/14. Development partners accounted for 57.1 per cent of the total development budget in 2014/15 compared with 59.8 per cent in 2013/14.

Human resources

The health workforce constitutes those persons recruited primarily for health and related service provision and management in the state and non-state sectors, who have undergone defined, formal recognized training programmes. An effective delivery of healthcare would require an adequate, productive and equitable distribution of a pool of trained workers who are accessible.

The World Health Organization (WHO) recommends 21.7 doctors per 100,000 population and 228 nurses per 100,000 population. However, due to sub-optimal working conditions, which lead to brain drain, a common feature in the Kenyan health labour market, the country had 21 doctors per 100,000 population and 165 nurses per 100,000 in 2014.

The distribution of the workforce tends to favour regions perceived to have high socio-economic development, leaving marginalized and hard to reach areas to a disadvantage, despite the contribution of Faith-Based Organizations (FBOs) health sector workers in hard to reach areas. There is a skewed urban-rural distribution of health workers, with urban areas having the highest proportions at the expense of rural and remote areas, where 70 per cent of the population lives. More specialized medical care is mostly available in urban areas.

Table 3.8: Medical personnel in Kenya, 2013-2014

Type of Personnel	Registered Medical Personnel				In Training	
			2013	2014	2013/14	2014/15
	Number	No. Per 100,000 Population	Number	No. Per 100,000 Population		
Doctors	8,682	21	9,149	21	3,457	3,279
Dentists	1,045	3	1,090	3	291	369
Pharmacists	2,202	5	2,355	5	826	969
Pharm Technologists	6,204	15	7,041	16	434	610
BSc Nursing	1,873	4	2,418	6	2,736	3,979
Registered Nurses	37,907	91	41,371	96	2,708	2,702
Enrolled Nurses	26,841	64	27,186	63	279	509
Clinical Officers	13,216	32	15,960	37	1,125	1,583
Public Health Officers	8,637	21	9,039	21	568	751
Public Health Technicians	5,969	14	5,969	14	-	-
Total	112,576	269	121,578	282	12,424	14,751

Source: KNBS (2015)

Lack of essential medical tools and medical and non-medical supplies in health facilities, and sometimes unsafe working environment, contribute to low morale and productivity of health workers. Other challenges that affect the performance and motivation include uneven remuneration and disparities in terms of service among the same cadre of staff in the public sector.

Health products and technologies

Health products and technologies encompass a wide range of items that are vital for healthcare delivery. The scope of areas in which investments need to be made include regulation, production and trade, procurement, supply and distribution and utilization. Adequate contribution of health outcomes would ideally require that such health products and technologies are available, affordable, safe, efficacious and of good quality and appropriately used. The Kenya Medical Supplies Agency (KEMSA) as a medical logistic provider has been able to reach the 47 counties and referral hospitals. The agency has been able to register repeat orders and this is an indication of improved quality in service and customer satisfaction. The agency reported the customer satisfaction index improving from 53.6 per cent in 2012/13 to 62.5 per cent in 2013/14 in 2014/15.

Health infrastructure

Health infrastructure relates to all physical infrastructure, non-medical equipment, transport and technology infrastructure (including ICT) required for effective delivery of services by the national and county governments, and other health service providers. The goal of this policy is to have adequate and appropriate health infrastructure. The network should be functional, efficient, safe and sustainable based on the needs of the consumers of health services. Different facilities have different levels of infrastructure; currently there are 8,401 registered health facilities according to the Health Information System 2015. Nairobi County has the highest number of facilities at 10.4 per cent, while Isiolo County has the least number of health facilities at 0.5 per cent. Public health facilities account for 49.0 per cent of all health facilities in the country. Sixteen per cent (16.0%) are private-not-for-profit and 33 per cent are private-for-profit. Of the total health facilities, 66.0 per cent are in rural areas and 34.0 per cent in urban areas. Hospitals constitute 7.0 per cent, health centres 13.0 per cent, dispensaries 46.0 per cent, private clinics 30.0 per cent and maternity and nursing homes 4.0 per cent.

3.4 Challenges for the Health Sector

The health sector has a huge task in ensuring provision of the highest attainable standards of health to the Kenyan population as enshrined in the Constitution of Kenya under the Bill of Rights. However, the increasing population is placing a lot of demand for health services and, therefore, the sector needs to expand its capacity to provide quality, equitable and efficient healthcare. Devolution of governance requires properly designed systems of fiscal management, evidence-based planning, effective human resource planning, and proper and effective coordination to ensure efficient and effective service delivery through devolved governments.

Communicable diseases account for the highest proportion of the disease burden in the health sector. Despite the significant decrease on HIV/AIDS prevalence rate, the co-infection of the disease and Tuberculosis (TB) coupled with the emergence of drug-resistant strains of TB poses a serious problem to the health sector. In addition, funding for HIV/AIDS programmes and interventions still remains donor-dependent.

Non-Communicable Diseases (NCDs) in Kenya are also exerting immense pressure to the healthcare system. Hypertension, heart diseases and diabetes are of major health concern.

Data from the Kenya Demographic and Health Survey 2014 shows that over 10 million Kenyans suffer from chronic food insecurity and poor nutrition, and between one and two million Kenyans require food assistance each year. The report further states that nearly 30.0 per cent of Kenya's children are undernourished, and micronutrient deficiencies are widespread.

Kenya's high fertility rate is a threat to the quality of life of Kenyan women, their households and communities and is a challenge to the realization of development objectives such as the Vision 2030 and the Sustainable Development Goals (SDGs). However, if urgent and comprehensive interventions are initiated to fast-track fertility decline, the country could benefit from accelerated economic growth derived from its youthful population. In order to open the window of opportunity for demographic dividend, policies need to focus on addressing the challenges that have contributed to sustained level of high fertility, including investing in an effective and voluntary family planning programme, and improving child survival to assure parents to have smaller families and keep girls in school for longer.

The rapid spread of drug and substance abuse is also a major problem facing the youth in Kenya today. Statistics from the World Health Organization (WHO) show that global average consumption of alcohol among drinkers aged 15 years and above was 17.2 litres by 2010. The African region average was 19.5 litres. Average consumption of alcohol in Kenya was 18.9 litres per year in 2010. Drug and substance abuse is a major concern in the education and health sectors across all the counties, and is rampant among young people (both male and female) who are in and out of school at all levels of education and in all age groups.

3.5 Policy Implications

The health of Kenyans is being undermined by the double burden of communicable diseases and the emergent and fast rising non-communicable diseases,malnutrition, drug and substance abuse, and weak healthcare systems. If the government does not make increased and strategic investments to tackle these bottlenecks to health, the country will not have a healthy and productive workforce necessary to achieve the Vision 2030, nor will it harness the demographic dividend.

For Kenya to achieve a rapid decline in fertility levels from the current 3.9 to 2.6 per woman by 2030, the country needs to invest in both short and long-term strategies on both family planning and women education. Improvement of child survival will also go a long way in reducing fertility in the country, especially in the marginalized counties. Existing policies against early marriages and teenage pregnancies should be fully enforced. In addition, initiatives that have been put in place to improve child and maternal health should be fully exploited to address reduce mortality rate.

At the county levels, more advocacy and sensitization on the benefits of family planning is needed to create and increase budget allocation for essential commodities and technologies.

3.6 Recommendations

The threat of communicable and non-communicable diseases, which is increasingly becoming a burden for both household and the nation at large, needs to be addressed by all actors. There is therefore need to balance allocations of resources between competing needs of communicable and NCDs in the country.

The health sector needs to strengthen the link between policy, planning and budgeting to ensure the achievement of outputs and outcomes for the health sector. This requires proper coordination between policy at the national level and implementation at the county levels.

PART II

SELECTED SECTOR PERFORMANCE

This part focuses on the performance of key selected sectors of the economy and infrastructure development. Specifically, it covers the analysis of the performance of Agriculture; Extractive Sector; Tourism; Manufacturing; Micro and Small Enterprises; Trade and Foreign Policy; Financial Services; Building and Construction; Transport; Energy; Water and Sanitation; and Information and Communication Technology

Chapter 4

Agriculture

4.1 Introduction

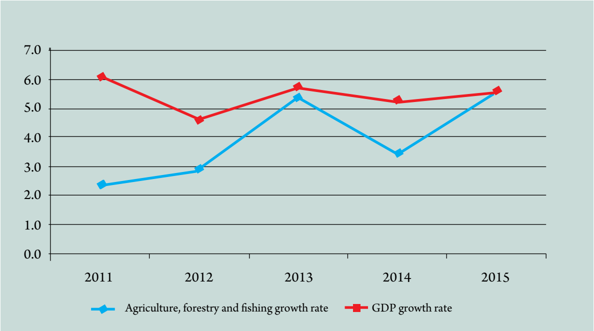
Agriculture has continued to play a critical role in the economic development of the country. Agricultural productivity has more or less remained the same over the last decade, and public expenditure has stagnated at an estimated two per cent of total government spending. The agriculture sector is a source of employment, food, raw materials for agro-industries and export earnings. With the enactment of the Constitution in 2010, most of the sector's functions were devolved to the county government, with the role of national government as stipulated in Schedule 4 being the development of agricultural policy and veterinary policy. This means that counties are expected to drive the double digit growth envisioned in Vision 2030, in addition to ensuring food and nutrition security, in collaboration with the national government. According to the Medium Term Expenditure Framework report for the fiscal year 2014/15, most counties are having challenges in fulfilling their constitutional mandate due to lack of over-arching policies to guide policy formulation at county level, old and obsolete equipment, limited office space inherited from the national government, and dysfunctional management and reporting systems, among other factors. Moreover, the national government has continued to participate in functions that have been devolved to the counties, resulting in conflict of interest.

4.2 Performance of Agriculture

Over the 2010-2015 period, the agricultural sector and the overall economy in Kenya showed almost a similar trend (Figure 4.1). The agricultural and forestry growth rate declined from 5.2 per cent in 2013 to 3.5 per cent in 2014 (KNBS, 2015). This was attributed to decline in total marketed value of agricultural production. The crops sub-sector comprising food, horticultural and industrial crops, among others, contributed 72.0 per cent of the agricultural Gross Domestic Product (GDP) and about 19.7 per cent of national agricultural GDP in 2014. The livestock sub-sector contributed about 18.0 per cent of agricultural GDP and about 4.9 per cent of national agricultural GDP. The fisheries sub-sector contributed about 0.8 per cent of the country's national GDP and 5.0 per cent of agricultural GDP (KNBS, 2015).

In 2015, agriculture, forestry and fishing grew by 5.6 per cent from the 3.5 per cent reported in 2014 (KNBS, 2016). Unlike in 2014, the total marketed value of agricultural production increased by Ksh 37.8 billion (11.8%). During the review period, the crops sub-sector comprising food, horticultural and industrial crops, among others, contributed 74.7 per cent of the agricultural Gross Domestic Product (GDP) and about 22.4 per cent of national agricultural GDP in 2015. The livestock sub-sector contributed about 16.8 per cent of agricultural GDP

Figure 4.1: Trends in GDP growth rate in Kenya, 2010-2015

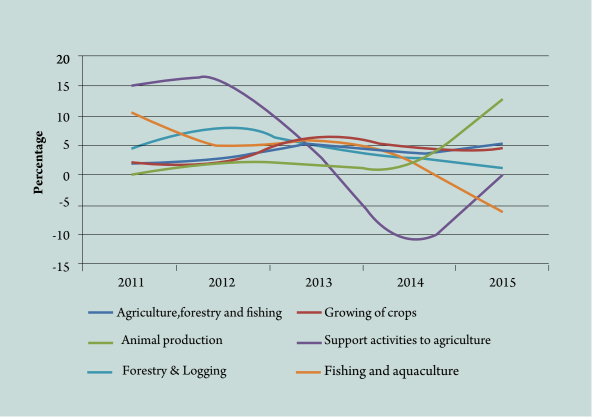


Source: KNBS (2016), Economic Survey

and about 5.0 per cent of national agricultural GDP. The fisheries sub-sector contributed about 0.7 per cent of the country's national GDP and 2.2 per cent of agricultural GDP (KNBS, 2016).

The agriculture sector is still the leading source of employment in the rural sector, accounting for an estimated 75.0 per cent of the labour force, in addition to accounting for 66.0 per cent of all manufactured goods. The sector's contribution to GDP increased by 0.9 per cent in 2014 from 26.4 per cent observed in 2013. This could be attributed to the 17.0 and 3.5 per cent increase in the sector's output value added at current and constant prices, respectively. Crop growing and animal production

Figure 4.2: Percentage change in agricultural GDP by activity



Source: KNBS (2016), Economic Survey

exhibited a decline mainly due to erratic weather and poor rainfall distribution in various parts of the country such as Central, Eastern and Coastal regions, which contribute significantly towards agricultural output. For example, during the short rains (October-December) and long rains (March-May) period, the North Rift experienced near normal rains, hence reducing maize production (Figure 4.2).

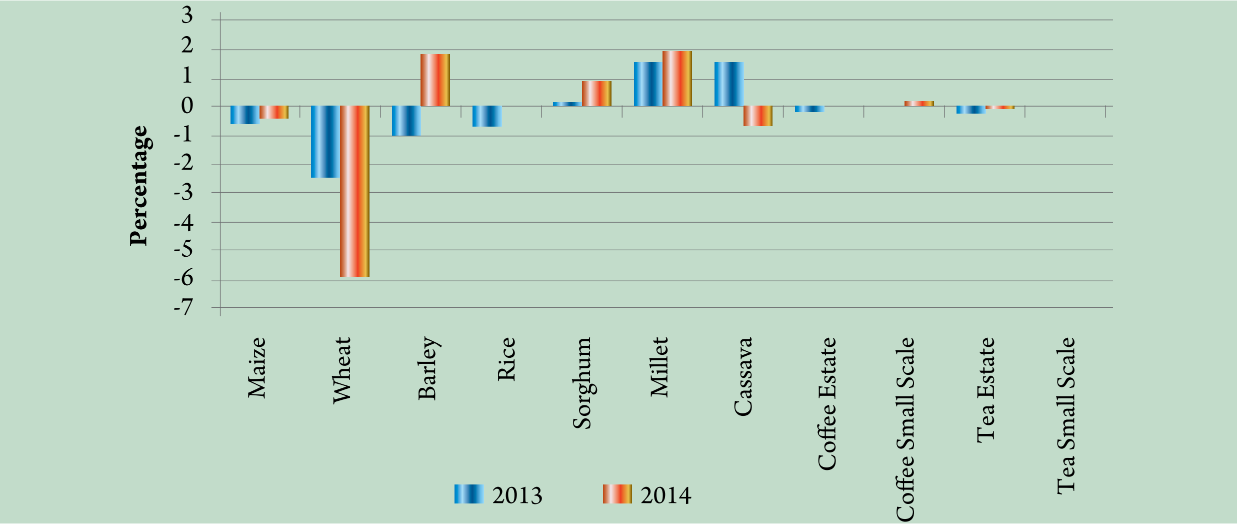
In 2015, the sector exhibited a continued upward trend in contribution to GDP by recording its highest contribution to GDP at 30.0 per cent, a 2.7 per cent increase from the 27.3 per cent observed in 2014. This is attributed to 6.2 per cent increase in the sector's output value added at constant prices, coupled with good weather and well spread abundant rainfall in most regions of the country. For example, the short rains were characterized by El Nino during the month of November.

The first and second quarters of 2015 recorded an increase of 4.4 per cent and 5.4 per cent, respectively, in comparison to first and second quarters of 2014. This is mainly a result of improved/favourable climatic conditions, which led to increased growing activities of major crops such as maize, vegetables and fruits. Furthermore, the first quarter of 2015 recorded increased demand and use of fertilizer based on increased import quantities (KNBS, 2015).

4.3 Agricultural production

The poor rainfall distribution that affected Central, Eastern and Coastal regions contributed to a marginal decline in maize production in 2014 by 4.2 per cent. Production of maize in the Rift Valley region was further worsened by prevalence of Maize Lethal Necrosis Disease (MLND), as well as by decline in area under production, which decreased by 0.2 million hectares in 2014 (ERA, 2015).

Figure 4.3: Annual changes in yield in relation to previous year for selected crops (tonnes/ha), 2013-2014



Data Source: Ministry of Agriculture, Livestock and Fisheries (2015)

The reverse happened in 2015, whereby maize production increased by 9.0 per cent from the 39.0 million bags recorded in 2014. Apart from the improved rainfall, this increase in maize production was also as a result of reduced incidence of MLND. Production of maize in the Rift Valley region was further improved by a 0.05 million hectares increase in area under production (USDA FAS, 2016). However the value of marketed maize reduced by 11.4 per cent due to lower process paid to farmers.

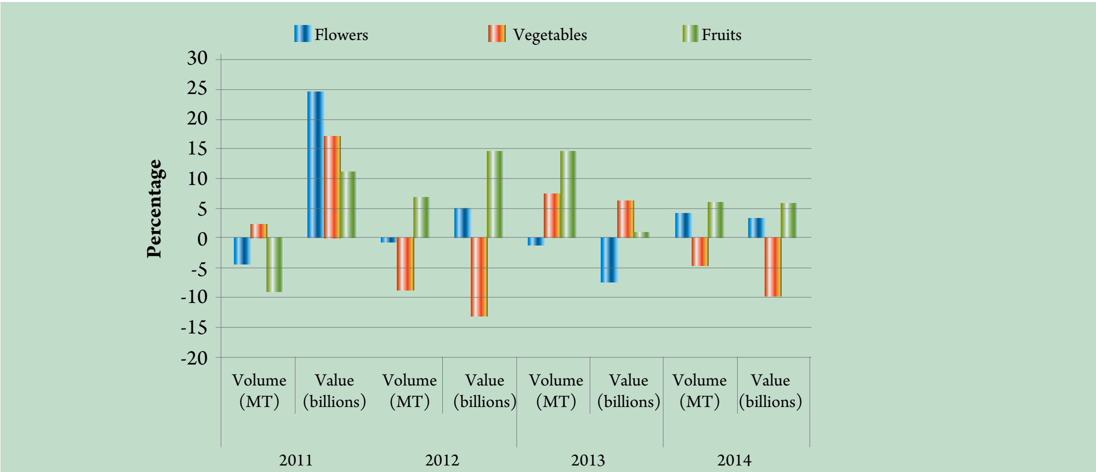
Rice production has also been declining over the last few years. In 2014, the area under production was 28,390 hectares and, as a result, output declined by 10.3 per cent. Although wheat production increased to 228,900 tonnes in 2014, its share is only less than 15 per cent of the total wheat supply in the country (KNBS, 2015). Narok County, which accounts for 45 per cent of the national production, was greatly affected by erratic rainfall.

Barley production increased in 2014 by 13.4 per cent from 640,783 bags in 2013. This increase in production could be attributed to the 25 per cent increase in area under crop (ha) and expanding demand for barley by beer companies through contractual agreements. In addition to having a ready market from the beer industry, sorghum has over the period 2012-2014 been promoted by the Ministry of Agriculture as one of the Traditional High Value Crops (THVC), consequently leading to its progressive increase in production. This growth is also reflected in 2014, which recorded a 9.5 per cent increase in yield (90kg/ha). Millet production recorded the highest (37.8%) increase among the selected crops, even despite 17.5 per cent decline in area under the crop to 168,291 hectares in 2013. Similar to the trend from 2010, millet production is also increasing due to increased awareness and adoption of drought tolerant, high yield varieties. The decline in cassava production shows that the crop has not yet evolved from subsistence to commercial crop despite efforts by the government to promote it as one of the THVC (Ministry of Agriculture, Livestock and Fisheries, 2015). In 2015, wheat production increased by 4.2 per cent from 228.9 thousand tonnes recorded in 2014. Coupled with improved weather, this growth is attributed to high demand for wheat products during the period.

4.3.1 Industrial crops and horticulture

Tea and coffee are the leading agricultural export earners. Overall, coffee production increased in tonnes by 30 per cent, mainly due to better management practices used at estate and

Figure 4.4 Annual percent change in volume and value of horticultural crops

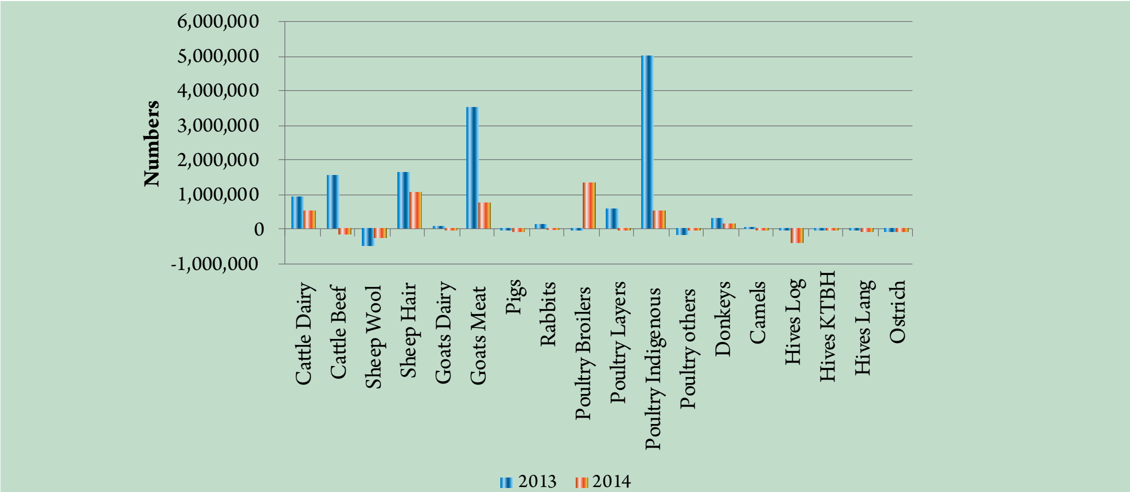


Source: KNBS (2015), Economic Survey

cooperative levels. Tea yields increased under both estate and smallholder sub-sectors by 0.04 and 5.0 per cent, respectively. In addition to increased area under production, the increase in tea production is also due to good rains received in the tea growing regions in 2014. In 2015, however, tea and coffee production declined by 10.3 per cent and 16.0 per cent, respectively, due to excessive rains, coupled with frost in some of the tea zone areas, ultimately leading to a fall in production. Despite this, high tea prices have prevailed owing to increased demand and low global production of the crop (KNBS, 2016).

Figure 4.4 shows that horticultural crops significantly contributed to Kenya's foreign exchange earnings, though the vegetable sub-sector recorded an estimated 10.0 per cent decline from the 2013 earnings, while cut-flowers recorded a 4.0 per cent increase 2013. During the 2014-2015 review period, the volume and value of marketed exports of fresh horticultural produce increased by 8.4 per cent and 7.5 per cent, respectively. This is attributed to better unit prices for vegetables and higher volumes of fruits exported.

Figure 4.5: Annual changes in animal numbers in relation to previous year for selected animals, 2013-2014



Data Source: Ministry of Agriculture, Livestock and Fisheries (2015)

4.3.2 Livestock production

Kenya has very diverse livestock populations due to its wide climatic and geophysical variation. From Figure 4.5, growth was experienced in nominal terms in the sector. While there was lower cattle and pig production, the higher shoats and poultry production was able to offset the difference. The increase in shoats was also due to a shift in preference from cattle to shoats, as the latter are more adaptable to climate change, more resilient and disease-resistant and easier to transfer from one area to another. This is also observed in the 0.9 per cent increase in number of sheep and goats slaughtered in 2014 from 6.08 million in 2013. A similar trend was observed in 2015, following a 6.9 per cent increase in thousand head of sheep and goats slaughtered. Figure 4.5 also shows a 21.2 per cent nominal decline in sheep reared for wool, and this was mainly associated with the increased competition from synthetic fibre (ERA, 2015).

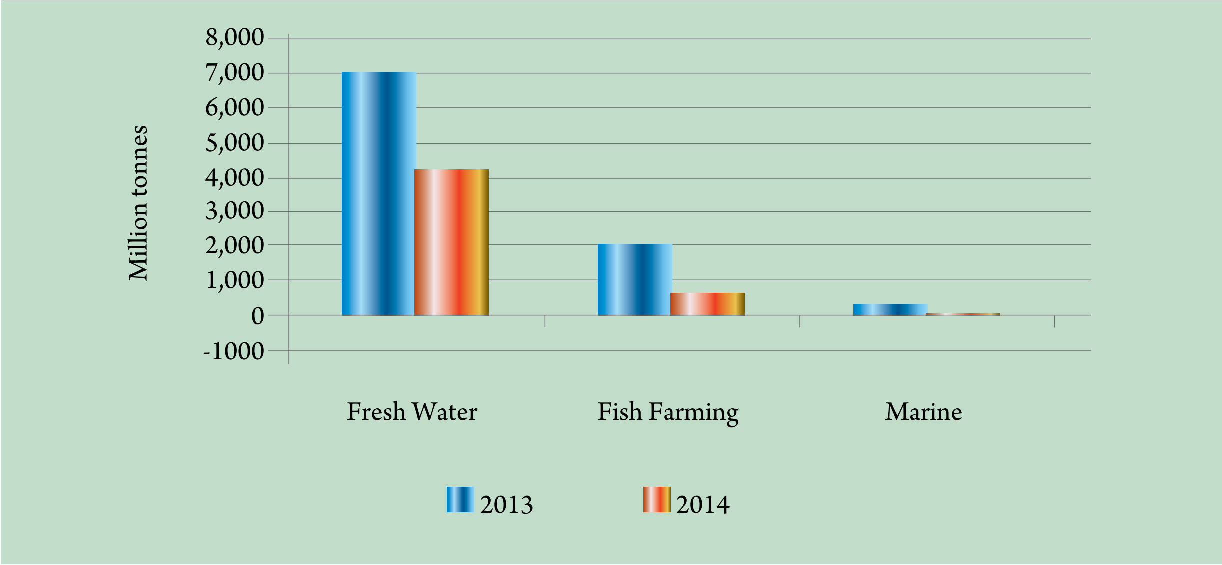
Dairy and beef cattle units reduced due to drought shocks, high mortality and destocking. However, the number of cattle and calves sold at abbatoirs increased by 9.5 per cent in 2015 from 2077.6 thousand head in 2014. The population of poultry increased under all categories as shown in Figure 4.5. Most noteworthy is the increase in indigenous poultry owing to their preference by consumers, and their low production costs in comparison to exotic breeds. Increased rural-urban migration coupled with a rising middle income group population explains the marginal increase in production of layers and broilers in 2014. Camels remain the main source of livelihoods among pastoralists and, as the population of pastoralists increases, so does the population of camels due to their resilience to adverse weather conditions.

Despite the fact that log hives have the advantage of low production costs and ease of construction using locally available farm materials, the number of Kenya Top Bar Hives (KTBH) increased, largely due to comparatively higher yield per hive, and due to marketing initiatives by the manufacturers of the Kenya Top Bar Hives.

4.3.3 Fishery production

The volume of fishery production increased by 2.7 per cent from 194,557 metric tonnes in 2013 to 199,741 metric tonnes in 2014 due to an increase in area of farmed fish in the high aquaculture potential areas through increased support from the Economic

Figure 4.6: Annual changes in capture fish in relation to previous year in million tonnes, 2013-2014



Data Source: Ministry of Agriculture, Livestock and Fisheries (2015)

Stimulus Programme (ESP). Fisheries from lakes accounted for the largest increase in fish production with 2.7 per cent, followed by fish farms with a 2.5 per cent increase. A decline in marine production was observed in 2014, which can be attributed to lack of adequate investment in that area. Lake Victoria, which accounted for 89.5 per cent of all the capture from fisheries, had a 4.2 per cent increase in production of *Rastrineobola argentea (Omena)* (Ministry of Agriculture, Livestock and Fisheries, 2015).

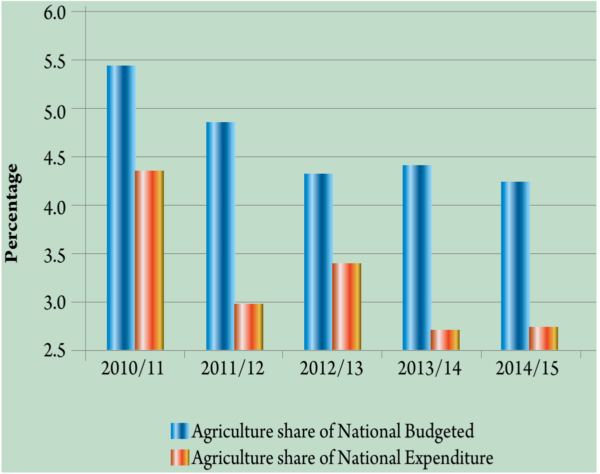
Despite the increase in fish production, Figure 4.6 shows that the rate has been declining despite the government having been promoting aquaculture development in the country. Among the developments have been the construction of a fish breeding structure with over 200,000 brood-stock capacity, and the procurement and distribution of 54 Fish Feed Pelletizing machines distributed to clusters of fish farmers in selected counties. This is in addition to construction of over 69,194 fish ponds by the government since the year 2009 and 22,370 others by farmers, of which investors had stocked with over 100 million fingerlings.

4.4 Resource Allocation and Expenditure Review

4.4.1 Overview of budget execution

Development expenditure in the agriculture sector, which comprises agriculture, fishing, forestry and hunting, has been on a steady increase from 2010/11-2014/15 (revised estimates). The trend on recurrent expenditure is in tandem with the overall expenditure in the sector. However, allocation to the agriculture sector from the total national budget has declined from 5.4 per cent in 2010/11 to 4.2 per cent in 2014/15. The expenditure, on the other hand, has declined similarly from 4.3 per cent to 2.7 per cent (Figure 4.7).

Figure 4.7: Shares of agricultural sector in the national budget and expenditure (%), 2010/11-2014/15



Data Source: National Treasury (Various)

The share of spending in the agriculture sector in the national spending has been an average of 3.0 per cent while that of GDP is an average of about one per cent, yet the sector contributes about 25.0 per cent of national GDP, on average (Figure 4.8).

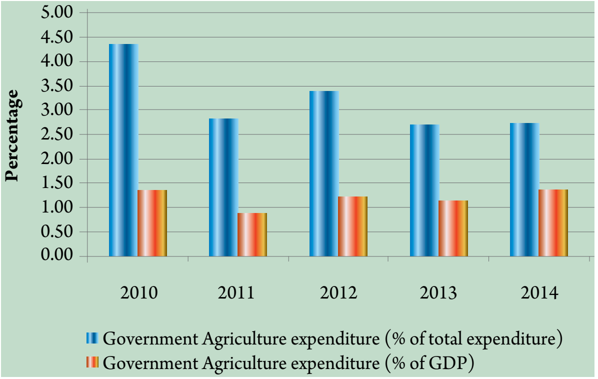
The expenditure analysis shows that over the review period, total allocation to the sector increased from Ksh 60,460 million in 2012/13 to Ksh 65,285 million in 2013/14 (8% increase) then to Ksh 79,308 million in 2014/15 (21% increase). The development budget increased from Ksh 38,531 million in 2012/13 to Ksh 47,411 million in 2013/14, then to Ksh 61,155 million in 2014/15. The recurrent budget allocation in 2012/13 was Ksh 21,929 million, which reduced to Ksh 17,874 million in 2013/14 and then increased to Ksh 18,153 million in 2014/15. Actual expenditure was Ksh 51,902 million in 2012/13, Ksh 51,641 million in 2013/14 and Ksh 62,679 million in 2014/15.

Table 4.1: Programme/sub-programme expenditure analysis

Sub-programme	Approved estimates (Ksh millions)			Actual expenditure (Ksh millions)		
	2012/13	2013/14	2014/15	2012/13	2013/14	2014/15
General Administration, Planning and Support Services	3,369	1,219	1,836	2,785	1,106	1,447
Programme 2: Crop Development and Management						
SP 2.1: Land and Crops Development	3,701	1,951	2,326	2,005	1,616	1,902
SP 2.2: Food Security Initiatives	280	2,360	6,090	269	1,955	5,939
SP 2.3: Agriculture Extension Services	6,687	4,662	5,744	5,634	3,861	4,883
SP 2.4: Agricultural Research	5,129	4,005	2,400	3,845	3,317	2,109
Programme 3: Agribusiness and Information Management	4,019	11,962	4,769	3,912	9,342	4,663
Programme 4: Irrigation and Drainage Infrastructure	-	12,092	15,897	-	9,370	9,090
Programme 5: Livestock Policy Development and Capacity Building Programme	23,186	38,251	39,085	18,451	30,566	30,055
Programme 6: Livestock Resources Management and Development	7,492	4,678	5,625	7,321	3,971	5167
Programme 7: Fisheries Development and Management	3,996	2,882	3,218	3,517	2,062	3,157

Source: Government of Kenya (2015), Agriculture, Rural and Urban Development Sector (ARUD) Medium Term

Figure 4.8: Trends in agricultural expenditure as a per cent of national expenditure and GDP, 2010-2014



Data Source: National Treasury (Various)

The overall average absorption capacity of the sector for 2014/15 was 96.0 per cent; this comprises absorption for recurrent at 96.0 per cent and development at 74.0 per cent. The variance in absorption rate was caused by late approval of Supplementary II Estimates, and lack of exchequer releases at the closure of financial year resulting to pending bills that form the first charge in the following financial year. A detailed analysis of programme/sub-programme expenditure is shown in Table 4.1.

4.4.2 MTEF 2016/17-2018/19

In 2014/15, the State Department of Agriculture received 79.0 per cent of the resources while Livestock and Fisheries received 15.0 per cent and 6.0 per cent of resources, respectively (ERA, 2015). This was mainly attributed to the Ksh 12 billion allocation to a new programme in irrigation and drainage and infrastructure. Similar to 2013/14, expenditure analysis for 2014/15 shows an increase in total allocation in the agricultural sector. Generally, for 2014/15, 90 per cent of budget allocation was spent, indicating a 3.0 per cent improvement from 2013/14 period but still lower than the 5.0 per cent from the 2012/13 review period. In 2014/15, actual expenditure to budget estimate ratios increased under all programmes except under programmes 1, 4 and 5 by 11.9, 20.3 and 3.0 per cent, respectively. Despite the 2014/15 reduction in the proportion of budgeted amount spent under land and crops development, programme 2 still recorded a 6.8 per cent increase in the total share of expenditure compared to the estimated budget from 2013/2015. The variance in absorption rate was due to late approval of the Supplementary II Estimates, and lack of exchequer releases at the closure of financial year, resulting to pending bills that form the first charge in the following financial year.

Table 4.1 shows that within the programme, crop development and management sub-programmes, agricultural extension services expenditure is averages 50.0 per cent of the programme's budget, while agricultural research budget averages 20.0 per cent of the budget. Agricultural extension is a devolved function and, therefore, it is anticipated that this component of the programme needs to be realigned.

4.5 Food Balance Sheet

The total self-sufficiency ratio (SSR) declined by 7.1 per cent in 2014 from 80.0 per cent in 2013. This increased the import dependency ratio by 25.3 per cent, unlike in 2013 in which import dependency ratio had declined. The increase in import dependency ratio was mainly due to import of substantial quantities of maize and wheat as a result of their low production within the country (KNBS, 2015).

The per caput daily supply of calories, proteins and fats all declined during the same period by 1.2, 1.5 and 4.3 per cent, respectively, though at a lower rate than in 2013 except for fat-grams. This reduction is due to a significant reduction in the supply of animal products, for example lower milk production and less supply of meat due to less slaughter of cattle and pigs. However, an increase was observed in the per caput caloric daily supply of cereals products in form of caloric energy.

On the contrary, a 0.8 per cent increase in SSR was observed in 2015, leading to 28.3 per cent import dependency ratio, which was a reduction by 3.1 per cent. This is attributed to the 3.1 per cent decline in imports for food supplies under vegetables, which was registered at 31.7 per cent. Unlike in 2014 where per caput daily food did not increase under cereals, in 2015 there was an increase under all by caloric energy.

Table 4.2: Changes in food balance sheet for selected indicators, 2013-2014

Indicator		2013	2014
Per Caput Daily Supply	Calories - '000	-6.7	-1.2
	Proteins - Grams	-9.5	-1.5
	Fats - Grams	-2.1	-4.3
SSR (%)	Total	3.2	-6.4
	Vegetable Products	3.5	-7.3
	Animal Products	-1.0	0.8
IDR (%)	Total	-9.3	24.5
	Vegetable Products	-8.5	23.1
	Animal Products	0.0	0.0
Per Caput Caloric Daily Supply/	Vegetables Products - '000 Kcl.	-7.2	0.4
Per Caput Daily Food Utilization	Vegetable Utilization (grams)	41.7	-27.1
	Cereals - '000 Kcl.	-7.2	6.5
	Cereal Utilization (grams)	-8.0	8.1
	Animal Products - '000 Kcl.	-2.7	-12.0
	Animal product utilization (grams)*	6.4	-8.0

Data source: KNBS (2015)

4.6 Agricultural Sector and the Sustainable Development Goals

The agriculture sector goals are in line with five (5) main Sustainable Development Goals (SDGs). These are:

(i) Goal 2: End hunger, achieve food security and improve nutrition, and promote sustainable agriculture

(ii) Goal 12: Ensure sustainable consumption and production patterns

(iii) Goal 13: Take urgent action to combat climate change and its impacts

(iv) Goal 14: Conserve and sustainably use the oceans, seas and marine resources for sustainable development

(v) Goal 15: Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss

The main constraint in Kenya in relation to the SDGs is the lack of resources to finance the related activities. Moreover, unfavourable international trade practices continue to reverse the gains made in the country. However, Kenya is still making considerable effort towards achievement of these goals, as highlighted below:

- Recent policy and legal reforms include the: Agriculture, Fisheries and Food Authority Act, 2013; Crops Act, 2013; Kenya Agricultural Research Act, 2013; the Veterinary Surgeons and Para-Professional Apiculture Act, 2012; and the operationalization of the National Land Commission. These are eventually expected to lead to sustainable land use.
- Aquaculture development is expected to encourage investments along the value chain, thus making fish farming a viable commercial venture. The introduction of Electronic Fish Market Information System assists both buyers and sellers with data from landing sites, markets and fish farms to a central database, which is active on a daily basis.
- Establishment of empowerment funds for youths and women as well as for social protection fund for the aged to promote income generation.
- *Njaa Marufuku* Kenya programme aims at increasing farm productivity and improving food security at household level by supporting community-driven food security improvement initiatives, community nutrition and school meals programmes, and support to private sector food security innovations.
- Through the National Expanded Irrigation Programme, irrigation schemes with 3,800 acres of land under crop were operationalized in 2012, while the Tana Delta irrigation scheme was launched with a total of 4,654 hectares.
- The National Accelerated Agricultural Inputs Access Programme (NAAIAP) promotes sustainable public-private partnerships through subsidized credit and ensures that smallholder farmers and businesses along the maize value chain access farm inputs. The project aims to increase agricultural productivity and output at farm level for 2.5 million smallholder farmers with one hectare or less of land in 90 sub-counties.
- Construction of abattoirs and slaughter houses to promote livestock trade in the Arid and Semi-arid Lands (ASALs) to boost value addition in the livestock sectors.
- Sustainable Land Management Programme targeting increased productivity in arid areas.

4.7 Devolution and Agriculture

4.7.1 Background

Schedule 4 of the Constitution identifies the functions that the national and county governments will perform. County functions were clarified through legal notices (range No. 100-147) sent to respective counties and dated 9th August 2013 on transfer functions. The functions transferred to the county governments are:

1 Crop husbandry including:

(i) Providing agricultural extension services or farmer advisory services.

(ii) Developing and implementing programmes in the agricultural sector to address food security in the county.

(iii) Constructing grain storage structures.

(iv) Enforcing quality control regulations and standards for inputs, produce and products from the agricultural sector.

(v) Availing farm inputs such as certified seeds, fertilizer and other planting material such as cassava cuttings or potato vines to farmers.

(vi) Developing programmes to intervene in soil and water management, and conserving the natural resource base for agriculture.

(vii) Promoting market access for agricultural products.

(viii) Providing infrastructure to promote agricultural production and marketing as well as agro-processing and value chains.

(ix) Enhancing accessibility to affordable credit and insurance packages for farmers.

(x) Managing agricultural training centres and agricultural mechanization stations, provided that their management shall be transferred after six months, to enable the Transition Authority to put in place the requisite structures and mechanisms.

(xi) Providing land development services such as construction of water pans for horticultural production for food security.

(xii) Formulating and reviewing county-specific policies.

(xiii) Developing and enacting legislation and regulatory frameworks for county-specific policies.

(xiv) Implementing national and county-specific policies and legislation.

2. Animal husbandry including livestock extension services to deliver husbandry technologies to livestock farmers and pastoralists, through farm demonstrations, farmer field days, farmer field schools, agricultural shows, individual farm visits, farmer training courses (residential and non-residential), barazas, farmer tours, posters, brochures or leaflets.

3. Plant and animal disease control, including carrying out, coordinating and overseeing:

(i) Communal dipping and spraying operations and vaccination campaigns.

(ii) Control of plant pests, diseases and noxious weeds that are specific to counties.

4. Fisheries, including:

(i) Providing fisheries extension services.

(ii) Up-scaling sea weed, fin fish and crustacean culture.

(iii) Maintaining county fish seed-bulking units.

(iv) Carrying out on-farm trials.

(v) Providing fish health certification.

(vi) Developing and maintaining fish-landing stations and jetties, fish auction centres and levying fish-landing fees.

(vii) Demarcating all fish-breeding areas and fencing of fish landing stations.

(viii) Licensing fish trade and fish-movement permits.

(ix) Collecting statistics on fish production statistics.

(x) Enforcing fisheries regulations and compliance with management measures.

(xi) Implementing fisheries policy, fisheries management measures, and regulating and limiting access to fishing.

(xii) Carrying out fisheries monitoring, control and surveillance.

(xiii) Zoning aquaculture county-specific disease control.

4.7.2 County budget allocation and expenditure review

Eighteen (18) counties have restructured their Ministry of Agriculture to accommodate the Departments of Agriculture, Livestock and Fisheries while other counties only have Department of Agriculture alone. Some counties have also integrated functions such as irrigation, lands, and even cooperatives, and thus the county analysis below accounts for all these variants and is compiled from the Office of Controller of Budget (OCOB) reports. The county analysis for the recurrent budget and expenditure for 2014/2015 shows that Bungoma had the highest recurrent budget allocation of Ksh 377 million while Taita Taveta had the lowest with Ksh 15 million. Murang'a had the highest recurrent expenditure of Ksh 688 million while Laikipia had the lowest recurrent expenditure of Ksh 14 million. Despite having the lowest recurrent budget allocation, Taita Taveta had the highest recurrent budget absorption rate while Kisumu had the lowest.

The analysis of development budget and expenditure for 2014/2015 shows that Turkana had the highest development budget allocation of Ksh 970 million while Kisumu had the lowest with Ksh 10 million. Kitui had the highest development expenditure of Ksh 675 million while Isiolo had the lowest development expenditure of Ksh 9 million. Overall, Kisumu had the highest absorption rate of development budget at 150 per cent while Narok had the lowest development absorption rate at 18 per cent. This variation in resource allocation and absorption rates has far reaching implications on the county food and nutrition security status.

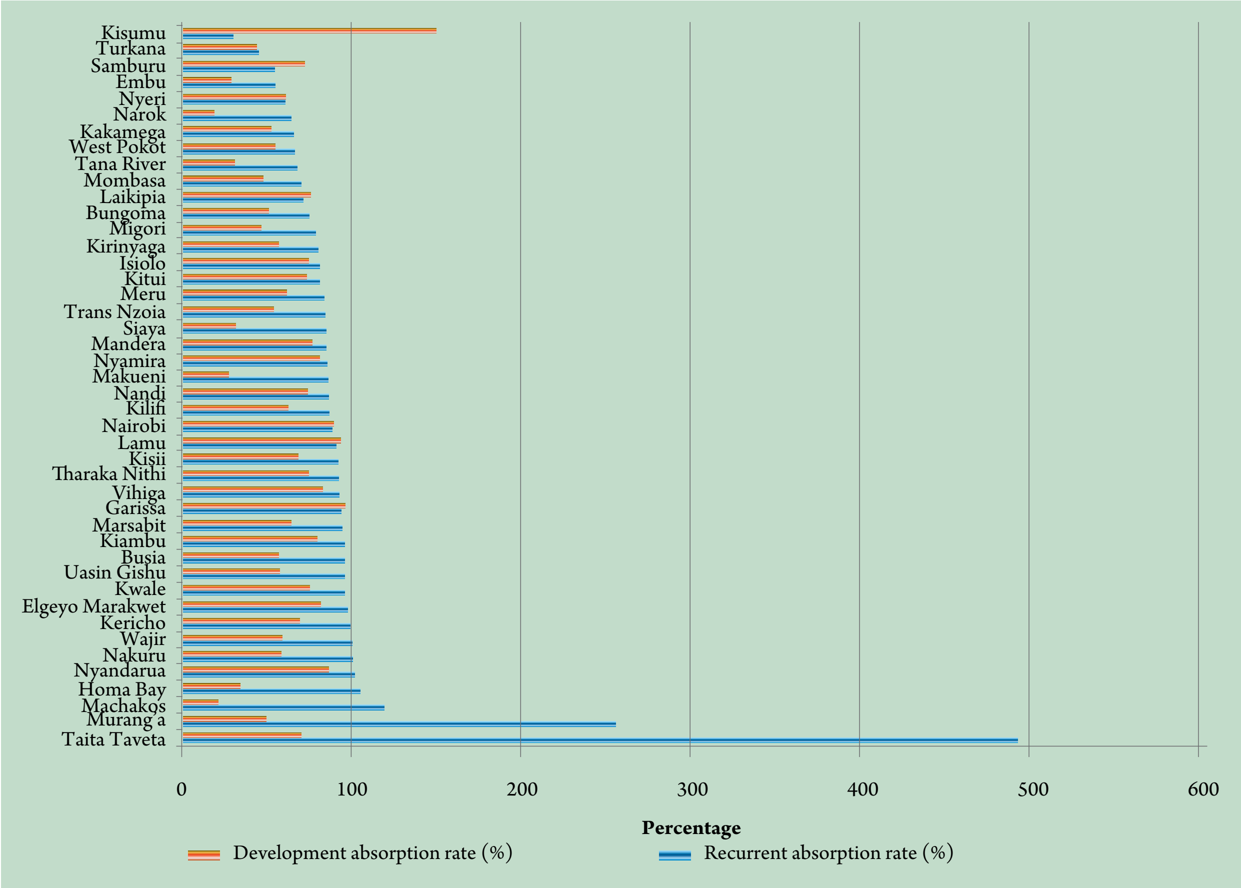
All counties continue to develop policies, legislation and administrative procedures to facilitate the delivery of agricultural services. Most counties reported that only a few of the policies developed by the Executive had been finalized and approved by County Assemblies. Most of the bills were either being developed by the Executive or had been submitted to County Assemblies for debate. Very few of these bills had been enacted into law. Most counties reported that they had put in place structures that facilitate the decentralization of

Table 4.3: Absorption rate by county 2014/15

Top Counties			Bottom Counties		
County	Recurrent (%)	Development (%)	County	Recurrent (%)	Development (%)
Taita Taveta	494	70	Kakamega	66	52
Murang'a	257	49	Narok	64	18
Machakos	119	21	Nyeri	61	61
Homa Bay	105	34	Embu	54	28
Nyandarua	102	86	Samburu	54	72
Nakuru	100	58	Turkana	45	44
Wajir	100	59	Kisumu	30	150

Source: Adapted from Office of Controller of Budget (2015) Report

Figure 4.9: Absorption rate by county 2014/15



Source: Adapted from Office of Controller of Budget (2015) Report

service delivery from county to ward levels. It was also reported that the Divisional Offices of the Ministries of Agriculture, Livestock and Fisheries that existed before devolution had now been converted to county ward offices.

4.7.3 Underlying issues regarding devolution

Various counties are experiencing a number of challenges regarding devolution. These include:

(i) Dysfunctional management and reporting systems: Staff absorbed from the national government often do not recognize the authority of the county governments, and in some cases get instructions from the national government's Ministry of Agriculture, Livestock and Fisheries without reference to county authorities.

(ii) Insufficient number of serviceable equipment: Most of the machines, equipment and vehicles inherited from the former Local Authorities are old and dysfunctional. This has forced county governments to invest in repairs and purchase of new vehicles, agricultural machinery and equipment. This has been quite expensive for county governments.

(iii) Inadequate office space and equipment: Most of the offices that belonged to the Ministry of Agriculture and Livestock prior to the 2013 General Elections were inadequate for the needs of the county governments, and need rehabilitation and upgrading.

(iv) Difference in interpretation of functions: There is a challenge in the interpretation of some components of the agriculture function. National corporations are purporting to perform functions which, according to the Fourth Schedule, are under the jurisdiction of county governments. For example, Bura Irrigation Scheme and Hola Irrigation Scheme in Tana River County are managed by the National Irrigation Board and Tana River Development Authority (TARDA).

(v) Most of the policies developed at county level are still work in progress by the County Executive: The slow pace of development of policies is due to lack of national over-arching policies, inadequate technical personnel, limited time for policy development, financial constraints and differing priorities of the many activities being undertaken by county governments.

4.8 Forestry and Logging

4.8.1 Overview

Forests play an important role in Kenya's socio-economic and environmental well-being. Forests provide important services upon which rural communities derive their livelihood directly or indirectly. Many perennial rivers supplying water for domestic, irrigation, industrial and hydro-power generation flow from forest catchment areas. Further, protected forests provide habitat for wildlife, upon which the tourism industry thrives. Forests also provide important regulatory services such as climate and diseases control; support nutrient cycle and crop pollination; and general well-being through recreation. Close linkages between forests and other economic sectors such as agriculture and food security, tourism, energy and water implies that changes in forest conditions affect sectors and households elsewhere in the economy through reduction in the value of regulating services (UNEP, 2012).

Broadly, forests in Kenya are categorized into natural and plantation forests. Natural forests mainly comprise indigenous tree species, unlike plantation forests which consist of exotic and fast-maturing species. Trees planted on farms, though not forests, have increasingly become an important part of the sector, as driven by adoption of agro-forestry systems. Forests can further be classified as public, community or tree on private farmlands. Public forests are government-owned and are managed to provide goods and services such as water from natural forests and commercial and subsistence requirements of wood from the plantations. Community forests are owned and managed by respective communities and county governments.

It is estimated that forests comprise 7.6 per cent of Kenya, of which natural forests account for 77.0 per cent, public natural forests 18.0 per cent, public plantations 3.0 per cent and community plantations 2.0 per cent (World Bank, 2013; Government of Kenya, 2013a). This means that most of the country's forests are found within community lands. Public natural forests are found in protected areas and are managed for provision of environmental services, although minimal consumption in form of wood fuel collection by forest adjacent communities is allowed.

Gazetted forest area covers 1.24 million hectares (Government of Kenya, 2013b) and the management is vested in the Kenya Forest Service (KFS) as provided in the Kenya Forest Act, 2005.

4.8.2 Resource allocation and sector performance

Forestry falls within the environmental protection, water and natural resources of the Medium Term Expenditure Framework (MTEF) sector. In 2013/14, allocation to the forestry sub-sector was 14.8 per cent of total sector allocation, but this declined to 9.8 per cent in 2014/15 (Government of Kenya, 2015) as shown in Table 4.4. During the same period, actual expenditure in the sub-sector declined from Ksh 5,680 million to Ksh 5,580 million. Investment was concentrated in increasing tree cover, promotion of high value on-farm tree species, and sustainable technologies.

Table 4.4: Forestry budget allocation and expenditure, 2014/15 (Ksh millions)

	2013/14	2014/15	% Change
Allocation	7,091	5,680	-19.8985
Expenditure	6,251	5,580	-10.7343

Source: Government of Kenya (2015)

The contribution of forestry to GDP has stagnated at 1.4 per cent over the past three years. Growth in the sector persistently declined from 8.1 per cent in 2012 to 4.8 per cent in 2013 and further to 4.2 per cent in 2014 (KNBS, 2015). Forest encroachment and illegal logging remained a threat to the sub-sector in 2015, and the problem was compounded by partial lifting of the moratorium on logging at the start of 2015.

Forest revenue data obtained from KFS (Table 4.5) show an increase of 18.8 per cent between 2013 and 2014, mainly driven by an increase in revenue from land assessment fees and leases. Earnings from eco-tourism sites, resin and movement fee recorded a negative growth.

Table 4.5: Changes in forest revenue, 2014-2015 (Ksh millions)

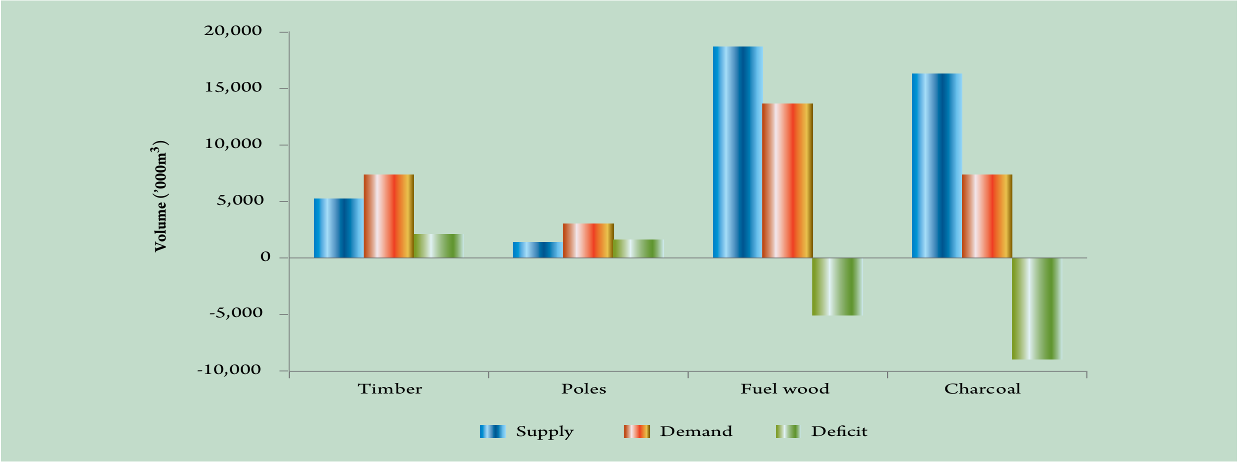
Activity	2013/14	2014/15	% change
Timber	2,002.88	2,481.43	23.9
Poles	42.98	52.93	23.2
Fees and license	302.38	75.47	-75.0
Water chargers	4.52	3.45	-23.7
Fuel wood	37.75	15.63	-58.6
PELIS/shamba rent	178.51	80.28	-55.0
Leases	77.30	230.82	198.6
Others	52.67	265.07	403.3
Total	2698.99	3205.09	18.8

Source: Kenya Forestry Service (2015)

Overall, Kenya's forests cannot meet the increasing demand for forest products. The deficit on wood fuel is 10.3 million m^3 arising from a potential of 31.4 million m^3 against a national demand of 41.7 million m^3. Although timber recorded a big increase between 2014 and 2015, current production is unable to meet the country's demand. As shown in Figure 4.10, Kenya has a deficit in poles, while there is surplus in fuel wood and charcoal production.

The deficit in timber is met through imports from neighbouring countries of Tanzania, Malawi and Democratic Republic of Congo.

Figure 4.10: Status in demand and supply of key timber products



Source: Kenya Forest Service (2015)

A 20 years forecast shows a 20.0 per cent increase in supply and 21.6 per cent increase in demand by the year 2032, which signifies a gradually increasing deficit. This can be covered through supplies from public forests (17.6%), forests on land managed by county government and private farms (23.0%), and farm trees (59.4%).

Besides timber, forests provide charcoal used as a source of energy. It is estimated that over 70 per cent of Kenyans, mainly in urban areas, use charcoal as their primary energy source. The most recent comprehensive study showed that close to 700,000 people are employed in the charcoal industry, which generates about US$ 427 million (KIPPRA, 2010). However, this contribution is seldom captured in the national accounts because the industry is informal and there is no sufficient data (Njenga et al., 2013). The charcoal industry, however, is unexploited due to low compliance to existing regulations, widespread use of unsustainable production technologies, and lack of transparency along the value chain.

4.8.3 Policy developments in forestry

Policy reforms in the forest sector started long before the promulgation of the Constitution in 2010. The reforms were spearheaded by the Forest Policy of 2007 and the Forests Act 2005 aimed at enhancing the contribution of forestry in socio-economic development and in providing environmental goods and services (Government of Kenya, 2007). Specifically, the reforms aimed to address forest loss, poverty, and unemployment among forest communities. The reforms provided for Participatory Forest Management (PFM) as a model for increased community participation, equity and benefit sharing, and overall improvement in forest efficiency (Mogoi et al., 2012). Under the reforms, forest adjacent communities were allowed to establish Community Forest Associations (CFAs) to enter into co-management of certain forests with the State.

The CFAs were expected to register with the Kenya Forest Service (KFS) and be granted some responsibilities and use rights in line with sustainable forest management goals. Section 47 of the Forests Act defines the functions of the CFAs to include: protecting, managing and conserving forests; formulating and implementing forest programmes, consistent with traditional forest user rights and in accordance with sustainability criteria; protecting sacred groves and protected trees; assisting KFS in enforcing provisions of the Act; with the approval of the Board, entering into partnership with other persons or organizations in managing the forest; helping fight forest fires; and engaging in any other act consistent with efficient conservation. Despite implementing the reforms, forest loss has been alarming, with about 12,000 hectares being lost annually from expansion of agriculture and human settlement (KFS, 2010).

An important policy in forestry is the requirement for a 10 per cent tree cover as provided in the Constitution. The Ministry of Environment and Natural Resources has promoted programmes towards attaining this ambitious goal. Particular emphasis has been given on strengthening the protection of gazetted forests, and promoting commercial plantations. Other measures include mobilizing investments through programmes such as Reduced Emissions from Deforestation and Degradation (REDD+) and System for Land-based Emission Estimation for Kenya (SLEEK), which generate data and model emissions and sink capacity of the greenhouse gases from land-based sectors. Implementation of the project will enable the country participate in the carbon market, besides fulfilling her obligation under the United Nations Framework Convention on Climate Change (UNFCCC). More needs to be done before these measures yield the desired outcomes. In particular, attaining the 10 per cent target will require various incentives for farmers to adopt tree farming.

Participatory Forest Management (PFM) is hampered by weak incentive systems. In areas where CFAs have been established, the cost and benefit to the CFA members is not known. Benefit sharing has remained contentious because the rules that govern benefit sharing are not well set out (Agrawal and Ribot, 1999; Koech et al., 2013), and tends to benefit the State more. There is, therefore, likelihood that communities bear the greatest cost while the State, through KFS, receives the greatest benefits. Generally, CFA members are allowed to access non-timber forest products that have low income but are excluded from other timber products through stringent conditions by KFS. In addition, community scouts recruited from the community to monitor illegal forest activities lack the necessary incentive to effectively discharge this function, and are often in conflict with forest guards.

Although the reforms in general and PFM in specific have been piloted in many parts of the country, awareness among stakeholders is low. For example, majority of forest neighbouring communities who are central in the success of PFM are ignorant on its objectives and implementation process. This is particularly so in areas where CFAs have not been established and civil society organizations do not exist. The early stages of implementing the reforms were characterized by different expectations. For example, Ongugo (2007) observed that some CFAs expected that forests would be converted to provide land for agriculture, a fact that slowed the uptake of PFM.

The process of establishing CFAs is slow, and so far only a few have been created and are operational (Osumba, 2011; Ongugo, 2007). The process is further limited by the requirement for a management plan prior to their registration with KFS, a requirement which is beyond the technical capacity of many CFAs.

Since the promulgation of the Constitution, there has been little effort to clarify forest governance in light of devolution. The functions, linkages, coordination and partnerships between national and county governments hinder the participation of the county government and limit overall efficiency in forest management.

Increase in illegal forest activities in public forests is a major threat in the sector mainly due to the weak capacity of the KFS and weak coordination with other agencies such as the Kenya Wildlife Service, and Water Resources Management Authority, both of which have a stake in forests.

In some areas, benefits derived from forests constitute an important source of income for the communities. However, lack of markets coupled with information gaps on supply and demand means that the benefits cannot sustain local livelihoods (Gathaara, 2014). At the same time, poor linkages between CFAs and timber industry, low application of forest products processing technologies, and low adoption of international standards for certification affect the forestry market.

These challenges and the need to align forest governance to the Constitution are central in any amendments to the Forests Act.

4.9 Policy Directions

4.9.1 Agriculture

Increase investments in agriculture: There is need to increase investments in the sector, especially in agricultural research, science and technology and development of rural infrastructure (feeder roads storage and markets). Public spending to the agriculture and rural development (ARD) sector has averaged at about 2.5 per cent per annum of national expenditure for the last four years. It is therefore critical to mobilize financial resources to the agricultural sector in order to tackle the infrastructural deficit facing the sector and increase its supply-side flexibility. Investments should target irrigation, drainage systems and promotion of small scale value adding practices. Counties need to increase their spending in the sector.

Reduce duplication of functions between national and county governments: The national government may need to realign its budget lines to reflect the functions that are outlined in Schedule 4 of the Constitution and develop guideline to compel county governments to allocate funds to the sector.

Strengthen/increase the capacity of the counties to implement their constitutional obligations: Agriculture is a devolved function, and thus the growth of this sector should be driven by the counties.

4.9.2 Forestry and logging

Achieving sustainable forest management will contribute to the attainment of the Sustainable Development Goals No. 13 and 15.

Clearly, the reforms implemented so far have not yielded the desired results. The rate of forest loss through illegal activities, weak institutional framework and inadequate community participation are some of the factors that hinder Kenya's optimal management of forest resources. Lack of data on forest stock, and values of forest services further constrain sustainable management of forests. Weak mechanisms for Kenya Forest Service to collaborate with the county governments constrain the scale-up of best forestry practices to areas beyond the protected forests.

The contribution of forestry in sustainable development could be enhanced through better regulatory regimes, increased community participation, and use of economic incentives. Thus, measures to incentivize farmers to plant more trees will be particularly useful towards attaining the 10 per cent tree cover.

Chapter 5

Extractives Sector

5.1 Introduction

The extractives industry involves the processes that deal with the extraction of raw materials from the earth to be used by consumers. The operations involved help in removing metals, minerals and aggregates from the earth. The extractives processes include oil and gas extraction, mining, dredging, and quarrying. The extractives industry is a major player in the economic landscape of many developing countries. The proceeds from the extraction of oil, gas and other minerals contribute substantially to public budgets, although with a variation from one country to another. For example, the extractives industry contributes 20 per cent of Nigeria's GDP and 65 per cent of budgetary revenue. In Kenya, the extractives sector is small and under-developed; contributing only about 1 per cent to GDP. However, recent discovery of mineral deposits and oil reserves presents considerable untapped potential of the sector[1].

During the global boom in oil and gas, Kenya became an important frontier for exploration activities. On-shore oil exploration was spurred by significant finds in the Rift Valley, particularly in Western Uganda. However, prior to the discovery of titanium and coal, artisanal (small scale) mining dominated the extractives sector. Major gas discoveries off-shore Tanzania and Mozambique encouraged off-shore exploration along the Kenyan coast. To date, some 600 million barrels of crude oil deposits have been found in the South Lokichar basin of Turkana (Tullow, 2015). Further field deposits have been found in North Eastern Kenya, and offshore Kenya's coast. There are prospects for further oil finds in south-western part of Kenya around Lake Victoria. Kenya is already mining titanium in Kwale, coal in lower Eastern Kenya, and gold in Western Kenya, among other minerals. This mineral endowment will have value for Kenya in the future, even though exploration has slowed down significantly in the current downturn of global commodity prices.

Kenya's Constitution explicitly recognizes the need for sustainable exploitation and utilization of natural resources (Article 69). It contains provisions that emphasize good governance, transparency, accountability and public participation in the management of natural resources. The national blueprint, Kenya Vision 2030, through Medium Term Plan (MTP) II, has also prioritized oil, gas and other minerals as the seventh sector with high potential to spur the country's economic growth and development. There is a general recognition, however, that the extractives industry will only contribute to improving the well-being of Kenyans if there is good resource utilization and management, equitable sharing, effective policy dialogue, appropriate legislation, strong oversight institutions and communities feeling the benefits of the extractives sector (IEA, 2014).

Compared with other resource-rich developing countries, Kenya has relatively good economic indicators, institutions and policies in place to take advantage of mineral and energy resources. The big question is whether Kenya's politics will be able to harness recent discoveries of oil, gas and other minerals for development and conflict transformation, given the history of conflicts around general elections, which often tend to disrupt Kenya's socio-economic and political fabric.

There is evidence that sub-national resource revenue transfers may intensify rather than resolve resource conflicts (Arellano-Yanguas, 2011; Schultze-Kraft, 2013). However, this can be avoided if there are significant institutional reforms. The preparation of various legislations (though in bill form) such as the Mining Bill 2014, National Sovereign Wealth Fund Bill 2014, Community Land Bill 2014, Evictions and Resettlement Bill 2014, Minimum and Maximum Land Holding Acreage Bill 2015, EMCA Amendment Bill 2014, Energy Bill 2014, Petroleum Bill 2015, and the Prevention and Control of Marine Pollution Bill 2014 are expected to provide better environment for the extractives industry to thrive.

5.2 Sector Overview

5.2.1 Performance of the extractives sector

Table 5.1 shows the performance of the extractives sector. The sector registered the highest percentage growth of 14.2 per cent between 2013 and 2014 (KNBS, 2015), mainly attributed to the commencement of titanium ore mining by Base Titanium Ltd in Kwale County (comprising Ilmenite, Rutile and Zircon). The first export consignment was shipped in February 2014, and more or less offset declines in production of most of the other minerals. Increased contribution to GDP from extractives is evident in 2014, where the sector contributed 2.3 per cent compared to -1.5 per cent in 2013.

Table 5.1: Extractives sector performance 2013-2014

Indicator	% change/ growth		
Sector contribution to GDP	2013	2014	Change
Percentage change (sector growth)	-8.9	14.2	23.1
Sources of growth of GDP	-1.5	2.3	3.8
Percentage contribution to GDP	0.8	0.8	0.0
Compensation of employees (Ksh millions)	8,768	13,890	58.4
Value added, gross (Ksh millions)	38,771	42,543	9.7

Source: Authors calculations based on KNBS (2015)

The compensation to employees grew by 58 per cent between 2013 and 2014, notably from increased activities in exploration in Turkana, Rift Valley and North Eastern, and mining in Kwale. The overall value added to the economy grew by 9.7 per cent, indicating the potential of the sector to contribute to development.

As shown in Table 5.2, the overall value of mineral production rose by 6.0 per cent to Ksh 20.9 billion from Ksh 19.7 billion in 2013, mainly on account of production of titanium ore. The value of fluorspar increased to Ksh 1901.0 million in 2014 while that of salt increased substantially from Ksh 71.6 million in 2013 to Ksh 173.5 million in 2014 (KNBS, 2015).

The total quantity of mineral production in the country rose by 16.7 per cent from about 1.5 million tonnes in 2013 to 1.8 million tonnes in 2014 (Table 5.2). Most minerals recorded declines in 2014, except for fluorspar and salt. The production of gemstones dropped significantly by 35.0 per cent between 2013 and 2014. Similarly, gold production declined by over 90.0 per cent in the same period. The decline in production of gemstones and gold

Table 5.2: Value of mineral production, 2013-2014

Minerals	Value (Ksh millions)			Quantity in Tonnes		
	2013	2014	% Change	2013	2014	% Change
Soda ash (MT)	8,865.0	7,840.0	-11.6	468,215.0	409,845.0	-12.5
Fluorspar (MT)	1,783.0	1,901.0	6.6	71,987.0	97,156.0	35.0
Salt (MT)	71.6	173.5	142.3	8,895.0	18,936.0	112.9
Crushed refined soda (MT)	631.9	568.4	-10.0	947,074.0	851,906.0	-10.0
Carbon dioxide (MT)	466.0	395.9	-15.0	17,283.0	15,069.0	-12.8
Diatomite (MT)	69.6	10.2	-85.3	1,054.0	168.0	-84.1
Gold (Kg)	7,432	695.3	-90.6	2.1	0.2	-90.5
Gemstones (Kg)	411.0	263.6	-35.9	563.0	247.3	-56.1
Titanium Ore						
	Ilmenite		3,697.0	100.0	281,543.0	100.0
	Rutile		4,085.2	100.0	52,465.0	100.0
	Zircon		1,281.2	100.0	40,123.2	100.0
TOTAL	19,730.9	20,912.1	6.0	1,515,073.0	1,767,459.0	16.7

Source: Authors calculations based on KNBS (2015)

was mainly attributed to low prices in the export markets.

During the same period, the country produced 281,543.0, 52,465.0 and 40,123.2 metric tonnes of ilmenite, rutile and zircon, respectively, valued at Ksh 3,697.0, 4,085.2 and 1,281.2 million. The decline in the quantity of soda ash by 11.6 per cent from 468,215 metric tonnes in 2013 to 409,845 metric tonnes in 2014 was attributed to the closure of soda ash premium grade plant due to high cost of energy.

5.2.2 Employment and job creation

Extractive industries are not labour-intensive, and complains abound over shortage of skills. Employment is somewhat concentrated in the construction phases of capital projects, but less so during exploration, on-going operation, and close-down phases. In addition, extractive industries can have negative impact on jobs elsewhere in the economy. Moreover, the skills deficit in the extractives sector tends to be exacerbated by the high premium paid to skilled workers in modern extractive sector employment, to the extent that it could erode the effectiveness of the public sector and other sectors, since there would be an incentive for staff to leave for more attractive opportunities in the extractives industries.[2] Local jobs and business opportunities along the supply chain, especially during the construction phase of extractive projects, are critical to ensuring the accommodation of sub-national interests.

In 2013-2014, overall wage employment for Kenya's extractives sector grew by 3.8 per cent mainly driven by the private sector, which contributed 40.2 per cent while the public sector wage employment declined by 14.3 per cent (Table 5.3). The growth in the private sector wage employment can be attributed to increased exploration activities for oil in Turkana and other parts of the country, and the commencement of titanium mining in Kwale.

Total wage payment for the private sector grew by 62.2 percent compared to the public sector at 0.8 per cent, indicating the potential of the private sector to drive the extractives. The average earnings per employee for the private sector increased by 15.5 percent compared to the public sector at 8.1 per cent.

Table 5.3: Employment in the extractives sector 2013-2014

	Indicator	2013	2014	% Change
Wage Employment	Employment (private sector)	8,700	1 2,200	40.2
	Employment (public sector)	700	600	-14.3
	Total wage employment	2,283,100	2 ,370,200	3.8
Total Wage Payment				
	Total wage payment (Ksh million per annum) Private	2,587.9	4,196.5	62.2
	Total wage payment (Ksh million per annum) Public	1 97.3	1 98.9	0.8
	Total wage payment (Ksh million per annum) All	1,174,935.9	1,315,872.0	12.0
Wage Earning				
	Average wage earning per employee (private)	297,797.2	343,893.9	15.5
	Average wage earning per employee (public)	284,224.0	307,348.0	8.1

Source: Authors calculations based on KNBS (2015)

5.2.3 Training and capacity building

Engineers and scientists are critical to the development of the extractives industry. Kenya still has an acute shortage of engineers, whose number at less than 8,000 for a population of over 40 million is far below the UNESCO recommended ratio of engineers to national population (1: 2,000). There is a worldwide shortage of mining engineers, with Kenya having her first few indigenous mining engineers trained abroad (in 1970s in Romania). It was not until the year 2005 that Kenya began training mining and mineral processing engineers locally, beginning with a low number of only six.

The training programme is ongoing at the School of Mines and Engineering, Taita Taveta University College, a constituent college of Jomo Kenyatta University of Agriculture and Technology (JKUAT). The average number of graduates from this programme has risen to 50, and is expected to rise after the qualification of the institution in 2016 as a Centre of Excellence for Mining, Environmental Engineering and Resource Management (CEMEREM), under the Kenyan-German Centres of Excellence grants initiative meant to support the training of practice-oriented resources engineers and resource managers for the extractives industry.

Kenyatta University started admitting students to the BSc (Petroleum Engineering) programme more recently in 2013. Kenya's Ministry of Education, Science and Technology and the African Development Bank have laid out plans to start supporting local training in 2016 at MSc and PhD level in Mining Engineering at Taita Taveta University College, and Masinde Muliro University of Science and Technology in collaboration with Curtin University of Technology, in Australia. The German Academic Exchange Service (DAAD) is also sponsoring in-country training in MSc (Mining Engineering) and MSc (Mineral Processing) at Taita Taveta University College from 2016. A joint proposal by the World Bank and the Inter-University Council of East Africa (IUCEA) for the "Africa Centres of Excellence for Eastern & Southern Africa Programme (ACE II)" holds similar promises for training in applied resource management for the region. This notwithstanding, Kenya requires professionals at all levels in the extractives value chain to prepare the country for mining of the minerals discovered so far, with future discoveries anticipated.

5.2.4 Benefit sharing

The impact of oil and minerals on economic diversification and inclusive growth depends on how governments manage the revenue from extractive industries. When allocated effectively and equitably, revenue flows from extractives industries can finance public goods and services such as education and training, healthcare and infrastructure, all of which ultimately contribute to expanded economic opportunity for host country citizens. However, this type of indirect contribution is not automatic. The mismatch between revenue generated and local benefits is due primarily to issues of governance, transparency, and accountability in funding allocation, as well as weak administrative capacity in some governments. There are also environmental and sustainability challenges that are to be addressed.

In Kenya, the Natural Resources (Benefit Sharing) Bill of 2014 establishes a system of benefit sharing in resource exploitation between mining companies, the national government, county governments and local communities. The Bill applies to the exploitation of petroleum, natural gas, minerals, forest structures, water resources, wildlife resources and fishery resources. It also establishes a Benefit Sharing Authority, which has the power to extend application to any other natural resource. The Authority also has the power to determine and review the amounts of royalties payable.

There is some legal uncertainty about revenue sharing. The Mining Bill of 2014 states that royalties payable are to be distributed to the national government (70%) and to the county government (20%). The remaining 10 per cent is to be distributed to the community where the mining operations occur. In contrast, the Energy Bill of 2014, Clause 112(3) stipulates that the royalties received by the national government from fluid produced through renewable energy shall be apportioned between the national government, county government and the local community as follows: 5 per cent to the local community, 20 per cent to the county within the boundaries of which the licensed areas or geothermal resources are or were exploited, and 75 per cent as national revenue. This uncertainty needs to be addressed or else no investor will agree to venture into mining in Kenya with this legal loophole. There is also a challenge in terms of royalties and taxes collected by the government. This will depend on the method used to value the mineral proceeds. Initially, royalty payments used to be determined based on the revenues/profits by investors. When this is the case, there is a weakness in the law because most investors under-declare profits or even declare losses so that the proceeds become negligible. This also needs to be addressed.

5.2.5 Gender and inclusivity

There have been gender disparities in employment in the extractives sector over the years. For instance, only 15.6 per cent of females worked in the extractives sector in 2014 compared to male (84.4%), while the percentage change in wage employment for females was only 17.6 per cent compared to 40.3 per cent for male between 2013 and 2014 as shown in Table 5.4.

Table 5.4: Gender participation in extractives sector

Indicator	2013	2014	% change
Wage employment (Male) '000	7.7 (82%)	10.8 (84%)	40.3
Wage employment (Female) '000	1 .7 (18%)	2 .0 (16%)	17.6
Wage employment (All) '000	9.4 (100%)	1 2.8 (100%)	36.2

Source: KNBS (2015)

A context-specific understanding of gender dynamics within each county and local community is needed for the extractives industry, so that the government can then develop effective strategies for gender inclusion and benefit sharing. Differences in status between women (for example, due to age, marital status, educational attainment) need to be recognized, for example, in benefit sharing agreements between extractives companies, communities and local government (Keenan and Kemp, 2014).

The emerging literature on Kenya's extractives industry is beginning to develop a nuanced gender analysis of the distribution of risks and opportunities between men and women within the different categories of actors at national, county and local community levels. For example, IEA (2014) analyses statistics on women's participation in various sectors of Kenya's economy and maps potential benefits for these women along the extractives sector value chain. They find a very low level of participation of women in the extractives sector and conclude that without policy intervention, the growth of the extractives industry is unlikely to benefit women directly (IEA, 2014).

5.2.6 Role of national and sub-national levels of government

An immediate and significant impact of new discoveries of 'point-source' minerals, oil and gas is that it changes the dynamics between the centre of power and the region where these finds are located (Bebbington, 2015). This includes relations between national and sub-national levels of government, as well as business actors in the commercial capital and remote regions. In addition to constitutional decentralization, the Natural Resources (Benefit Sharing) Bill 2014 26(a) provides for sharing of royalties and fees from petroleum, natural gas, mineral and other natural resource extraction. The proposed formula for revenue sharing is that 20 per cent is placed in the Sovereign Wealth Fund, and 80 per cent shared between the national (60%) and county (40%) governments where the extractive operations are located. At least 40 per cent of the county's allocation will be transferred to local community development projects controlled by a local community benefit sharing forum and agreement. At county level, a county benefit sharing committee is established to oversee the funds, and a county benefit sharing agreement is to be reached, with all operators paying royalties and fees within the county.

This proposed new law follows the current thinking in resource governance policy about how to balance the developmental custodian role of national governments with the rights and expectations of local actors impacted by extractive industries. The critical issue is whether devolution of power and revenue transfers to sub-national elites will work as mechanisms to contain conflict risks around the extractives industry and promote local economic development. The evidence from resource-rich developing countries such as Peru, Nigeria and Indonesia suggests not, although the experience of benefit sharing agreements in Papua New Guinea is more encouraging.

The lesson for Kenya at this stage of its preparation to regulate oil, gas and mining revenue is not so much whether to transfer a portion back to the resource-rich counties, but how much to be transferred. The Benefit Sharing Bill, which is before Parliament, could not be radically amended without raising alarm bells about the commitment to decentralization of government. The issue is how to implement revenue sharing effectively to ensure that it fosters tangible development outcomes for a broad range of stakeholders, and does not cause conflict. Arellano-Yanguas (2011) argues that the weakness of some of the local governments in Peru and their poor spending decisions have been the primary cause of protests in many local conflicts. In Kenya, the inclusivity and quality of the county and local community agreement-making process and oversight bodies will therefore be vital to the success of Kenya's extractives development model.

While some county governments have attempted to assert authority over the management of local natural resources, the national government has insisted that it has the final say over the control and use of these resources, especially in the mining and oil sectors (Khamadi, 2013). Despite institution-building efforts, such as the creation of an inter-governmental relations structure aimed at addressing some of the pitfalls of devolution (Intergovernmental Relations Act, No. 2 of 2012), sceptics continue to doubt the current management competence of county governments. For example, Kuria (2014) notes that the failure of county governments to embrace public participation in planning processes and policy formulation has led to poor development, even in areas where natural resources clearly contribute to the well-being of the community.

The importance of sound management of resource revenue at national level is also clear from the literature. For example, Poteete (2009) attributes Botswana's diamond development success to strong political control over the revenue at central government level. East Timor's use of a sovereign wealth fund to regain stability within its fragile political settlement after 2006 is also instructive (Ingram, 2012). Kenya is on the right track with its plans for a sovereign wealth fund, but the stabilizing effects of this centralized fund and the revenue transfers to counties and local communities are still some years away.

The negative environmental effects need to be offset by the investor while ensuring the investment is still attractive, but offsetting is not possible without understanding what these benefits are and how they can be shared out equitably among stakeholders. The proposed bills, such as the Mining Bill 2014, Energy Bill 2014, Natural Resources (Benefit Sharing) Bill 2014, and more recently the Petroleum Exploration, Development and Production Bill 2014 propose different regimes of benefit sharing between the two levels of government and local communities. The confusion should be clarified to avoid conflict in areas where different communities get different shares.

5.3 Prospects and Optimal Output

5.3.1 Mining

In prospect, Kenya's extractives industry is expected to grow, aided by the new mineral discoveries. However, volatility in global oil and commodity prices could particularly pose a challenge to the sector. Another risk is the delay in passing legislation for oil and gas sectors. The National Energy Policy, the Energy Bill, and the National Minerals and Mining Policy remain as drafts.

Table 5.5 shows the various scenarios for the extraction of mineral reserves at constant prices of 2013 but calculated with exchange rates for 2013 and 2016. At constant exchange rate of US$ at Ksh 102 in 2016, Kenya would gain approximately Ksh 17.122 trillion (if the exchange rate was to

Table 5.5: Value of Kenya's extractive resources at different dollar exchange rate

Type of Resource	Estimated Reserve	2013	2013	2016	
		Value in US$ billions	Value in Ksh trillions [3]	Value in Ksh trillions [4]	Difference (2016 - 2013) – Value in Ksh trillions
Rare Earth Minerals	10-40 million tonnes[5]	62.4	5.304	6.365	1.061
Niobium	105 million tonnes	35	2.975	3.57	0.595
Oil (Turkana)[6]	600 million barrels	66.6	5.661	6.793	1.132
Titanium [7]					
Ilmenite	4.6 million tonnes	0.69	0.059	0.070	0.012
Rutile	1.12 million tonnes	2.296	0.195	0.234	0.039
Zircon	0.42 million tonnes	0.874	0.074	0.089	0.015
Total			14.268	17.122	2.854
				Net Loss/Gain	2.854

Source: Various sources/Authors calculation persist throughout the extraction and mining life of the minerals). In contrast, if the exchange rate of 2013 was used, and the rate sustained throughout extraction period, the country would lose approximately Ksh 2.854 trillion! The implication is that with varying exchange rate and prices of the minerals, the proceeds from the extractives industry will vary from one period to another.

5.3.2 Oil

For the period 2015-2016, increased momentum and activity in Kenya's extractives industry (oil, gas and other minerals) is expected in the medium term. Recent exploits saw the discovery of between 600 million and 1 billion barrels of crude oil by the Tullow Oil in 2014, significant reserves above what Kenya currently imports. The implication is that Kenya could become a net exporter of crude oil. However, the consideration for a scenario if Kenya's reserves remain as they are without further discoveries means revenues of US$ 2.1 billion similar to what Ghana receives with approximately 98,000 barrels per day.

Table 5.6: Estimated annual oil revenues in billions (US$) based on estimated reserves

	2015	2016	Difference
Oil Reserves	*600 million	**2.9 billion	**2.3 billion
Oil barrels per day (p/d)	100,000 barrels/d	230,000 barrels/d	130,000 barrels/d
US$ 40.00 bbl (oil price)	Ksh 0.66 billion	Ksh 1.1 billion	Ksh 0.44 billion
US$ 60.00 bbl (oil price)	Ksh 0.79 billion	Ksh 1.8 billion	Ksh 1.01 billion
US$ 100.00 bbl (oil price)	Ksh 1.8 billion	Ksh 4.2 billion	Ksh 2.4 billion

Source: IEA 2014 and author's computation
*Proven reserves; **Estimated reserves

As indicated in Table 5.6, three oil price scenarios of oil revenue projections indicate that with current oil reserves (2015), and a pessimistic price of 40 dollars a barrel, the resource would generate US$ 660 million (Ksh 6.60 billion), US$ 790 million (Ksh 7.02 billion) for 60 dollars and US$ 1.8 billion for 100 dollars a barrel per year.

From these estimates, it implies that if these reserves remain the same, the extractives sector would for the next 25 years make a significant contribution to economic growth compared to the paltry 1 per cent the sector currently contributes. Relatively high oil prices would mean a boost to government revenue.

While, admittedly, these oil revenues have the potential to bring wealth to the nation, the expectations of the local communities in terms of revenue shares and employment creation may not be easily met. Issues of environmental degradation, and corruption, could contribute to the euphemism of the "resource curse". Moreover, as discussed earlier, oil price volatility could have detrimental impact on mining company's profits as well as slump in revenue for the country.

5.4 Risks and Opportunities

The oil and gas discoveries have raised apprehension that conflict may be exacerbated by competing interests in the sector. The evidence drawn from literature review is that this apprehension is well founded. Oil located in remote zones of weak state control is associated with insurgency and civil war in the resource conflict literature, rather than with the consolidation of state power enabled by more proximate discoveries (Le Billon, 2001). Most of the regions in Kenya where minerals, oil and gas are found are not only in arid areas, but are largely under-developed due to historical neglect by successive governments. With the discovery of resources, these areas remain susceptible to potential violence and armed conflict, just as has happened elsewhere on the continent. Conflicts fuelled by land grabbing practices and revenue sharing disagreement among communities, county and nation governments, could have potential negative impacts for the country. Compounding the question of historical injustice is the presence of an unusually high number of illegal weapons in the new oil areas. Kenya is a neighbour to countries with histories of armed conflict and, as a result, small arms are regularly smuggled across the borders. Currently, the proliferation of arms feeds into ethnic conflicts and cattle rustling. The discovery of resources could, thus, make matters worse especially if local communities are not persuaded by the distribution of the attendant rents. For example, in early November 2013, local residents in Turkana forced a two-week shutdown of Tullow Oil's operations, expressing dissatisfaction with Tullow's 'failure to employ enough locals' (Ataka, 2013).

Despite this tinderbox of problems, the mineral discoveries could be a stabilizing factor if, for example, they expand livelihood opportunities in Turkana where oil has been found, and change the region's historically marginalized status (Johannes et al., 2014). What is more, the political settlements framework of analysis theorises that grievances over exclusion alone do not account for conflict destabilizing a political settlement. Going forward, successful planning of a mining operation is to view it from the perspective of the entire mining life cycle/value chain, which includes the rehabilitation of the mining area after the mine has closed. Kenya must ensure that local communities see long-term development benefits, and that mining activities do not damage the environment.

5.5 Policy Development

5.5.1 International scene

Recent debate at the global, regional and national levels has been centred on the post-2015 development agenda, where the environment has been given prominence. Focus has been on the establishment of a proposed set of goals, targets and indicators to replace the Millennium Development Goals (MDGs) after 2015. At a Rio+20 Conference in 2012, all UN member states agreed on commencement of a process to develop a set of Sustainable Development Goals (SDGs) to succeed the MDGs. There are 17 proposed SDGs, out of which five are environment-related.

Going forward, stakeholders in Kenya's extractives sector will need to place primacy on issues of transparency and accountability. An important facet of this persuasion is to join global initiatives such as the African Mining Vision and the anti-corruption Extractive Industries Transparency Initiative (EITI) to ensure that its practices encourage openness and fairness, which are critical elements in building trust between elite actors and ordinary citizens. Kenya has already started coming up with a country mining vision in line with the recommendations of the African Mining Vision report.

5.5.2 Domestic scene

As mentioned earlier, Kenya's Parliament has come up with various bills for enactment in line with the constitutional requirement. The challenge is to secure the stakeholders' consensus as well as to fast-track the enactment of these bills by lobbying Parliament.

5.6 Conclusion and Recommendations

5.6.1 Conclusion

Compared with other resource-rich developing countries, Kenya has relatively good economic indicators, institutions and policies in place to take advantage of new-found oil and gas, as well as valuable minerals. With careful planning, the extractive industry could boost economic growth without distorting the political economy into the well-known patterns of the 'resource curse'. However, there are issues that require attention in order for Kenya to gain from extractives.

Most regions in Kenya where minerals, oil and gas are found are not only in arid areas, but are largely under-developed. With the discovery of resources, these areas remain susceptible to potential violence and armed conflict. The discovery of resources could, thus, make matters worse especially if the resulting revenues are not managed transparently, and inclusively. Moreso, gender inclusivity is central to attaining developmental outcomes from the extractive industry, and deeper research of gender dynamics within local contexts is needed.

There are serious risks of conflict associated with new mining, oil and gas operations and infrastructure projects. An important finding from international comparison is that sub-national resource revenue transfers may intensify rather than resolve conflict. Implementation of the Natural Resources (Benefit Sharing) law should thus focus on the political aspects of agreement-making at county and local levels, in addition to institutional capacity building. These include supporting participation, negotiation and mediation where needed.

Any political settlement will be limited in how it can respond to major global and regional security threats and economic crises. Kenya faces unique constraints of history and geography that cannot be overcome by applying generalized 'good governance' prescriptions. More informed decisions may be made, though, with a better understanding of the relationship between political settlements and extractive industries to steer the country towards inclusive development and away from conflict.

Unpredictability of election results and development potential of oil discoveries encourages short term thinking by political elites. The overt influence of ethnic politicians and business leaders could fuel corruption and exacerbate perceptions of ethnic exclusion from resources. Oil and gas is expected to similarly attract close involvement between business and political elites. Long-term planning for extractives-led development needs stability and consolidation of Kenya's post-2008 constitutional political settlement.

Contrary to expectations, transferring increased proportions of resource revenues to counties has been linked to increased incidents of localized conflict, as has been the case for Peru (Arellano-Yanguas, 2011; Bebbington, 2015). For Nigeria's case these transfers have not secured any meaningful stability in the region. The implication is that much as the resource transfer to counties is important, there is need to ensure that institutions charged with this role are strengthened and systems to ensure equitable share of resources are strong and able to detect and prevent conflicts.

Kenya's proximity to warring neighbours also poses a risk of conflict especially to new mining oil and gas operations and infrastructure. The risk from radicalized youth runs from exclusion to historical marginalization. However, this does not mean that a political settlement that excludes this sizeable group of Kenyans would improve the security situation.

The volatility of commodity prices makes uncertain predictions for oil production in Turkana county to commence in 2020 (Tullow Oil, 2015). This is a long time, both in Kenyan politics and global commodity markets. The challenge for the ruling coalition in the interim is to strengthen the capacity of sub-national governments without losing their consent in the political settlement before the revenue begins to flow.

Overall, the timing of extractives development could be better, since the commodities price boom looks to be over before production and revenues have begun to flow. Global markets are unpredictable and preparing to extract maximum value from a non-renewable national asset can never be a wasted effort. The challenge is to persuade all stakeholders to plan for the long-term rather than chase after short-term gains.

5.6.2 Recommendations

The foundation of responsible mining is the presence of comprehensive, credible and internationally recognized legislative framework, policy and institutions. There are areas that require policy attention for Kenya to draw maximum benefits from the extractives.

There is need to expedite the proposed policy, legislation and institutional frameworks essential to viable exploration, exploitation and sustainable resource management in the extractives industry. MTP II of Kenya Vision 2030 has already outlined the policies, legislations, and institutions that need to be in place by 2017 to realize this goal.

The Mining Bill yet to be signed into law has critical gaps that need to be addressed. For one, it lacks a provision prohibiting illegal armed groups, militias or members of the national army from benefiting from mining, and there is no requirement to consult with local communities over security. Second, the law lacks safeguards against corruption in the bidding process for mining concessions. Thirdly, the law only contains a requirement to publish the very large mining contracts, raising fears that the government of the day could reverse the widely-praised decision in 2014 to allow public access to almost all mining contracts. Fourth, the law does not require companies applying for mining licenses to publish their real owners, which is a key way to prevent corruption and conflicts of interest.

There exists inadequate local capacity to provide technical support and specialized services to the mining, oil and gas industries. To ensure practice-oriented specialization, the training of engineers and scientists for the extractive sector should take on a more specialized approach, so that graduates can be produced for specific areas especially in Mine Surveying, Mining Engineering, Mineral Processing and Extractive Metallurgy, Petroleum Engineering, Environmental Engineering, Rehabilitation Engineering, and Geology and Geophysics.

Endnotes

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Chapter 6

Tourism

6.1 Introduction

In the last three years, global tourism has been affected by geopolitical challenges such as the Middle East conflicts, increased global terrorism attacks, as well as global pandemics such as Ebola. While these challenges have only adversely affected some countries, their persistence, compounded by the decreased economic growth in developed and emerging countries, greatly impacts the entire tourism sector.

Kenya is one of the adversely affected countries. Overall, in 2015, there was decline in tourism performance indicators. International tourist arrivals declined by over 15.0 per cent largely due to travel advisories enforced by foreign governments for non-essential travel to Kenya for a better part of the year. Government initiatives to generate impetus for the sector are yet to contribute to meeting the goals of the sector. Hotel closures, which led to lay off of employees, declining passenger numbers leading to airlines withdrawing from Kenya, and the terrorism attack on Garissa University in April 2015 as well as subsequent travel advisories have continued to undermine Kenya's tourism investment climate and earnings.

Despite these challenges, the tourism sector continues to play a key role in Kenya's economic development in terms of job creation, and the industry's support to many key sectors such as accommodation and transport as well as its contribution in revenue generation. Although the medium term prospects look relatively unpredictable, there is still opportunity for growth if Kenya could prioritize and implement some key policy interventions for the sector.

6.2 Global Tourism Sector Performance Review

The global tourism industry has continued to grow despite various economic challenges that have been witnessed across the world. International tourist arrivals grew by 4.0 per cent in the first half of 2015 (UNWTO, 2015). This increase was largely driven by economic recovery in Europe. The number of tourists travelling the world over increased to 810 million from 779 million in the previous year (UNWTO, 2015).

Preliminary figures provided in the first three quarters of 2015 indicate that regionally, the Caribbean and Oceania led in growth in arrivals at 7.0 per cent, followed by Central Europe, Eastern Europe and Central America at 6.0 per cent, respectively. Europe, Asia and Middle East recorded 5.0 per cent growth in international arrivals. The growth in Europe was attributed to a recovering economy and steadily growing cruise tourism. The Americas region grew at 4.0 per cent in the first three quarters (UNWTO, 2015).

The number of international tourists to Africa in 2015 decreased by 5.0 per cent as a result of travel advisories related to terrorism threats and attacks, and Ebola outbreak in West Africa. Travel advisories have long term effects on tourism markets even after they have been retracted. The situation for Africa was worsened by decelerated economic growth in the region due to dependence on export and other oil commodities, whose prices in the last year have significantly declined (UNWTO, 2015). Despite the decline, the World Tourism Organization predicts a positive growth for Africa at 5.0 per cent in 2016.

Figure 6.1: International tourism receipts in 2015 (earnings in US$ billions)

UNWTO (2015)

With respect to tourism expenditure, China spent the highest amount of US$ 165 billion in 2014. China remained a top source market travel for Japan, Thailand, the United States and various European destinations (UNWTO, 2015). Countries such as India, South Africa and Egypt have also increased tourism expenditure, as well as European countries such as United Kingdom, France and Italy with 4.0 per cent, 11.0 per cent, and 6.0 per cent increase in tourism spending, respectively.

6.3 Performance of Kenya's Tourist Sector

The total contribution of tourism to GDP in 2015 was 10.5 per cent, and directly contributed 3.5 per cent to total employment. The sector accounted for an estimated 9.0 per cent of total formal employment, creating 14,000 and 71,700 jobs in the public and private sectors, respectively, in 2014 (Ministry of East Africa, Commerce and Tourism, 2015). Leisure and business tourists (inbound and domestic) generated 62.5 per cent and 37.5 per cent of direct travel and tourism in 2014, respectively (World Travel and Tourism Council, 2015).

6.3.1 Tourist arrivals and earnings

Tourist arrivals and subsequent earnings decreased in 2015. This decline can be traced to way back in 2012 when Kenya recorded 1.781 million tourist arrivals down from the highest level of 1.823 million achieved in 2011. Tourism earnings in the same year fell to Ksh 96 billion from Ksh 97 in 2012. Thereafter, tourism earnings marginally dipped in 2013 and 2014 to 2.1 per cent and 7.3 per cent, respectively (Figure, 6.2). 2015 was no different and saw a decline of Ksh 2.5 billion in earnings down from Ksh 87.1 billion in 2014. Notably, Kenya's tourism earnings significantly vary, as WTTC estimated tourism earnings in 2013 at Ksh 160 billion.

6.3.2 International tourist arrivals

Kenya receives the bulk of its international tourists by air, with a marginal number of cruise visitors coming by sea and visitors from neighbouring countries by road through border entry points. Tourist arrivals to Kenya in the last three years have fluctuated due to insecurity, travel advisories and global financial challenges, with negative effects on tourism's key indicators as shown in Table 6.1.

Although the visit by the President of the United States, Barack Obama, to Kenya in July 2015,

Figure 6.2: Tourism arrivals and earnings, 2010-2014

Source: KNBS (2015)

Table 6.1: Tourism indicators, 201-2015

	Unit	2011	2012	2013	2014	2015 [1]
Visitor arrivals	('000)	1,822.9	1,710.8	1519.6	1350.4	628,346
Visitors to parks	('000)	2,664.1	2,492.2	2,337.7	2,164.6	
Visitors to museum and historic sites	('000)	843.4	824.6	770.8	690.9	
Tourism earnings	Ksh billion	97.9	96.0	94.0	87.1	
Hotel accommodation	('000)					
Hotel bed nights occupied	('000)	7,015.2	6,860.8	6,596.7	6,281.6	
Rooms occupied	('000)	4,787.7	4,882.0	4,792.5	4,727.1	
Bed occupancy rate	('000)	40.3	36.4	36.1	31.6	

Source: KNBS (2015), Economic Survey

then the Pope's visit in November 2015 and the hosting of the 10th World Trade Organization (WTO) ministerial conference in December 2015 were expected to generate impetus to the tourism industry, the travel advisories due to insecurity that preceded these events still had an effect on tourist arrivals. Data indicates that the number of foreign visitors fell by 16.9 per cent to 555,795 between January and September 2015, a signal that the tourism sector is far from recovery. In September alone, tourist arrivals decreased to 59,276 from 60,521 in the same period in 2014 (KNBS, 2015). Mombasa experienced the biggest drop in foreign visitor arrivals in the year to September 2015 compared to the rest of the country.

The lower than expected number of tourists led to the closure of some of the hotels at the coast, with subsequent employee layoffs. The coast region is often most affected due to its large concentration of tourism offerings and hotels in the country. Bed occupancy rates declined from 36.0 per cent in 2013 to 31.0 per cent in 2014, indicating that hotel capacity was heavily under-utilized.

Wildlife safaris remain a key tourism product, with attraction sites being largely national parks and museums. Overall, the proportion of visitors to both parks and museums significantly dropped in 2014 from the previous year by 7.4 per cent and 10.3 per cent, respectively, impacted by the declining number of tourist arrivals. However, 2015 saw the number of visitors to the museums, snake parks and

Table 6.2: Domestic tourism bed nights, 2009-2014

	2009	2010	2011	2012	2013	2014
Kenya residents ('000)	2,150.9	2,348.9	2,603.4	2,787.7	2,699.1	1,802.2
Total hotel bed nights occupied ('000)	6,243.0	6,662.3	7,015.2	6,860.8	6,596.7	6,281.6
Share of bed nights by Kenya residents (%)	34.0	35.0	37.0	41.0	41.0	27.0

Source: KNBS (2015

other historical sites increase by 15.4 per cent. Parks and reserves continued to experience a decline, receiving only 1,953.8 thousand down from 2,164.6.

6.3.3 Domestic tourist market

Domestic tourism has been critical in driving the industry amidst decrease in international tourist arrivals to Kenya. In 2015, the sub-sector contributed 58.1 per cent of direct travel and tourism, and tourism revenue (WTTC, 2015). It therefore helped cushion the effects of terrorism that adversely affected international arrivals.

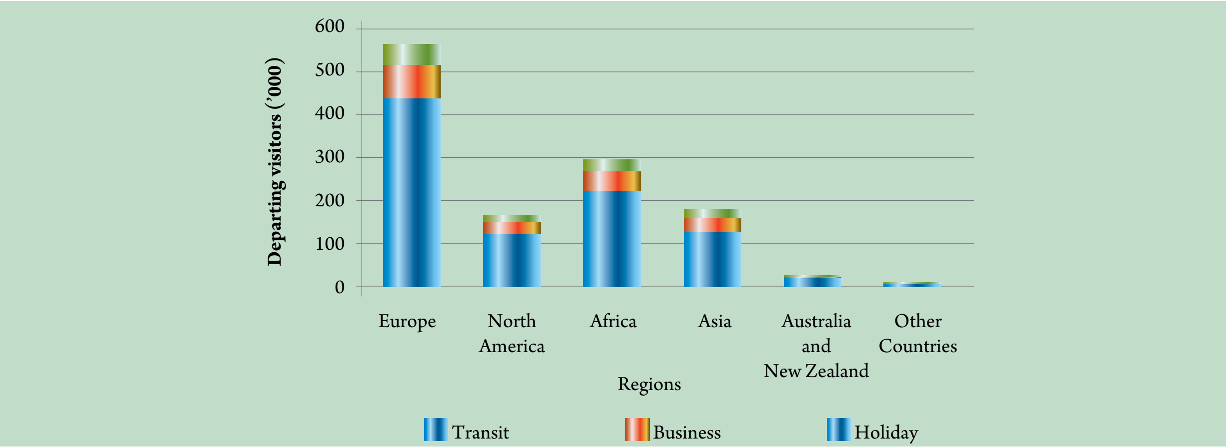
In 2015, Kenya had about 5.9 million bed nights occupied, which was a decrease from about 6.6 million the previous year (Table 6.2). In the last three years, the share of bed nights occupied by Kenyans was on average at 45.0 per cent. However, this increased to 46.3 per cent in 2015.

While domestic travel spending was expected to grow by 5.5 per cent in 2015 to Ksh 233.9 billion, the directive by the government for State departments and agencies to reduce meetings and other events in local hotels may affect the sector in 2016. On the other hand, the infrastructure tripartite agreement between Kenya, Rwanda and Uganda and the subsequent introduction of an East African Tourism visa could facilitate travel by tourists to the three countries, and Kenya might benefit from an increase in regional tourists.

6.3.4 Key tourist source markets

The key source market that reduced significantly in 2015 was Europe by 80,900 visitors while the American market has continued to grow to reach about 169,600 visitors up from the previous year that had about 168,400 visitors. On the positive side, the African and the Asian markets have continued to grow. African market increased by 8.9 per cent. Some non-traditional markets such as India performed well, moving to become among the top five tourist source markets. Other markets such as Poland have

Figure 6.3: Departing visitors by country of origin and purpose of visit ('000), 2014



Source: KNBS (2015)

grown by 180 per cent since 2007 to become the fourth largest source market to Mombasa.

Regional market share analysis of Kenya's inbound tourists in 2015 indicates that Europe still accounted for majority of Kenya's tourist arrivals, with holiday tourism forming the bulk of arrivals (Figure 6.3).

Africa and Asia regions follow in terms of arrivals, indicating their growing importance as a regional source market for Kenya's tourism. Apart from Australia and New Zealand, business tourists from Europe, America Asia and Africa also increased. The month of February, which is usually a high season month, witnessed considerable drop in terms of tourist arrivals. However, the seasonal nature of some of key source markets such as Europe shows a decline of tourist market share during the low season months of April, May and June.

Additionally, the fact that international tourist arrivals in August 2015 fell by 25.0 per cent compared to the same period last year, despite it being the peak period due to the annual wildebeest migration in the Maasai Mara (KNBS, 2015), indicates that seasonality remains a major challenge for the industry, contributing to the persistence of seasonal unemployment and under-employment.

6.3.5 Tourist arrivals by air

The international visitor arrivals through Moi International Airport (MIA) in Mombasa decreased to 126,900 in 2015 compared to 220,400 in 2014. The declines were experienced in all months except November, which showed a slight increase in the numbers from 7.2 to 7.7 thousand in a similar period last year. The cumulative decline in the arrivals was due to the travel advisories against travelling to the Kenyan coast in April, and the withdrawal of 25 chartered flights from the airport in the last couple of years (KTB, 2015).

The Jomo Kenyatta International Airport (JKIA) registered a 1.6 per cent increase in passenger traffic. The numbers increased in the last quarter of the year due to the Pope's visit as well as Kenya hosting the World Trade Organization (WTO) ministerial conference..

The total number of visitors who flew into the country through the two major airports made 63.4 per cent of the total visitors in 2015 compared to 58.7 per cent in 2014, underscoring the importance of air travel to the tourism sector.

Whereas 2014 saw declining arrivals at JKIA, both airports accounted for the largest share of arriving visitors in the last five years (KNBS, 2015). As indicated in Table 6.3, cross border arrivals are increasingly becoming significant entry points for regional visitors.

Table 6.3: Number of tourist arrivals at entry points ('000), 2010-2014)

Entry poiny/ year	2011	2012	2013	2014	2015
JKIA/ MIA	1,272.9	1,272.9	1,107.1	861.4	748.8
Cross border	550.0	475.3	412.4	489.0	431.8

Source: KNBS (2010; 2015)

On the other hand, domestic tourists significantly increased by 9.0 per cent on the JKIA-Mombasa and JKIA-Malindi routes on account of increased frequencies on low cost carriers such as SAX Aviation and Jambo Jet.

6.3.6 Conference tourism

Conference tourism is slowly growing in terms of absolute numbers, with the local conferences held in the country rising by 7.4 per cent and the number of local delegates increasing by 2.5 per cent. The number of foreign delegates declined to 71,620 in 2015, down from 77,848 in 2014. Despite the mixed performance in local and international conferencing, the total percentage occupancy remains low at 2.0

Table 6.4: Number of conferences held in Kenya, 2010-2014

	2011		2012		2013		2014	
	Local	Inter.	Local	Inter.	Local	Inter.	Local	Inter.
No. of conferences	2,995	309	3,338	328	2849	299	3,077	241
No. of delegates	408,596	33,566	413,037	35,663	401,809	40,109	432,998	77,848
% of total delegates	92.41	7.59	92.05	7.95	90.90	9.10	84.80	15.20
No. of delegate days	497,523	197,562	554,443	209,910	523,224	179,922	547,262	131,193
No. of delegate days available	5,520,344	5,520,344	5,652,611	5,652,611	5,498,958	5,498,958	5,925,801	5,925,801
% occupancy	9.0	3.6	9.8	3.7	9.5	3.3	9.2	2.2

Source: KNBS (2012; 2014), Economic Survey

per cent for international delegates and 9.1 per cent for local delegates, which is still a decline compared to the previous year. However, with the devolved government, the demand for conference facilities is expected to increase, and this could help caution the contracting international market in the short term. Kenya hosted, for the first time in Africa, the WTO ministerial conference with an estimated 7,000 delegates attending. It was also projected that the conference would earn Kenya an ambitious Ksh 2.1 billion (Kangethe, 2015). These conferences are expected to help boost the sector, and it is hoped that there will be gains in the coming year.

6.4 Hotel accommodation

Accommodation and restaurant sub-sectors account for key indicators of performance in the tourism sector. Table 6.5 provides statistics indicating that the accommodation and restaurant sector continued to contract, reaching a negative 10.6 per cent at the end of the third quarter, with hotel occupancy declining to 1.9 per cent. However, in terms of the percentage decline compared to the previous years, there are indications that the sector is recovering.

Table 6.5: Gross domestic product by accommodation and restaurant

Year	Quarter	Accommodation and Restaurant	% Growth
2013	1	16,659	-20.6
	2	12,566	-0.6
	3	15,617	13.4
	4	13,227	1.1
Totals		58,068	-4.6
2014	1	15,806	-14.1
	2	11,561	-19.3
	3	13,637	-20.5
	4	8,930	-16.0
Totals		49,934	-17.2
2015	1	13,538	-7.5
	2	10,229	-0.8
	3	12,188	-2.3
	4	-	-10.6

Source: KNBS(2015), Quarterly GDP

Regionally (Table 6.6), the coastal region saw a decline in hotel bed occupancy as a result of travel advisories and the curfew imposed in Lamu by the government following insecurity. The occupancy rate is high during the tourist season but low during the off-peak season. For example, Maasai Mara occupancy rates in April to August when the wildebeest are migrating are usually high. Other regions that experienced declines were Nairobi and central region. Maasai land and Nyanza basin have

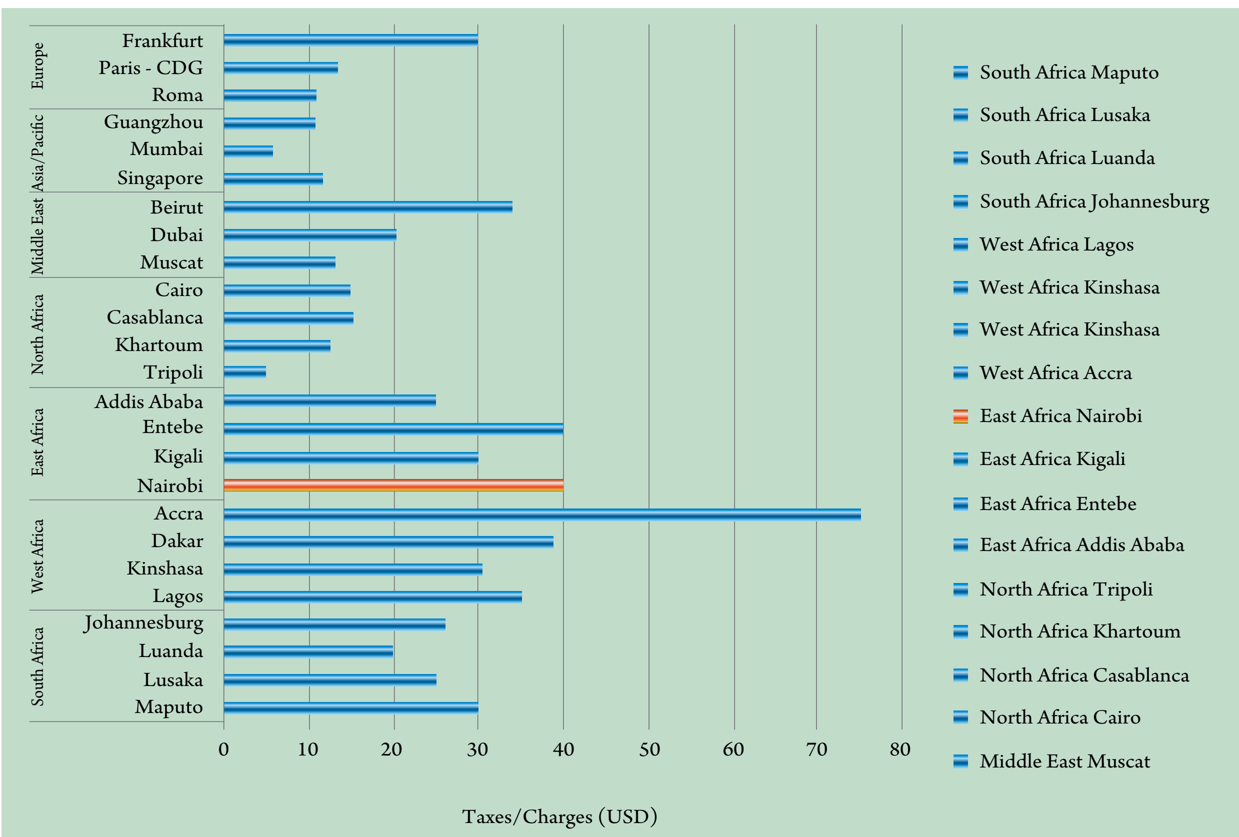
Table 6.6: Accommodation facilities distribution and occupancy, 2007-2014

Zone	2011	2012	2013	2014	2015
Coastal beach	3,144.6	3,132.6	2,750.3	2,527.7	2,113.8
Coastal other	283.8	260.0	124.0	95.9	116.6
Coastal hinterland	-	88.7	125.5	133.2	108.4
Nairobi high class	1,155.7	1,145.0	1,175.3	1,119.1	1,014.9
Nairobi other	526.2	490.5	455.7	388.0	378.0
Central	683.3	526.0	622.2	686.3	583.6
Maasailand	418.6	443.7	473.0	479.5	491.6
Nyanza basin	301.9	252.1	345.3	357.7	487.8
Western	374.9	464.3	454.1	433.3	448.8
Northern	43.9	57.8	71.2	60.9	135.1

Source: Constructed from KNBS (Various), Economic Survey

remained unaffected, with the occupancy increasing despite the travel advisories that were issued. The western region saw 3.6 per cent increased occupancy, but the most significant and largest increase was in the northern region at 122 per cent. This trend shows that tourism is steadily growing outside the traditional areas, and perhaps we should look into the counties as the frontiers of the sector. The fact that these growing areas are relatively rural and have minimal terrorist attacks is why they are perhaps considered safe to visit. The growth in the northern region can be explained by the continued

Figure 6.4 Comparative airport taxes in US dollars



Source: Ministry of East Africa, Commerce and Trade - MEACT (2015)

expansion of the conservancies, which have their own marketing strategies. Laikipia is also known for its abundance of wildlife.

6.5 Air Access

Robust infrastructure is fundamental to a thriving tourism industry. Airports provide access to the country especially for international tourists who form the bulk of tourist arrivals. Destinations that adopt open sky policies have witnessed increase in tourism numbers.

Kenya is a regional leader in having advanced air access infrastructure. The JKIA was initially built to hold a maximum capacity of 2.5 million passengers per year. Currently, it is ranked the third busiest airport in Africa, handling in excess of 6 million passengers and is projected to have an estimated 18.5 million passengers per year by 2030 (AFDB, 2015). The airport is undergoing expansion and modernization to accommodate this growth.

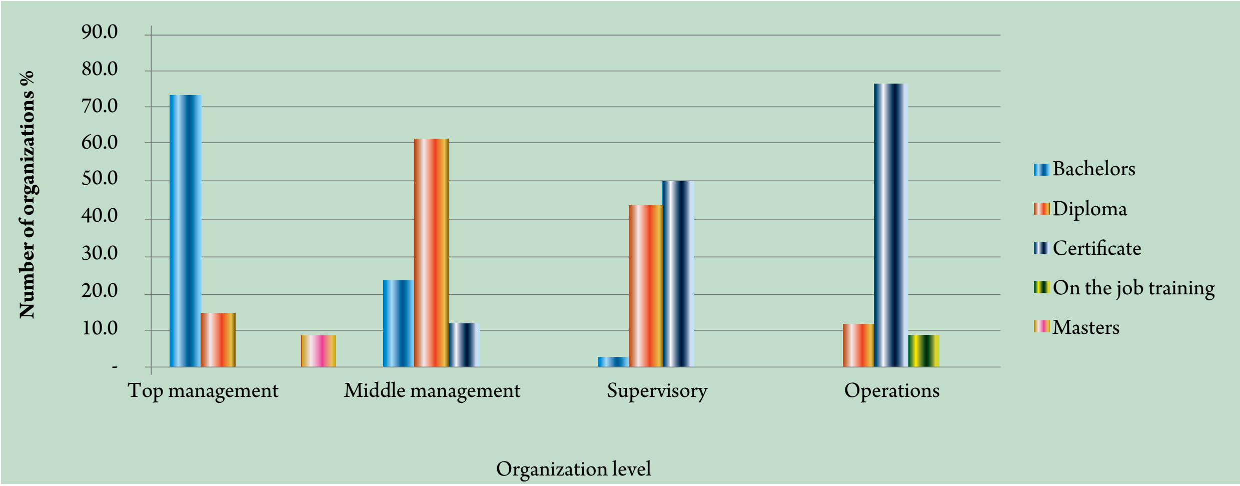
Despite the amount of traffic at JKIA, Kenya lags behind in air liberalization. According to the Infrastructure Consortium for Africa liberalization index, Kenya's 7.7 index ranks lowest in comparison to tourist competitor countries such as South Africa and Tanzania at 11.6 and 11.4, respectively. Liberalization would mean adopting an open sky policy and whereas Kenya subscribes to the policy, it is yet to be adopted at the Mombasa International Airport. This means that there are very few chartered flights from around the world to Mombasa.

On the other hand, aviation taxes and regulatory costs in the country are not competitive as shown in Figure 6.4. Besides Accra, which charges an airport tax of US$ 50, Kenya and Entebbe rank second in having the highest taxes in the region (MEACT, 2015).

6.6 Tourism Training

Tourism is a labour-intensive sector and heavily relies on human capital to aptly provide quality services to the industry. The increase in destination competition has, more than ever before, compelled the industry to look for professionally trained personnel to meet high industry standards. In Kenya, tourism accounts for an estimated 9.0 per cent of total formal wage employment (KNBS, 2015). Vision 2030 targets 30,000 trained staff for the industry, where it is estimated that two professionally trained staff are required per bed (Government of Kenya, 2008).

Figure 6.6 Desired qualifications in the tourism industry



Source: Kenya Utalii College (2012)

Refresher courses have always made the majority of the trainee in the industry but the figures from Utalii College indicate that the numbers have been on a continued decline from 936 trainees in 2014 to 813 in 2015. However, the rate of decline has reduced as to 13.1 per cent compare to 35.4 per cent the previous years. It is notable that the demand for short courses has risen in the same period. Overall, the decline in the demand for courses was 1.1 per cent but an improvement compared to the 21.7 per cent the previous year.

Table 6.7: Number of graduates from tourism related courses from Utalii College, 2012-2015

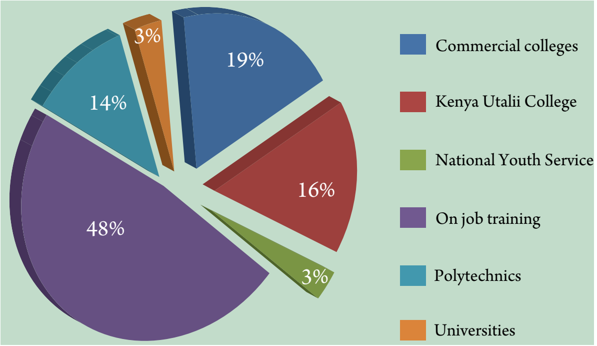
Year	2012/13	2013/14	2014/15	2015/16
Number of graduates	2,970	3,001	2,350	2,324

Source: KNBS (2012; 2014), Economic Survey

The statistics on the declining number of graduates is indication that industry demands for professional staff are not being met. According to a survey conducted in 2012 by the Kenya Utalii College (KUC), Kenya's first hospitality and catering training school, the bulk of professionals in the sector are employed through on-the-job training (Figure 6.5).

However, statistics from the same survey indicate that more than 70 per cent of the tourism and hospitality industry investors prefer bachelors degree holders for top management (Figure 6.6). Interestingly, for middle and lower level job cadres, most employers prefer certificate holders. The least preferred are those on-the-job training.

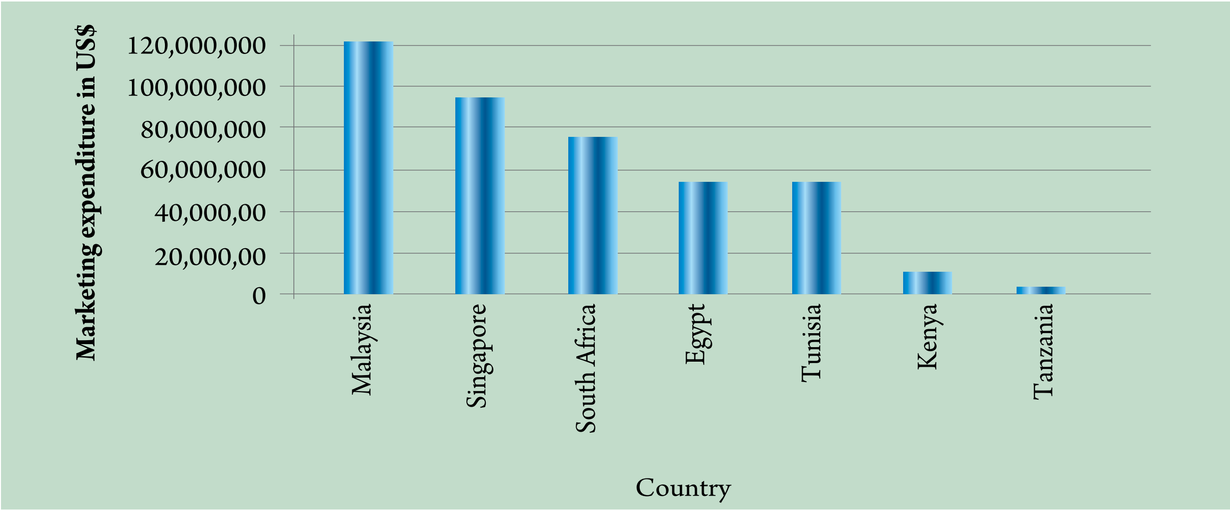
Figure 6.5: Sources of trained employees in the tourism industry (%)



Source: Kenya Utalii College (2012)

The survey also found that the largest proportion of those currently employed in the tourism industry have done so through on-the-job training (Figure 6.6). This implies that while employers least prefer to train on the job, they are forced to do so and this may compromise the level of service delivery in the industry. This may explain why there has been

Figure 6.7: Tourism marketing expenditure for selected countries in US$



Source: Ministry of East Africa, Commerce and Trade - MEACT (2015)

Table 6.8: Budgetary allocations to the tourism sector in Ksh millions (2011/12-2014/15)

	Approved budget			Actual expenditure			Absorption		
	2012/13	2013/14	2014/15	2012/13	2013/14	2014/15	2012/13	2013/14	2014/15
Tourism Promotion and Marketing	2,102.80	986.12	1,272.91	2,081.60	925.15	1,204.78	98.9	93.8	94.6
Niche Tourism Product Development and Diversification	-	581.07	884.75	-	581.07	846.10	-	100	95.6
Tourism Infrastructure Development	-	562.98	811.42	-	562.23	811.42	-	99	100
Tourism Training and Capacity Building	-	185.62	239.78	-	182.87	239.78	-	98.5	100
Total Programme	2,102.80	2,315.79	3,208.86	2,081.60	2,251.32	3,102.08	98.9	97.2	96.6

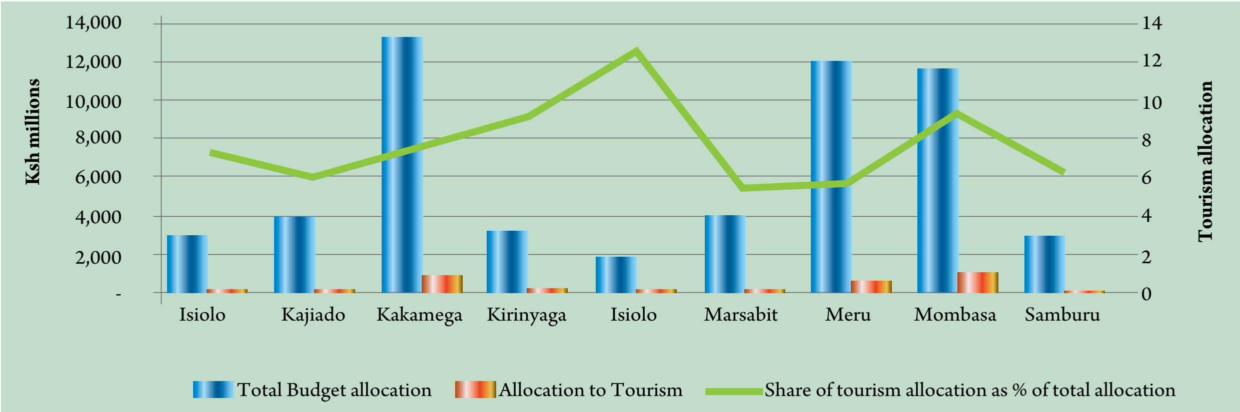
Source: Office of the Controller of Budget (2015)

an increase in expatriate employment in the sector, especially for job roles in spa therapy, mixologists and chefs (MEACT, 2015).

6.7 Tourism and Fiscal Decentralization

Tourism development is one of the functions that were devolved following the promulgation of the Constitution in 2010. Despite starting off without a clear framework for implementing tourism functions at county levels, county governments have now set up tourism departments and are developing policies and regulations for the sector at the sub-national level. The key challenges, however, for county tourism development is staff capacity, as each county is required to conduct its own recruitment for employment in tourism departments. Additionally, inadequate funding for county tourism (as counties

Figure 6.8: Budgetary allocation to the tourism sector for county governments



Source: Office of the Controller of Budget (2015) lack capacity to generate revenue) could impede county development outcomes in the tourism sector.

6.7.1 Resource allocation and expenditure review

Kenya's tourism industry contribution to economic growth has continued to decline due to decrease in international tourist arrivals. Similarly, the sector's exchequer funding as a percentage of total government budget has been on a decline. Between 2011/12 and 2013/14, budget allocation to tourism as a share of the national budget averaged at 0.19 per cent (Table 6.8). The most significant allocation was in 2014/15 of Ksh 3.2 billion, with 25.0 per cent going into both local and international marketing campaigns geared towards raising Kenya's profile as a competitive destination given dwindling tourist arrivals. In the same year, Kenya spent only about Ksh 120 million on marketing, which was quite meager compared to other competitor countries (Figure 6.7).

The least budgetary allocation was in tourism training and capacity building, while there was no indication of any funds allocated towards policy and research development (Table 6.8). Efforts to increase capacity of tourism training institutions saw expenditure of Ksh 811.4 million on construction of the Ronald Ngala Utalii College. Although all funds were fully absorbed, the college is yet to be completed. Tourism training and capacity building funds were also fully absorbed, implying that challenges of industry getting professional staff as well as institutional capacities will persist. In the 2015/2016 financial year, the State Department for Commerce and Tourism received the highest allocation at Ksh 7.8 billion for development expenditure. By the end of the second quarter, the absorption rate was at 48.4 per cent.

At the county level, figures for expenditure to the tourism sector are yet to be provided. This notwithstanding, county governments with highest proportions of budgetary allocation to the tourism industry in 2013/14 allocated an estimated Ksh 42 billion (Figure 6.8). Mombasa and Kakamega counties collectively allocated to the sector approximately Ksh 1 billion. In the financial year 2014/2015, most counties had allocated money to the sector, with the bulk of the allocation going to the development of the sector. Kakamega, Narok and Turkana counties were among the counties that allocated more than Ksh 400 million to the sector. Laikipia and Murang'a counties had the lowest allocations of the recurrent expenditure.

6.7.2 Revenue collection

Tourism is a diverse sector encompassing many actors including airlines, transport companies, hotels and other sub-sectors that support the industry. Thus there is potential for the government to collect substantive revenue from the sector. Due to the multifaceted nature of the tourism industry with other sectors, taxation and revenue collection begins from the point at which a visitor sets foot into the country, from landing fees, departure taxes, VAT and various tourism-specific levies for using public utilities. Tourism-related businesses are faced with the burden of complying and paying various taxes (Table 6.9), and the government the task of collecting these revenues.

Table 6.9: Summary taxes and levies paid by a typical hotel

Tax/Levy	% of sales	Collecting agency
Catering and tourism development levy	2% per visitor	Tourism Fund
Kenya Wildlife Service	4.0%	Kenya Wildlife Service
Service charge on food and accommodation	7.0%	
Service charge on beverages	5.5%	
VAT	16.0%	Kenya Revenue Authority

Source: Ministry of East Africa, Commerce and Trade - MEACT (2015)

Due to lack of rationalization of tourism devolved functions, fees and licenses continue to be paid to both national and county governments. The multiplicity of licenses does not lessen the tax burden for tourism business either. Table 6.10 gives a conservative summary of licenses, in excess of Ksh 600,000 annually, that one would require to pay to run a three star hotel.

Table 6.10: Licenses required to operate a three star hotel

License name	Collecting agency	Validity	License fees (Ksh)
KAMP-PRISK	National government	Annual	45,000
Liquor license	County government	Annual	50,000
Music copyright	National government	Annual	78,400
NEMA	NEMA	Annual	100,000
Public health	County government	Annual	3,000
Fire and ambulance services	County government	Annual	5,500
Food chemicals and hygiene	County government	Annual	5,000
Food handlers certificates	County government	6 months	100,000
Single business permit	County government	Annual	200,000
Tourist license	Tourism Revenue Authority (TRA)	Annual	47,000

Source: Ministry of East Africa, Commerce and Trade - MEACT (2015)

6.8 Policy, Legal and Institutional Reforms

In the last couple of years, policy implementation and reforms in the tourism sector have been geared towards reviving the sector. The Tourism Act 2011 prescribes that a National Tourism Strategy should be developed after every five years. Its implementation is currently ongoing for the period 2013-2018. The national strategy has been critical in prioritizing some key policy initiatives.

The Tourism Regulatory Authority was established in 2014 to regulate the industry and streamline industry standards. Currently, there is an effort to classify and standardize tourism facilities and services in the country to meet the deadline set by the East African Community of June 2016. In late 2015, the Authority conducted a classification and grading exercise for tourism accommodation and catering facilities in South Rift, Central and Upper Eastern Kenya tourism circuits. However, the results are yet to be shared. The new classification will assist Kenya to competitively price its tourism products as well as better regulate some of the tourism sub-sectors, such as home stays[2].

Other initiatives in the pipeline include setting up of the tourism tribunal, tourism protection service and the tourism research and monitoring institute.

The decentralization of power through devolution provides a framework for the transfer of tourism functions as well as funds from the national government to county governments. This means that county governments will have autonomy in how they allocate resources for development of the tourism sector within their zones. Besides the inter-governmental transfers, the immediate potential for some counties for revenue collection from tourism is significant. The regulatory framework for the collection of these revenues has, however, been marred by multiplicity of licenses paid to both national and county governments, affecting the cost of doing business in the sector.

The enforcement of an East African Tourism visa for Kenya, Rwanda and Uganda was an imperative policy direction. The single tourist visa, which allows one, for US$ 100, to make multiple trips among the three countries should increase the number of tourist arrivals in the region, for both leisure and business.

The efforts towards enhancing policy development for the sector notwithstanding, tourism continues to miss key targets, such as the three million tourist arrivals envisaged in another 15 years by the Vision 2030. The challenge is therefore to prioritize implementation of these policies amidst changing global tourist trends, terrorist threats and global economic slowdown.

6.9 Policy Recommendations

(i) Prioritize implementation of the Tourism Act 2011 and particularly develop and operationalize a specialized security agency to address insecurity that has affected performance of the tourism sector as proposed in the Act.

(ii) Prior to issuing travel advisories, foreign governments should, in consultation with the national and county governments, prepare a communication strategy that carefully considers spatial dimensions of which areas the advisories should be communicated and implemented.

(iii) As county governments embark on developing county-specific tourism policies and legislation, there is need for clear guidelines in the sector in relation to devolved functions for efficient delivery of tourism, as well as a county-specific monitoring and evaluation framework that will track key tourism performance indicators. The use of County Integrated Development Plans (CIDPs) to inform the monitoring framework would be useful.

(iv) Expedite the adoption of open sky policy for Mombasa International Airport to encourage charter flights from Europe and consequently increase tourist numbers to the coast region. Relaxing air access restrictions associated with air travel will be imperative for attracting more international visitors.

(v) A review of the regulatory framework is recommended, especially on issues of VAT, taxes and licenses. Kenya has one of the highest aviation taxes in the world, and a review of airport taxes would be imperative in boosting the economy. Additionally, multiplicity of licenses is a burden for tourism businesses, especially in the accommodation sub-sector.

(vi) Fast-track completion of the Ronald Ngala Utalii College to increase the number of students graduating to meet industry demands of skilled professionals.

(vii) Increase budgetary allocation to the sector, specifically in marketing, tourism training and capacity building, and policy development.

Endnotes

1. Data from January-October 2015 for visitor arrivals through MIA and JKIA. For the same period in 2014, tourist arrivals were 727,766.

2. Homestay refers to a tourist who during visit opts to stay with a host family, in their residential home, with the aim of interacting with the "local culture, lifestyle or language" usually for reasonable accommodation rates (Pusiran and Xiao, 2013).

Chapter 7

Manufacturing

7.1 Introduction

This chapter reviews the performance of the manufacturing[1] sector in 2014/2015 with regard to contribution to GDP, sector growth, exports performance and employment. Trends in producer price index and business environment ranking are also reviewed to highlight the dynamics of costs of production. The chapter also reviews policy developments relevant to the sector.

The manufacturing sector, on average, accounts for 66.0 per cent of the industrial[2] sector's real GDP and 10.7 per cent of national GDP (KNBS, 2016). The Kenya Vision 2030 recognizes manufacturing as one of the key sectors for realizing the 10.0 per cent economic growth and generate additional employment opportunities. Furthermore, the United Nations Sustainable Development Goal 9 prioritizes efficient use of resources and doubling of industrial sector contribution to GDP in developing countries (United Nations, 2015). The convergence between Vision 2030 and SDGs in prioritizing industrialization in development process presents Kenya with an opportunity to concurrently work towards realization of the two policies.

The case for manufacturing in economic development emanates from two strands of empirical literature. First, at low levels of development, manufacturing accelerates convergence of low income countries to advanced economies (Lavopa and Szirmai, 2012). Second, countries that export high value manufactured goods such as electronics, machinery and chemicals gain more from international trade than countries that export commodity exports (Hausman et al., 2007). Despite the importance of manufacturing in economic development, the sector growth in Kenya averaged about 4.0 per cent between 2011 and 2015, with the share of manufactured goods in merchandise exports at 36.0 per cent (KNBS, 2015d). The sector growth unfavourably compares with Vision 2030 target of 10.0 per cent annual manufacturing sector growth. Complementary policies are therefore required to enhance growth and export performance of manufacturing in Kenya.

7.2 Sector Performance

7.2.1 Contribution to GDP

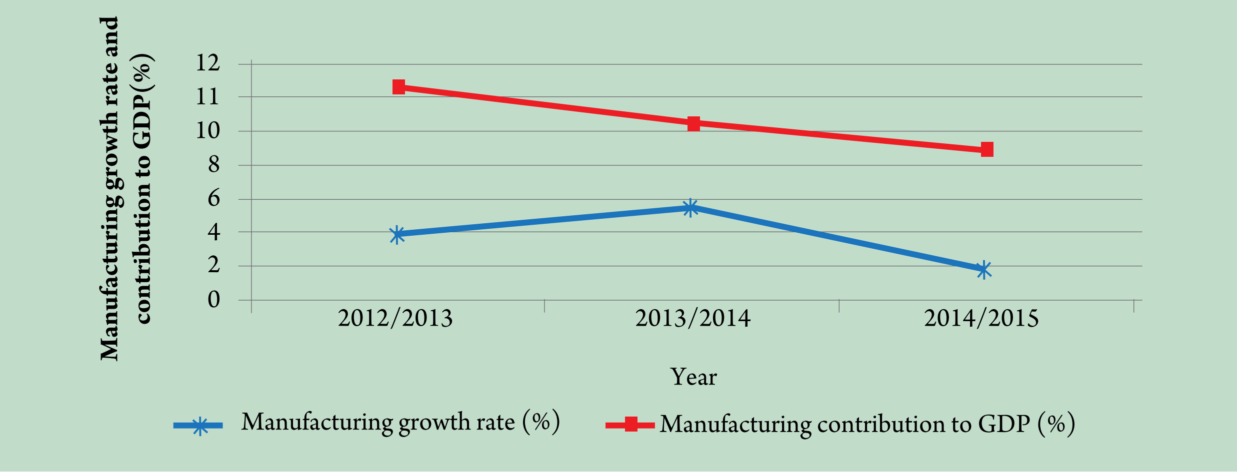
Manufacturing sector contribution to GDP slowed down from 10.4 per cent in 2013/14 to 9.3 per cent in 2014/15 (Figure 7.1). The sector share in GDP unfavouably compares to that of Korea at 30 per cent, Malaysia at 23 per cent, Mauritius at 16 per cent, and South Africa at 13 per cent (World Bank, 2016a). The factors that have contributed to decline in the performance of Kenya's manufacturing sector during the year emanated from both domestic and external factors. Domestically, growth of credit to the sector slowed from 24.0 per cent in 2013/14 to 20.0 per cent in 2014/15 (Central Bank of Kenya, 2015), which may have adversely affected sector investments. In addition, the Kenya Petroleum Refinery, which stopped operations in September 2013, continues to adversely affect the sector output. With the closure of the petroleum refinery, Kenya now imports refined petroleum products. The shift from importation of crude oil to refined petroleum products has significant implications, given that processing of petroleum products was significant to the Kenyan economy, accounting for 12 per cent of manufacturing GDP in 2011 (KNBS, 2015d). Further, although the cost of electricity fell from 20 cents per kilowatt hour to 14 cents per kilowatt hour in 2014, it remained higher compared to those of competitor countries such as China and Ethiopia at 7 and 6 cents per kilowatt hour, respectively (Government of Kenya, 2015a). Other challenges faced by the sector include informal sector competition, and constraints in accessing finance especially by micro and small enterprises (World Bank, 2013).

Externally, Uganda's manufacturing sector recorded a higher growth rate of 11.0 per cent in 2014/15 (Uganda Bureau of Statistics, 2015), possibly posing competition to Kenya's manufactured exports in the EAC market. The challenge is further compounded by cheap imports into the EAC market from China and India (World Bank, 2014). During the year under review, the Kenya shilling depreciated against the US dollar from 87.77 in July 2014 to 97.70 in June 2015 (Central Bank of Kenya, 2015), adversely affecting the cost of imported intermediate inputs. With imported inputs accounting for about 50.0 per cent of costs of raw materials for Kenyan manufacturing firms (KNBS, 2013), depreciation of the shilling inevitably amplifies the cost of production. Other international dynamics include reduction in cost of production especially in the US as a result of increased oil production (Celasun, et al., 2014). Since Kenya imports refined petroleum products, the benefits of pass through of reduced crude oil prices were not proportionate to reduction in crude oil prices (Energy Regulatory Commission, 2014).

7.2.2 Manufacturing sector growth

Manufacturing sector real GDP increased from Ksh 417.3 billion in 2013/14 to Ksh 425.9 billion

Figure 7.1: Manufacturing sector growth and contribution to GDP (%)



Data Source: KNBS (2015a)

in 2014/15, yielding a growth rate of 2.0 per cent compared to 5.5 per cent in 2013/14 (KNBS, 2016). The growth of the manufacturing sector in Kenya is driven mainly by manufacture of food, beverage and tobacco, which between 2010 and 2014 have been growing at an average rate of 6.7 per cent compared to non-food sub-sector, which recorded average growth of 2.6 per cent over the same period (KNBS, 2015d). The growth of the sector compares unfavourably to the 10.0 per cent annual growth envisaged in Vision 2030, and also to the average sector growth for developing and emerging industrial economies at 6.2 per cent (UNIDO, 2015). Moreover, it also compares unfavourably with regional economies such as Ethiopia and Tanzania, which have recorded sector growth in excess of 10.0 per cent and 6.0 per cent, respectively, between 2011 and 2014 (World Bank, 2016b).

7.2.3 Contribution to employment

Formal employment

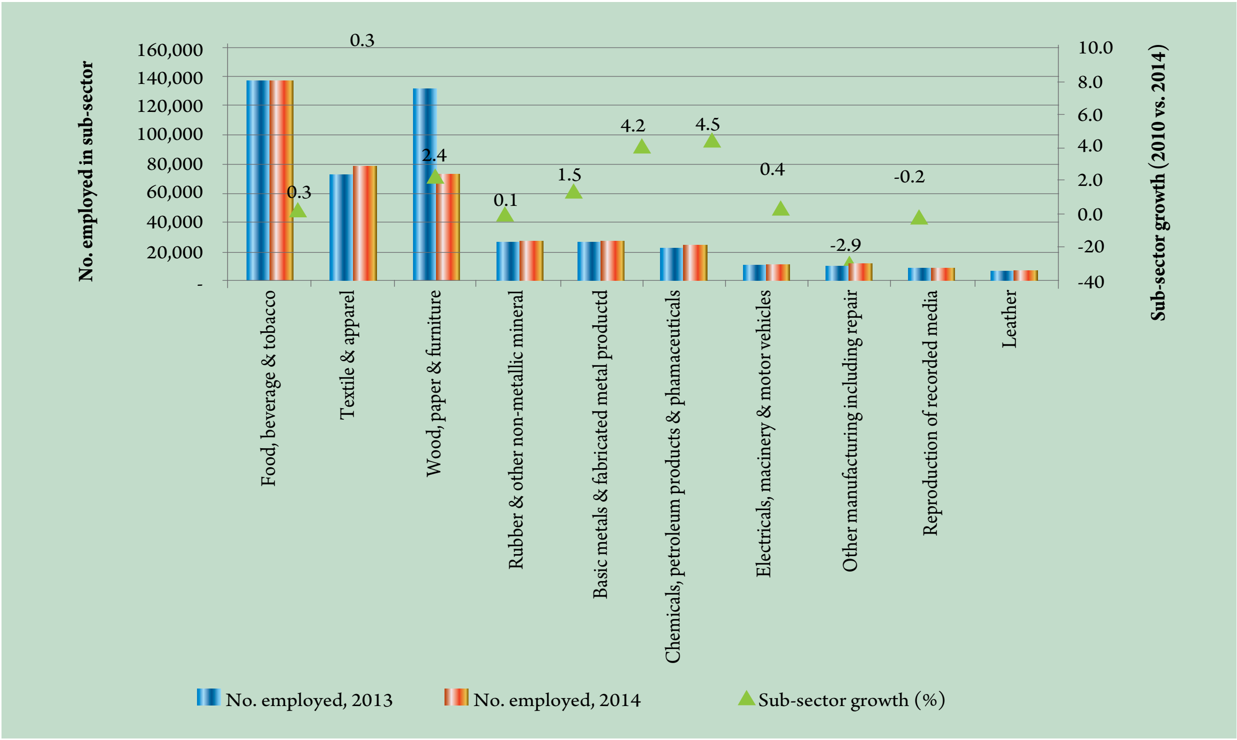
The manufacturing sector accounted for 11.9 per cent (295,400 jobs) of the 2.5 million formal sector employment in 2015 compared to 12.1 per cent (287,400 jobs) of the 2.4 million formal sector employment in 2014[3] (KNBS, 2016). The sector thus recorded employment growth of 2.8 per cent in 2015. While manufacturing sector employment has been increasing in absolute terms, its share in formal employment has been declining marginally in recent years. The decline in the sector contribution to formal employment can be explained by its slower growth rate relative to service sectors such as information and communication technology (ICT), which in 2014/15 recorded employment growth of 12.5 per cent while finance and insurance, and wholesale and retail trade all recorded employment growth rates in excess of 6.0 per cent (KNBS, 2015b). In terms of sub-sector performance, majority of the employment occurs in the food and beverage sub-sector, which provides 136,788 jobs followed by textile and apparel with 79,106 jobs in 2014 (KNBS, 2015d). With regard to sub-sector employment growth, textile and apparel recorded the highest growth in 2014 at 8.8 per cent followed by electrical, machinery and motor vehicles at 4.5 per cent and chemicals at 4.2 per cent (Figure 7.2). Higher employment growth in textile and apparel can be explained by positive effects of the African Growth and Opportunities Act (AGOA), which enabled impressive growth of 22.6 per cent of textile exports to the US in 2014/2015 (Export Processing Zones Authority, 2015). The improved performance in textile and apparel sub-sector also reflects prioritization by the national government through allocation of Ksh 3 billion in the 2014/15 budget (Government of Kenya, 2014). Indeed the quantum[4] of manufacturing production for textiles and wearing apparel sub-sectors increased by 2.8 per cent and 4.8 per cent, respectively in 2014 (KNBS, 2015b), an indication of positive change in output.

The sub-sectors that recorded negative employment growth include the reproduction of recorded media,[5] and leather, which shrunk by 2.9 per cent and 0.2 per cent, respectively, in 2014 (Figure 7.2). The employment decline in recorded media can be attributed to evolution of new media solutions such as higher bandwidth speeds, which facilitate digital downloads and internet piracy (IBISWorld, 2015). Some of the factors contributing to weak performance of the leather sub-sector include imports of low cost footwear from China and India as well as imports of second-hand imported footwear (Government of Kenya, 2015b). Kenya exports 89 per cent of leather in semi-processed form (Government of Kenya, 2015b), which further explains weak performance of the sub-sector.

Informal employment

About 89.6 per cent (2.5 million jobs) of manufacturing sector employment is in the informal sector (KNBS, 2016). A number of factors such as avoiding payment of taxes, and registration and regulatory costs explain the choice to remain informal (Bigsten et al., 2004; World Bank, 2013). While the informal sector provides employment

Figure 7.2: Sub-sector employment and employment growth, 2013 and 2014



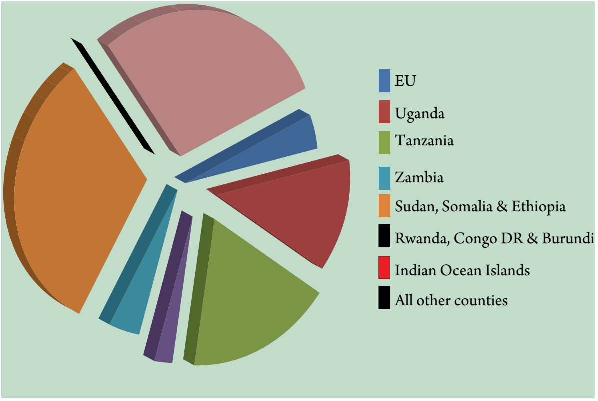
Data Source: KNBS (2015d), Statistical Abstract

opportunities to those lacking formal employment, it is dominated by small scale activities with limited opportunities for value addition. Manufacturing informal employment increased from 2.4 million persons in 2014 to 2.5 million persons in 2015. The growth in informal employment, however, slowed from 11.3 per cent in 2014 to 7.6 per cent in 2015 (KNBS, 2016) probably as a result of increased imports of cheaper competing manufactured goods from China and India (World Bank, 2014).

7.2.4 Contribution to exports

Manufactured exports declined by 20.3 per cent in 2014/15 compared to a decline of 3.1 per cent in 2013/14 (Central Bank of Kenya, 2015). The influx of imports into the EAC market (World Bank, 2014) and rebound of the manufacturing sector in Uganda (Uganda Bureau of Statistics, 2015) pose challenges to Kenya's manufactured exports. The EAC market remains a major destination for Kenya's exports, accounting for over 60.0 per cent of manufactured exports (Figure 7.3). Kenya's manufacturing performance is therefore sensitive to dynamics in the EAC market due to high concentration in terms of export destinations. This calls for diversification of the exports market, especially given that EAC countries demonstrate similar manufacturing structure.

Figure 7.3: Shares of Kenya's manufactured goods in export markets



Data Source: KNBS (2015d)

The Export Processing Zones Authority (EPZA) is mandated to promote and facilitate export-oriented investments. The garment sub-sector accounts for 53.1 per cent of EPZ exports (Export Processing Zones Authority, 2013). The performance of EPZ is critical in taking advantage of the African Growth and Opportunities Act (AGOA), which provides duty-free access to US imports of apparel and other selected items from eligible Sub-Saharan African countries, including Kenya. In 2014/2015, exports under EPZ increased by 10.2 per cent to stand at Ksh 52.5 billions (Export Processing Zones Authority, 2015). Over the same period, exports under AGOA expanded by 22.6 per cent while investments in manufacturing enterprises under EPZ increased by 10.9 per cent (Export Processing Zones Authority, 2015), which may explain the positive performance of exports manufacturing enterprises under EPZ. The extension of AGOA legislation in 2015 by a further term of 15 years creates incentives for investment in EPZs.

7.2.5 Producer price index

The producer price index (PPI) facilitates monitoring of price inflation through different stages of production (IMF, 2004). The PPI has important implications for private sector enterprises as it aids their operations, such as long term sales or purchase contracts to account for changes in costs (Bureau of Labour Statistics, 2015). The Kenya National Bureau of Statistics collects PPI data on quarterly basis as at 15th of February, May, August and November (KNBS, 2015e). The PPI inflation increased from 0.8 per cent in 2013/14 to 1.5 per cent in 2014/15, mainly driven by input costs of food and beverages, textiles, and chemical products (KNBS, 2015e). Depreciation of the Kenya shilling against the US dollar may also explain cost dynamics in the food, beverage and chemicals sub-sector due to reliance on imported materials.

7.2.6 Ease of doing business

The competitiveness of Kenya's manufactured goods is stifled by high costs of production (World Bank, 2014). Electricity and access to finance have been identified amongst the top five constraints facing micro and small manufacturing firms in Kenya (World Bank, 2013). The manufacturing sector is both electricity and capital intensive (KNBS, 2013), making it prone to related cost dynamics. In the 2016 World Bank's Doing Business rankings, Kenya was ranked among the top 10 economies with improvements in reforms. Kenya's ranking improved from position 129 in 2015 to position 108 in 2016 due to reduction in delays to electricity connection and improvements in access to credit information (World Bank, 2015). Despite the improvements, the costs of electricity and credit remain high compared to competitor countries. Enhanced policy efforts targeted at reducing the costs of production are therefore imperative.

7.3 Review of Policy Developments

7.3.1 Sustainable Development Goals

In 2015, the United Nations launched the Sustainable Development Goals (SDGs) that comprise 17 development targets that UN member states are expected to use to frame their development agendas over a period of 15 years (United Nations, 2015). SDG Goal 8 calls for policies that promote value addition in labour-intensive sectors, while goal 9 calls for inclusive and sustainable industrialization anchored on efficient resource use with the goal of doubling the industry's share of employment and contribution to GDP in developing countries (United Nations, 2015). The themes of SDGs align with Kenya's development plans such as Vision 2030, and the industrial transformation programme which aims to transform Kenya into an industrialized economy. The congruence between SDG and Vision 2030 in industrialization agenda and poverty reduction provides Kenya with an opportunity to concurrently implement the two policies. It is imperative to note that the SDGs underscore efficient use of resources in efforts to promote sustainable development (United Nations, 2015), which individual UN member states are expected to realize.

7.3.2 Kenya's industrial transformation programme

The industrial transformation programme launched by the Ministry of Industrialization and Enterprise Development prioritizes labour-intensive sub-sectors such as agro-processing, textile and leather as a strategy for employment creation and exports growth (Government of Kenya, 2015e). The convergence between SDGs and the industrial transformation programme in promoting labour-intensive sectors is a boon for Kenya in tackling unemployment challenges. To realize the policy goals of employment and exports growth, the industrial transformation programme aims to increase foreign direct investments five-fold, and improve Kenya's ranking in the Ease of Doing Business to top 50 economies (Government of Kenya, 2015e). To expedite implementation of the industrial flagship projects, a Steering Committee headed by the Presidential Delivery Unit[6] has been established as provided for in the industrial transformation programme (Government of Kenya, 2015e). The Steering Committee is expected to meet the presidency every six months and provide quarterly updates on programme implementation. Each partner ministry involved in implementation will consider joint projects in individual performance contracts. The programme therefore aims to prioritize sub-sectors that are labour-intensive, and improve coordination among government agencies involved in implementation of industrial projects (Government of Kenya, 2015e).

7.3.3 Budgetary allocations

Both the second medium term plan of Vision 2030 (Government of Kenya, 2013) and the national industrialization policy framework (Government of Kenya, 2012) recognize limited budgetary allocation as a constraint to implementation of industrial flagship projects. In the financial year 2015/2016, the government prioritized industrial transformation as one of the six thematic areas for realizing resilient economic growth, diversifying exports, and generating additional employment opportunities (Government of Kenya, 2015d). Towards this end, the government allocated Ksh 3 billion for industrial development and Ksh 13.2 billion for geothermal power development (Government of Kenya, 2015d). Investment in geothermal energy is aimed at lowering the cost of production.

The impact of the funding allocation for industrial development can be enhanced through selective allocation based on policy outcomes such as employment, poverty alleviation and sector growth. If the policy goal is to generate additional employment, emphasis should be on sub-sectors with high backward linkages that often source intermediate inputs locally (National Economic and Social Council, 2011). If the policy goal is to increase sector growth or contribution to GDP, high value manufactures such as machinery and electronics would enhance the impact (Ajakaiye and Page, 2012). In recent years, the government has continued to invest in manufacturing sub-sectors such as leather and textile (Government of Kenya, 2015f), which will likely impact on employment outcome. With regard to energy, the share of geothermal in total electricity generation has increased from 33.8 per cent in July 2014 to 47.1 per cent in June 2015 (KNBS, 2015f). Consequently, fuel levy for electricity reduced from Ksh 7.22 in July 2014 to Ksh 2.31 in June 2015 (KPLC, 2015). Thus, additional investment in geothermal energy is expected to further lower the cost of electricity for industrial use.

7.3.4 Progress under second Medium Term Plan

The progress towards the second medium term plan is summarized in Table 7.1. A notable achievement is the enactment of legislation on Special Economic Zones (SEZs), which will provide firms operating in these areas various fiscal and infrastructure incentives to attract investment (Government of Kenya, 2015c). One of the challenges faced by Export Processing Zones (EPZs) in Kenya is the expansion of the domestic market to include the EAC market (Export Processing Zones Authority, 2013), thus curtailing export potential in addition to generating conflict with Vision 2030 goal of increasing Kenya's share of manufactured goods in the EAC market from 7.0 per cent to 15.0 per cent (Government of Kenya, 2013). The SEZs programmes are expected to overcome this challenge as there is no restriction on sale to domestic markets. However, while SEZs have success histories in Asia, particularly China, the results are mixed in Sub-Saharan Africa (Zeng, 2015). To realize the policy goals of technology transfer, foreign direct investments and export growth associated with SEZs, policies should aim at providing a competitive business environment, strategically positioning SEZs to access international markets, set clear goals in terms of contribution to the economy, and embrace efficient production technologies that minimize negative externalities (Farole, 2011; Zeng, 2015). The SEZ Act No. 16 of 2015 empowers the Cabinet Secretary for industrialization to establish the application criteria and conditions for enterprises that will operate within the zones, through regulations. This offers an opportunity for defining the criteria aimed at attracting investments and promoting technology transfer.

Progress towards the second medium term plans have been hampered by various challenges,

Table 7.1: Progress towards second Medium Term Plan targets

Second Medium Term Plan Targets	2012/13 progress	2013/14 progress	2014/15 Progress
Establishment of three Special Economic Zones in Mombasa, Lamu and Kisumu	• Land profiled in Lamu and Kisumu • Final SEZ Bill and policy was prepared	• Land profiled in Mombasa • Prepared draft master plan for Mombasa SEZ	• 3,000 acres of land was confirmed in Dongo Kundu, Mombasa • Special Economic Zones Act No. 15 of 2015 enacted • Prepared final master plan for Mombasa SEZ
Development of SME industrial parks in each of the 47 counties	32 and 25 acres of land identified in Juja and Taveta, respectively	135 acres of land identified in Eldoret	Title deed for 25 acres of land in Taveta was issued, and the land fenced
Development of three industrial clusters for meat, leather and dairy products		• 500 acres of land was identified in Athi River for leather city • Established 2,000 SME operators, skills gap and equipment needs	• Master plan was done for the leather city • Partnership negotiation with the county government on space allocation at Kariakor, Nairobi
Development of Integrated Iron and Mini Steel Mills	-	Drafted feasibility study report	Final feasibility study report done
Skills development for technical human resource	1,380 students trained at Kenya Industrial Training Institute (KITI)	1,450 students trained at KITI	1,850 students trained at KITI

Source: Government of Kenya (2015f)

including lengthy process of land identification and transfer, delays resulting from stakeholder consultations, funding constraints and inadequate training facilities for industrial skills (Government of Kenya, 2015f).

7.4 Conclusion and Recommendations

7.4.1 Conclusion

The manufacturing sector in Kenya is improving in absolute terms with regard to indicators such as sector value added and employment. However, its contribution to GDP and employment are marginally declining due to both internal and external factors. The external factors include competition from cheap imports, and rebound of manufacturing in regional countries such as Uganda. On the internal front, the cost of production relating to electricity, credit and competition from informal sector pose challenges to growth of the sector. Nevertheless, the government has made significant investments in energy in recent years, with costs of electricity easing in 2014. However, relative to competitor countries such as Ethiopia, the cost of energy is still high. Further, with high dependence of the sector on intermediate imports, depreciation of the shilling against the dollar may have amplified the cost of production. Progress towards the second medium term plan has been hampered by various challenges, including the lengthy process of land identification and transfer, delays resulting from stakeholder consultations, funding constraints and inadequate training facilities for industrial skills.

With regard to policy developments, the Sustainable Development Goals (SDGs) launched in 2015 underscore prioritization of labour-intensive sectors, efficient use of resources and doubling of industrial sector contribution to employment and GDP in developing countries. Domestically, two notable policy developments include the enactment of the Special Economic Zones Act No. 15 of 2015, and the launch of the industrial transformation programme. Special economic zones are aimed at attracting industrial investments through fiscal and infrastructure incentives in designated geographical areas. The industrial transformation programme, on the other hand, aims to address unemployment through investments in labour-intensive sub-sectors such as textiles, agro-processing and leather in addition to providing a framework for fast-tracking flagship projects. The congruence between SDGs and Vision 2030 in industrialization agenda and poverty reduction provides Kenya with an opportunity to concurrently implement the two policies.

7.4.2 Recommendations

The following recommendation could be considered for the manufacturing sector:

(i) Enhance policy efforts to lower the cost of production with regard to energy, credit and industrial land. This is important because electricity tariffs are still high compared to competitor countries. With regard to access to industrial land, there is need for a framework for stakeholder engagement, including county governments, for identification and seamless transfer of land for industrial development.

(ii) Diversify exports destination for manufactured goods. This is especially necessary because the EAC market accounts for 60.0 per cent of Kenya's manufactured exports. With Uganda's manufacturing sector on a rebound, and with cheap imports from China, this regional market will continue to shrink.

(iii) Given that the manufacturing sector is highly dependent on intermediate imports, depreciation of the shilling amplifies the cost of production. Enhanced policy efforts targeting exchange rate stabilization is therefore imperative.

(iv) Develop SEZ regulations aimed at attracting investments and promoting technology transfer. This is especially critical as Kenya lacks a national foreign investment or technology transfer policy.

(v) Finally, there is also need to address informality in the manufacturing sector, given the competition it poses to formal sector enterprises. There are also risks associated with informal sector. Given that most informal enterprises operate outside the law, they are likely to relax standards and quality provisions, hence posing health and safety concerns. Some of the approaches that can be considered to address informality include reduction of the cost of registration and operations.

Endnotes

1. Manufacturing involves physical or chemical transformation of raw materials into new products.

2. Other components of the industrial sector are construction, mining and quarrying. The average performance referred to covers the period 2010-2014.

3. Employment data are available only for calendar year January-December.

4. Quantum index reveals change in quantity of goods manufactured.

5. Under ISIC Revision 4 code 1820 defines Reproduction of recorded media to include reproduction from master copies of gramophone records, compact discs and tapes with music or other sound recordings; reproduction from master copies of records, compact discs and tapes with motion pictures and other video recordings; and reproduction from master copies of software and data on discs and tapes.

6. The Presidential Delivery Unit monitors progress on behalf of the President.

Chapter 8

Micro and Small Enterprises

8.1 Introduction

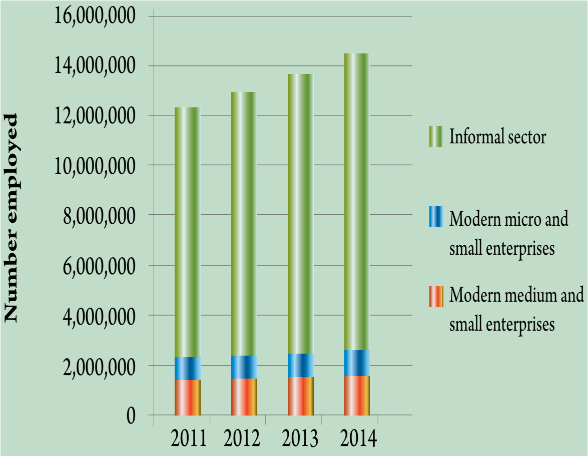
The Micro and Small Enterprise (MSE) sector is an important source of goods and services and employment in Kenya. In 1999 when the last comprehensive survey was conducted, the sector accounted for 2.3 million people, which represents over 50.0 per cent of the working population. Although majority of MSEs in Kenya operate informally, there are over 41,000 formal MSEs, employing over 42.0 per cent of the working population (KNBS, 2012).

In this analysis, MSEs are defined as enterprises, whether formal or informal, which employ 1-50 people.

8.2 Characteristics of Enterprises in Kenya

Kenya's business environment is largely dualist in nature, with a portion operating formally (modern establishments) and others operating informally. Informality in this context refers to establishments that do not have business registration and do not meet other business statutory obligations. This dualist view of Kenya's business environment was evidenced in the 1972 International Labour Organization (ILO) employment mission to Kenya, which highlighted the informal sector (ILO, 2002). The informal sector emerges as a result of limited formal job opportunities, slow economic growth, and high population growth (Chen et al., 2004). To date, employment opportunities in the formal sector have not moved in tandem with market needs, and thus the informal sector has been growing.

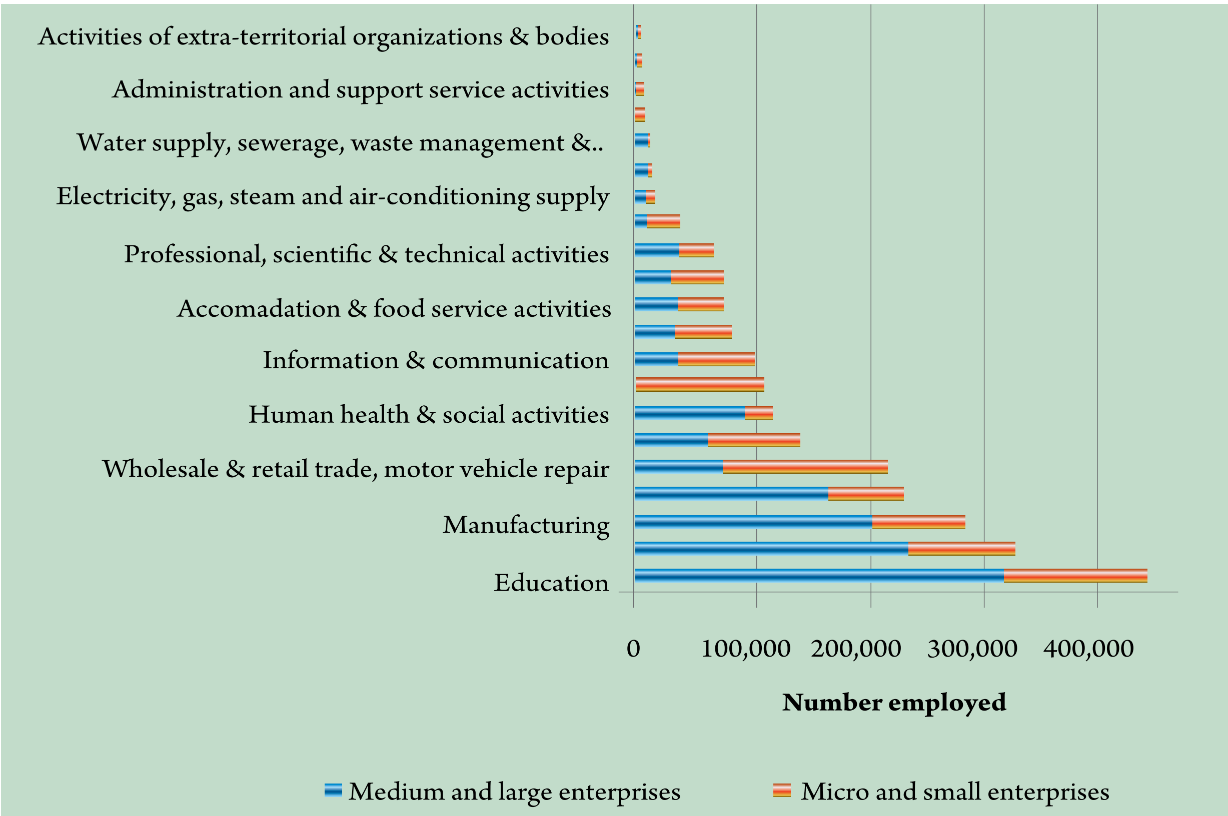
Figure 8.1: Employment in different segments in Kenya (2011-2014)



Data source: KNBS (2015a); KNBS (2015b)

Figure 8.1 shows that majority of the working population in Kenya are engaged in the informal sector. Of those engaged in modern establishments,

Figure 8.2: Employment trends by economic activity (2014)



Data source: KNBS (2015b)

Figure 8.3: Employment trends (2012-2014)

Data source: KNBS (2013; 2014; 2015b)

41.0 per cent are in micro and small enterprises. Further, majority of modern establishments in Kenya are micro or small in size. About 75.0 per cent of all modern enterprises, for instance, are MSEs (KIPPRA, 2014).

A large proportion of those employed within MSEs operate in the service sector as shown in Figure 8.2.

The trend in employment among modern MSEs shows an increase in most sectors, especially those in services. Only one sector, agriculture and forestry, experienced a decline in employment figures, while real estate and accommodation and food services remained largely unchanged over the period under review.

MSE start-ups often face challenges that limit their growth, and in some instances contribute to their eventual closure. In fact, 50.0 per cent of MSEs in Kenya, as established in a study by Liedholm (2001), closed within the first three years of operation. This high mortality is also expressed in Sessional Paper No. 2 of 2005 on Development of Micro and Small Enterprises for Wealth and Employment Creation for Poverty Reduction.

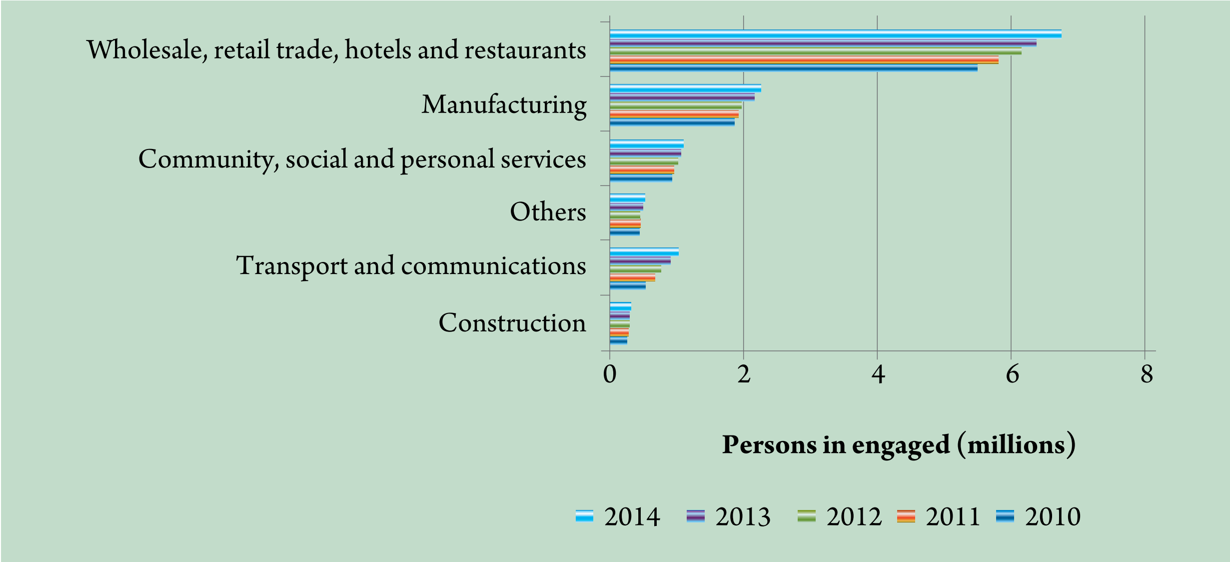
8.3 Informality within the Sector

The service sector engages a large proportion of the population operating in the sector, as shown in Figure 8.4.

It is interesting to note that businesses operating in wholesale, retail, accommodation, food service and motor vehicle repair are mainly either MSEs or informal enterprises. As much as these sectors present less business entry challenges, they experience survival challenges. A study by Liedholm (2001), for instance, establishes that 30.0 per cent of MSEs operating in retail trade in Kenya are likely to close within one year.

Despite the informality of MSEs in Kenya, a good number have at least a business permit or license.[1] County governments such as Nairobi County have specific licences directed to informal sector traders.

Figure 8.4: Employment in the informal sector



Data source: KNBS (2015a)

Table 8.1: Fees and charges for informal sector operators in Nairobi

Activity	Fees/Charges
Small business informal sector	Ksh 200 per month
Informal dry cleaner and tailors	Ksh 150-300 per month (depending on level of income)
Informal carpenter	Ksh 300-900 per month (depending on level of income)
Hawker (outside CBD)	Ksh 30 per day
Hawkers	Ksh 500 per month
One hawker with motor vehicle	Ksh 7,000 annually
One hawker without motor vehicle	Ksh 5,000 annually
Small informal sector trader/service provider	Ksh 2,500 annually
Semi-permanent informal sector trader: up to 2 persons	Ksh 3,500 annually
Other informal sector	Ksh 2,000 annually

Data source: Nairobi City County Finance Act, 2013

The enterprises operating informally face challenges of accessing support infrastructure, as well as participating in government procurement opportunities. Such enterprises, by the fact they are informal, are under no obligation to meet the regulations for working conditions, product standards, etc. They are faced with high levels of risk, disadvantages and uncertainty largely due to the limited social and investor protection provisions for such enterprises. Informal enterprises, however, have a slight advantage when compared to formal enterprises, given the relative ease of entry and lower cost of compliance.[2] This creates an uneven playing field for formalized competitors. Electronic commerce has encouraged the establishment of online shopping platforms such as OLX, Jumia and Rupu. Given that sellers do not necessarily need to be formal enterprises, individuals operating informally can easily access this market place. The Kenya 2013 Enterprise Survey identifies practices of the informal sector as the top business environment constraint experienced by the formal enterprises sampled (World Bank, 2013).

There is evidence that informal sector workers experience higher risks of poverty (ILO, 2011). The informal sector is further associated with poverty or underground activity, and some previous policy interventions have been aimed at encouraging formalization of such enterprises. Interestingly, countries with a large proportion of labour force in the informal sector are also the countries with lower income per capita and high rates of poverty. Data from ILO reveals, for instance, that the lowest percentage of informal employment is in European countries (ILO, 2012).

8.4 Formal MSEs

The MSEs operating formally are either registered as a business name, partnership or company.[3] The Companies Act No. 17 of 2015 was assented into law in 2015. The Act will be operationalized in phases, and application of certain sections of the law has already come into operation following publication in the Kenya Gazette.[4] Starting 31st January 2016, incorporation company documents will be on the format prescribed in the 2015 Companies Act (Musau, 2016).

The government's efforts to enhance the use of ICT in business registration has led to two key developments, first of which is the recognition electronic means, including electronic addresses, electronic form, copy or documentation and electronic signatures. Additionally, searching and reserving business names is done real-time, electronically either at Huduma Centres located around the country, using the online E-Citizen platform, or through a mobile phone service offered by Safaricom Limited.[5] These are bound to lower transaction costs especially for MSEs.

8.5 MSE Associations

According to the Micro and Small Enterprises Act 2012, the Registrar of MSEs is responsible for registering and regulating MSE associations. The Registrar is not yet in operation; however, in 2015, the position of Registrar of MSEs was advertised. Registered MSE associations are to maintain a register of all members, which is to be maintained with the Registrar. There are a number of MSE associations in operation in the country, which offer members a number of services while also providing a coordinated approach within which to lobby the government and obtain relevant services. These associations have, however, not been regulated before and have been subject to claims of fraud and ineffective representation. The Act, through the Registrar, introduces a number of governance mechanisms aimed at promoting efficiency and transparency. The law provides penalties for failure to comply, and further empowers the Registrar to conduct investigations or operation of any registered association.

8.6 Accessing Finance

Most MSEs face the challenge of accessing finance because they operate informally, lack business registration, and majority do not keep proper records and often face the challenge of limited collateral.[6] They often face the challenge of raising capital, often resulting to use of own savings or borrowing on taking a personal loan from a bank. There is no separation between the business owner and the business, and therefore all obligations, liabilities and risks attached to the business are born by the business owner. Banks are often hesitant to offer credit facilities other than personal loans to such entities. Some banks view the sector as risky, as most banks lack appropriate risk appraisal and management tools (FSD, 2015).

The government has introduced a number of initiatives over the years aimed at enhancing access to finance, which include the devolved funds (Women Enterprise Fund, Youth Enterprise Development Fund and Uwezo Fund). There have also been regulatory reforms with enactment of the Micro-Finance Act No. 19 of 2006 and the SACCO Societies Act No. 14 of 2008, which introduced effective supervision and regulatory framework to enhance stability and sustainability of relevant lending institutions, hence expanding opportunities for MSEs. This has resulted in growth in micro financing solutions through micro finance institutions and SACCOS in the country. Further, a number of commercial banks have introduced products targeting small enterprises. The unique characteristics of MSEs, however, as noted earlier render them risky to financial institutions. Access to credit, therefore, remains a challenge. Furthermore, the cost of credit is disproportionately higher for MSEs. The average annual interest for microenterprises is 20.6 per cent, while that for small enterprises is 18.5 per cent and for medium and large enterprises 17.4 per cent and 15.3 per cent, respectively (FSD, 2015).

Alternative credit solutions that would cater to MSEs should be endorsed by the government. Some of the ones that should be prioritized include credit guarantee funds to offer lending to start-ups, and invoice discounting to provide MSEs with relevant resources in times of cash flow shortfalls. In India, the government has a credit guarantee fund that provides collateral-free credit to MSEs.[7] The UK and the US also have a similar fund known as Enterprise Finance Guarantee and Small Business Administration Guarantee Scheme, respectively, which offers loan guarantees to SMEs (Department for Business, Innovation and Skills, 2013; FSD, 2008). Guarantee schemes are of great benefit to MSEs who lack collateral and MSEs that lack historical business financial data.

8.7 Public Procurement Preferences for local MSEs

The public procurement preference and preservation established in the Public Procurement and Disposal Act (2005) (Cap 412C) and the Preference and Reservations Regulations provide MSEs with improved access to government tenders and contracts. However, a good proportion of these firms face financial challenges, which are compounded by slow or delayed payments from the procuring entity. This disproportionately affects MSE's capital base (KIPPRA, 2006).

8.8 The Challenge of Corruption

According to the Kenya 2013 Enterprise Survey, corruption is the second top constraint faced by the sector. Corruption, which occurs in both the public and private sector, has the effect of increasing the cost of doing business, while also distorting conventional competitive forces (World Bank, 2013). Public procurement is vulnerable to fraud and corruption, which then has the effect of inflating the cost of goods and services by up to 20 per cent (EACC, 2015). To address corruption in the public procurement system, the government has sought to enforce a business code of ethics. As noted earlier, public procurement preference and reservations is accorded to MSEs, specifically micro and small enterprises owned by youth, women and persons with disabilities. The Public Procurement Oversight Authority (PPOA) is mandated by the Public and Procurement and Disposal Act 2005 to ensure that all procurement and disposal is conducted in accordance with the established code of ethics. The code of ethics, which applies to all government suppliers large and small, aims to ensure that suppliers comply with relevant statutes and statutory requirements. The code of ethics specifically forbids corruption (PPOA, nd). In November 2015, the President directed that all companies seeking to do business with the government be required to sign a code of ethics. This move is aimed at curtailing corruption in the public sector.

8.9 Conclusion and Recommendations

8.9.1 Conclusion

As noted earlier, the MSE sector though growing is faced with challenges that limit the productivity of enterprises. These challenges include informality within the sector, limited access to credit, and inefficiency. The sector is also not able to access other business support services, including technology and infrastructure, which further affects the productivity of enterprises.

8.2 Recommendations

The government should consider innovative mechanisms to supporting MSEs in accessing finance, particularly government-supported invoice discounting and credit guarantees targeting MSEs based on a certain criteria. MSEs providing goods and/or services to public entities offer a good opportunity for potential target group.

Informality, especially amongst certain service providers, is a key challenge in Kenya. MSEs operating informally are unable to access certain services, especially financial services. Given that business registration and tax compliance is a requirement for beneficiaries of the public procurement preference and preservation, informal sector players do not benefit. Addressing constraints associated with formalizing a business should therefore form a policy priority. The government should, therefore, facilitate the transition of enterprises from informal to formal sectors. This requires a review of the regulatory environment with the aim of identifying the laws and requirements that discourage formalization, and subsequent introduction of a comprehensive multi-agency coordinated approach aimed at promoting formality in business; enhancing social employment and investor protection; and ensuring compliance or conformity to statutory and regulatory requirements.

The Huduma Centres should be enhanced and facilitated to host all relevant business service providers. A one-stop-shop where MSEs can carry out all relevant business licensing and registration in a single location would enhance efficiency and lower transaction costs. Simplification of procedures is another critical policy consideration to address any unnecessary bureaucracies.

The government should hasten the operationalization of the office of Registrar of MSEs, which will have a significant role to play in initiating registration of MSEs. Through relevant regulations, the Registrar can introduce a number of self-governance mechanisms to enhance social, employment and investment protection for MSEs. Additionally, strategies and policies should be introduced to offer incentives to registered MSE associations to encourage formalization, for instance by offering tax exemptions to certain segments of MSEs. Moreover, the importance of MSE associations in enhancing collective approach to public tenders, in offering training opportunities to members, and in enhancing access to information cannot be overlooked.

The government's efforts to combat corruption should be enhanced by adopting transparent and efficient procedures and systems that are devoid of rent seeking opportunities. This is especially critical in business registration and support structures that address micro and small enterprises.

Finally, accurate and current data is critical in policy and strategy formulation and implementation, thus bringing out the need for a national survey of micro and small enterprises.

Endnotes

1. According to a study by KIPPRA and Ernest and Young (2008), 85 per cent of firms sampled had the Single Business Permit, which was a requirement then as provided in the Local Government Act (now repealed). Businesses are now required to obtain relevant licence from counties as established by respective County Finance Acts.

2. Informal sector businesses avoid paying taxes, registration, licensing and are often not compliant with statutory labour and quality requirements.

3. As provided in the Registration of Business Names (Cap 499), Limited Liability Partnership Act No. 42 of 2011 (Cap 30A), Partnerships Act No. 16 of 2015, and Companies Act No. 17 of 2015.

4. Parts 1 to 14, Part 23, Part 31 & 32, Part 38, Part 40, Part 42 abd the First, Second and Sixth Schedules came into operation on 6th November 2015 through Legal Notice No. 232 of 13th November 2015. Details are available at http://www.attorney-general.go.ke/index.php/companys-q-a/

5. The E-Citizen platform is available at https://www.ecitizen.go.ke/; the mobile phone service is accessed by dialling *271#

6. A study conducted by KIPPRA in 2015 revealed that the major reasons limiting MSEs from accessing credit in Kenya include insufficient collateral, poor business records, business informality, high interest rates and lack of information on business credit. Similar challenges were identified in the Financial Sector Deepening Study (2015).

7. More information available at http://www.dcmsme.gov.in/schemes/sccrguarn.htm

Chapter 9

Trade and Foreign Policy

9.1 Introduction

The domestic retail and wholesale trade sector has been evolving, with greater concentration of firms as well as developments in electronic commerce, thus making Kenya a regional business hub. However, there is need to strengthen and rationalize the regulatory framework, taking into account the roles of the national and county governments to increase the sector's contribution to GDP and wage employment. The expansion of trade requires improvement of the commercial environment by addressing domestic constraints to international business development through trade facilitation projects, which would facilitate regional production sharing and diversification into new export lines amidst declining transportation costs.

This chapter reviews Kenya's performance in trade and foreign policy. In particular, it focuses on the performance of domestic trade in relation to GDP and wage employment, participation in regional economic integration as well as performance in regional and international trade. The final section reviews Kenya's performance in foreign policy.

9.2 Domestic Trade

9.2.1 Evolution of domestic trade

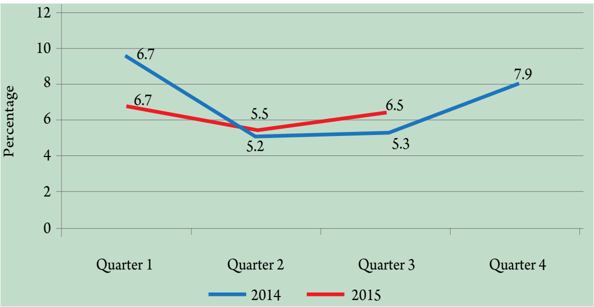
Domestic trade encompasses retail, wholesale, distribution and franchise trade. The bulk of retail enterprises consist of single shops operated as sole proprietorships. Besides, a large part of the sector is engaged in food retailing. Other important sales categories are textiles, clothing and footwear, household equipment and motor trade.

The domestic trade sector has evolved significantly, with firms becoming more concentrated over the last few decades. This is manifested in closer linkages between manufacturers, wholesalers and retailers. Traditional basic shops selling basic products are facing stiff competition from larger chain stores, supermarkets, exhibition centres and shopping malls. Besides, there is a general reduction in the role of traditional wholesalers, with firms integrating to provide a wider variety of supply chain from manufacturer to retailer. This is reflected in retail outlets such as Nakumatt, Tuskys, Uchumi and Naivas, which provide space for manufactures in their outlets, and offering a myriad of goods including fruits, vegetables, clothing, food items, manufactured goods, etc. The latter have spread their operations in several urban centres in various counties. The emergence of shopping malls and complexes, which provide a wide range of products and services, including packing spaces, also attract many individuals and family units within single precincts. Finally, the development of new technologies in electronic commerce has seen the emergence of online vending platforms such as the OLX, which provide platforms for selling and/or buying of all kinds of merchandise. In a report by New York Stock Exchange research firm Nielsen, Kenya was ranked second in terms of the degree of modernization of its retail services, behind South Africa, in a survey targeting five Sub-Saharan economies (Nielsen, 2015).

9.2.2 Performance of Domestic Trade

Statistics on the performance of domestic trade are generally scarce, mainly due to informality associated with many transactions and the reluctance of many players to enter the tax bracket. However, according to KNBS (2015a), the sector's contribution to GDP declined in the first three quarters during the year 2014. It contributed 9.7 per cent in the first quarter, declining to 5.3 per cent in the third and increasing by 2.6 per cent to 7.9 per cent in the fourth. The sector's contribution to GDP in the first quarter of 2015, however, started at a lower level of 6.7 per cent in comparison to the first quarter of 2014, declining by 1.2 per cent to 5.5 per cent in the second quarter, then finally increasing to 6.5 per cent in the third quarter of 2015. Overall, the sector annual contribution to GDP declined by 0.5 per cent from 8.0 per cent in 2014 to 7.5 per cent in 2015. This trend is attributed to decrease in consumption of wholesale and retail products in the first two quarters of the year, as opposed to the third and fourth quarter where consumption increases. The change in consumption is mainly due to seasonal changes and festivities, especially building in the months of December. Figure 9.1 shows the quarterly contribution of wholesale and retail trade to GDP in the year 2014 and the first three quarters of 2015.

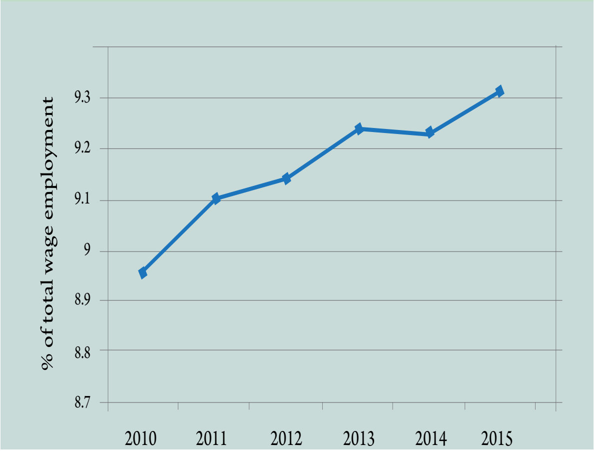
Figure 9.1: Quarterly contribution of wholesale retail sector to GDP



Source: KNBS (2016)

In terms of wage employment generation, the sector's contribution has been increasing over the years (Figure 9.2). In the year 2010, the sector contributed 8.96 per cent of the country's total wage employment. This increased to 9.31 per cent in 2013 and remained so in 2015. The Small and Medium scale Enterprises (SMEs) have also contributed greatly to the growth, given that they constitute the largest number of players in the retail sector. The improved performance of the sector is mainly attributed to its evolution. The sector was initially characterized by relatively low wages, and employing a large number of relatively low-skilled workers. However, changes in consumer preferences and technology, reflected in the increased sophistication of products, is creating a move towards higher quality and hence increased demand for higher-skilled workers.

Figure 9.2: Wage employment generation in wholesale and retail sector



Source: KNBS (2016)

9.2.3 Domestic business environment

Following the enactment of a new Constitution in 2010, county governments have been vested with greater roles in the regulation of domestic business activities. In addition, the Finance Acts prepared by various county governments provide for enactment of rates for business licences, levies and charges for various types of businesses within the counties. Besides, there are instances where there is multiplicity of licences, especially for firms that operate in more than one county. However, no mechanisms have been put in place to rationalize the regulation of the sector between the two levels of government, as well as across one county to another.

A survey on business levies and other charges across various counties conducted by KIPPRA in 2015 established that many county governments have either introduced new charges or increased the rates of existing ones, thereby increasing the cost of doing business. Subsequently, private sector lobby groups including the Kenya Association of Manufacturers, Kenya Private Sector Alliance (KEPSA) and Kenya National Chamber of Commerce and Industry have raised concerns about multiple payments of some charges, e.g. the single business permits, advertisement fees and bus park charges. Other charges also contravene or go against commitments made by the national government in regional trading blocs. For example, the Mombasa County Government has proposed introduction of an Import Inspection fee and a 20 dollar per tonne on all cargo entering the Port of Mombasa, ignoring the fact that the Port of Mombasa is a national project and that its operations have regional implications in the Eastern and Great Lakes region.

9.3 Regional Economic Integration and Trade

Regional economic integration initiatives have potential to spur economic growth and development through expansion of markets for inputs and finished products, increasing efficiency in allocation of resources, and locking trade reforms to promote long term investments. Kenya has continued to actively participate in regional economic integration initiatives, namely the East Africa Community (EAC), the Common Market for Eastern and Southern Africa (COMESA), the EAC-COMESA-SADC Tripartite Free Trade Area (TPFTA), the EAC-EU Economic Partnership Agreement, the Inter-Governmental Authority on Development (IGAD), as well as the African Union.

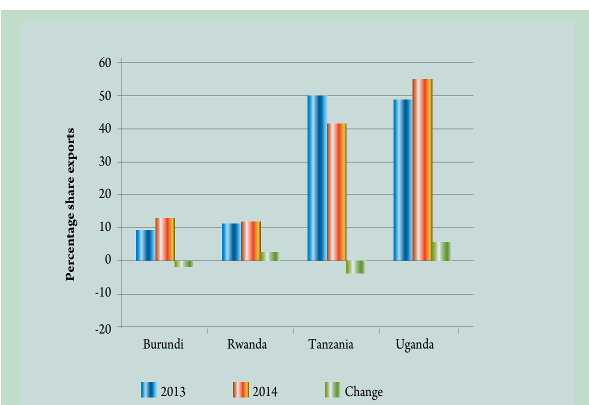
9.3.1 East African Community

The EAC has a combined population of 145.5 million people and GDP of US$ 147.5 billion and provides many opportunities for trade and investment. Kenya is the region's largest economy and hub for regional trade, finance and manufacturing. Having implemented the Customs Union in 2005 and the Common Market Protocol in 2010, the EAC Heads of State signed the protocol on the establishment of the East African Monetary Union (EAMU) on 30th November 2013 (EAC, 2013). The latter is the third level of integration envisaged by the EAC Treaty, and a macro convergence criterion to be met by each country prior to entry into the monetary union has been put in place. Full implementation of the convergence criteria follows three phases of implementation: first phase (2007-2010), second phase (2011-2015), and third phase which was revised in 2013 and to be achieved within a period of eight years (2016-18) (Central Bank of Kenya, 2015).

According to Article (6) of the EAC Monetary Union Protocol, the convergence criteria that each of the EAC countries must achieve are the following macroeconomic status: (a) average annual inflation of not more than 8 per cent; (b) fiscal deficit, including grants of no more than 3 per cent of GDP; (c) gross public debt of no more than 50 per cent of GDP in Net Present Value terms; and (d) maintenance of official foreign reserves at 4.5 months of imports (EAC, 2013). Kenya has so far met most of the targets. However, there are concerns following widening current account deficit and growing public debt. According to the Central Bank of Kenya (2015), the current account deficit increased from US$ -4,888.2 to US$ -6,131.8 during the 2013/14 and 2014/15 financial years, respectively or a 25.4 per cent reduction. This was largely attributed to the sluggish external demand for exports. Besides, total public debt as a percentage of GDP increased from 44.3 per cent to 52.8 per cent during the 2013/14 and 2015 fiscal years, respectively, mainly due to reduced revenue and higher expenditure on long term projects.

According to KNBS (2016), Kenya has continued to maintain a surplus trade balance in total intra-EAC trade. The trade surplus increased marginally from Ksh 840 millions in 2014 to Ksh 984 millions in 2015. Total exports to the EAC region marginally increased from Ksh 125.8 billion to Ksh 126.8 billion between 2014 and 2015, mainly due to the increase in the share of exports to Uganda as indicated in Figure 9.3, which grew by 12.8 per cent (KNBS, 2016).

Figure 9.3: Percentage shares of Kenya's exports to EAC region

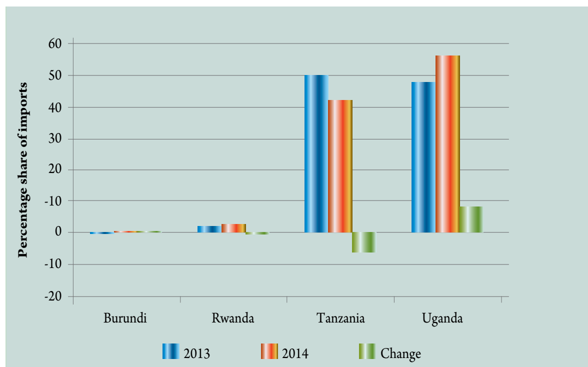


Source: KNBS (2016)

In 2015, Uganda was the leading destination for Kenya's domestic exports, accounting for 54.1 per cent of total exports to the EAC region followed by Tanzania at 26.6 per cent (Figure 9.3). The main export products to Uganda were cement, flat rolled products of iron, lubricants, medicaments, steel and salt (KNBS, 2016). Domestic exports to Uganda increased by 12.8 per cent from Ksh 60.8 billion in 2014 to Ksh 68.6 billion in 2015.

Kenya's imports from EAC partner states increased by 9.7 per cent to Ksh 40.2 billion in 2015 from Ksh 36.7 billion in 2014 (KNBS, 2016). The main imports were tobacco, raw cane sugar and un-milled maize. During the review period, imports from all the partner states increased, except for Tanzania whose exports to Kenya increased as shown in Figure 9.4.

Figure 9.4: Percentage share of Kenya's imports from EAC partner states



Source: KNBS (2016)

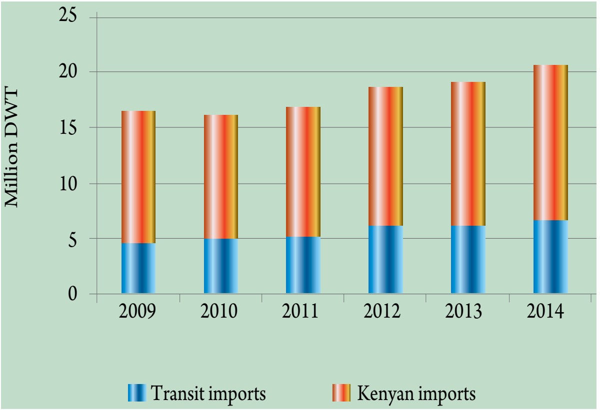
Successful implementation of EAC monetary union is expected to yield several economic and social benefits, including promotion of trade through the enhancement of the payments system for goods and services in the region; creation of a larger regional market; broadening of business and trade-related income-earning opportunities for the sub-region; and promotion of competitiveness and efficiency in production, leading to increased Gross Domestic Product (GDP).

Trade Facilitation under the EAC Integration Framework

So far, a number of regional trade reform measures have significantly reduced time and transaction costs, increased the volume of traded imports and exports, and improved the competitiveness of local firms involved in production and cross-border trade. Some of the specific initiatives include:

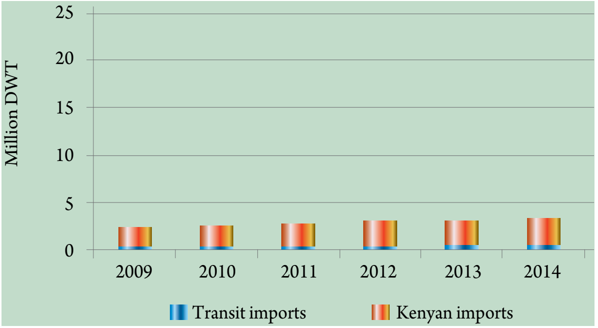
1) Improvement of the Port of Mombasa and the one-stop border post facilities: The port serves the hinterlands and land-locked neighbouring countries including Uganda, Rwanda, Burundi, Eastern DRC and South Sudan. As a result, the volume of cargo at the Port of Mombasa has grown steadily. Similarly, traffic along the Northern Corridor has grown steadily over the last four years, with more growth seen in imports as the region continues to import more goods than it exports. Figures 9.5 and 9.6 illustrate the import, export and transit traffic through the Port of Mombasa for the years 2009 to 2014. .

Figure 9.5: Kenyan import/transit imports via Port of Mombasa, 2009-2014



Source: Northern Corridor Transit and Transport Coordination Authority - NCTTCA (2015)

Figure 9.6: Kenyan exports/transit exports via Port of Mombasa 2009-2014



Source: Northern Corridor Transit and Transport Coordination Authority - NCTTCA (2015)

2) Development of the northern transport corridor: This links the land locked countries of Uganda, Rwanda and Burundi with Kenya's maritime port of Mombasa. Similarly, the Northern Corridor serves the Eastern part of the Democratic Republic of Congo, Southern Sudan and Northern Tanzania. Thus, the Northern Corridor infrastructure connects all the five countries of the East African Community and beyond. The Northern Corridor Transit and Transport Coordination Authority (NCTTCA) has undertaken various measures aimed at facilitating smooth flow of cargo and the movement of vehicles along the Corridor. Significant achievements include simplification of Port clearance procedures. A Comparative Transport Cost and Performance Study released in June 2015 by the NCTTCA revealed that the combined effects of the initiatives taken at the highest political level since October 2013 has led to very real reductions in time from the arrival of cargo through delivery to final inland destinations, the direct cost of transportation along the Northern Corridor, and the indirect or hidden cost of transport arising from transit delays. The initiatives undertaken so far to improve the performance of the Corridor and consequently

to make impact on the transportation cost include:

- Establishment of the Single Customs Territory (SCT), which encompasses three pillars: free circulation of goods; revenue management system; and legal and institutional framework. The launching of the SCT has reduced time for and cost of clearance of cargo. Under the SCT, multiple security bonds and multiple customs declarations are not required. According to the Rwanda Revenue Authority, the time for clearance of cargo destined for Kigali has dropped from 21 to six days since the launching of the SCT in 2014. Besides, the cost of clearing a container destined for Rwanda dropped from US$ 4,990 to US$ 3,387 while the same cargo destined for Kampala dropped to US$ 1,731 from US$ 3,375 .
- Elimination of differences in Customs laws and instruments;
- Interfacing of Customs systems across the region;
- Replacement of multiple Customs by joint verification;
- Reduction of road, police and Customs roadblocks along the transport corridor;
- Introduction of high speed weigh-in-motion system, and
- Reduction of congestion at the Port and border posts.

Subsequently, the average dwell time for cargo inside the port has been substantially reduced over the past five years. For instance, transit time between the port gate and Malaba stands at 3.4 days, compared to 12 days in 2008 for most transit traffic (NCTTCA, 2015). In addition, the transportation logistics cost has reduced as shown in Table 9.1.

3) The establishment of the EAC time bound programme on elimination of Non-Tariff Barriers (NTBs). This is a joint initiative by various stakeholders to efficiently resolve unnecessary cross-border trade barriers and disputes as they arise. During the 15th EAC regional forum on elimination of NTBs that was held from 25-27 September 2014 in Arusha, Tanzania the following NTBs were reported as resolved:

(a) A requirement that cigarettes exported to Uganda must have a local material content of 75.0 per cent;

(b) The construction of verification sheds and parking yards at border posts, which were initially lacking;

(c) Charging of full duty on aluminium products on EAC duty remission scheme produced in Kenya and exported to Uganda;

(d) Introduction of a levy of 1.5 per cent for railway development in Kenya for imports destined to Kenya;

(e) Stoppage of imposition of a 25.0 per cent duty on metal products from Kenya in Burundi;

(f) Stoppage of imposition of 25.0 per cent duty of plastics from Kenya in Tanzania;

(g) Removal of US$ 500 charges for all trucks registered in Burundi when they ferry cargo through Tanzania;

Table 9.1: Trends in transport costs from Mombasa (US$) of TEU along the northern corridor

	Bujumbura	Goma	Juba	Kampala	Kigali	Nairobi
2011	8,000	9,500	9,800	3,400	6,500	1,300
2014	6,500	7,000	4,700	2,900	4,800	1,045
Change (%)	-19	-26	-23	-9	-26	-20

Source: NCTTCA (2015), accessed from http://www.ttcanc.org/documents.php on 14th October 2015

(h) Stoppage of 25.0 per cent of consignment of Kiwi shoe polish of SC Johnson and Son Kenya Ltd at Namanga border while company had been de-gazzetted from EAC Duty Remission scheme.

Major concerns and challenges

The main challenges facing the EAC integration relate to ineffective implementation of already signed protocols, including the Customs Union and Common Market protocols. Specific challenges include:

(i) Advancing full implementation Customs Union and Common Market protocols;

(ii) Persistence and evolution of non-tariff barriers. The status of NTBs in March 2015 was as follows:

- Eighteen (18) NTBs were unresolved;
- Four (4) NTBs were reported as new; and
- Eighty three (83) NTBs were reported resolved cumulatively.

(iii) Economic disparity of the partner States and possibility of some countries being more dominant.

(iv) Disparity in education and skills/enterprise development - free movement of labour.

(v) Land issues, given the varying population/land ratios and the right of establishment.

(vi) Loss of sovereignty and political power at various governance levels under decentralization.

(vii) Issues related to security and migration, given ease of movement of people across borders.

9.3.2 Common Market for Eastern and Southern Africa

Kenya was among the founder members of COMESA, which was established in 1981 under the African Union's Lagos Plan of Action as a building bloc towards the African Economic Community. With a population of about 480 million and combined GDP of over US$ 520 billion, COMESA provides an opportunity to generate self-sustaining economic growth through trade and investment.

Kenya has maintained a positive trade balance with its COMESA partners in the last five years as shown in Figure 9.7. According to KNBS (2015a), trade balance improved by 33.16 per cent in 2011 before declining by 9.56 per cent and 7.67 per cent in 2012 and 2013, respectively. However, an improvement of 3.99 per cent was realized in 2014 due to, among other factors, an increase in exports to COMESA by 3.85 per cent in 2014 and the depreciation of the shilling against the US dollar.

Figure 9.7: Kenya's overall trade balance in COMESA in (Ksh billions)

Source: KNBS (2015a)

In 2015, trade balance improved by only 1.32 per cent mainly because imports grew more rapidly than exports to COMESA. Specifically, exports to COMESA increased by 5.35 per cent, whereas imports from the region increased by 11.23 per cent.

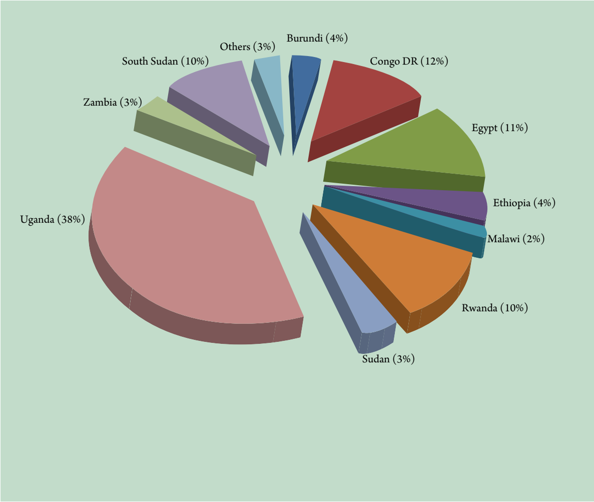
Overall, Kenya's exports to COMESA declined steadily between 2011 and 2013 as indicated in Figure 9.8. However, exports to the region increased by 3.99 per cent and 1.32 per cent in 2014 and 2015, respectively. Imports, on the other hand, have been increasing marginally since 2010, with a reduction being realized only in 2013. The reduction in export performance is attributed to rising competition from imports from China and India, as well as increased production of various merchandise in COMESA countries.

Kenya's exports to COMESA are still dominated by agricultural and low-technology manufactured products. The major exports include tea, cement, cigarettes and beer, as well as steel and iron products. The main imports from the region include manufactured tobacco, paper/paper boards, and chemicals. This shows that Kenya exports products that are also produced in other COMESA countries. Therefore, diversifying exports by introducing new products in which Kenya has a comparative advantage is necessary to improve its export performance in COMESA. The main export destination for Kenya's products in COMESA in 2015 was Uganda, which accounted for 38.0 per cent of the value of exports as indicated in Figure 9.9. This was followed by Congo DR at 12.0 per cent, Egypt at 11.0 per cent and South Sudan at 10.0 per cent.

Figure 9.8: Exports and imports in COMESA (Ksh billions)

Source: KNBS (2015a)

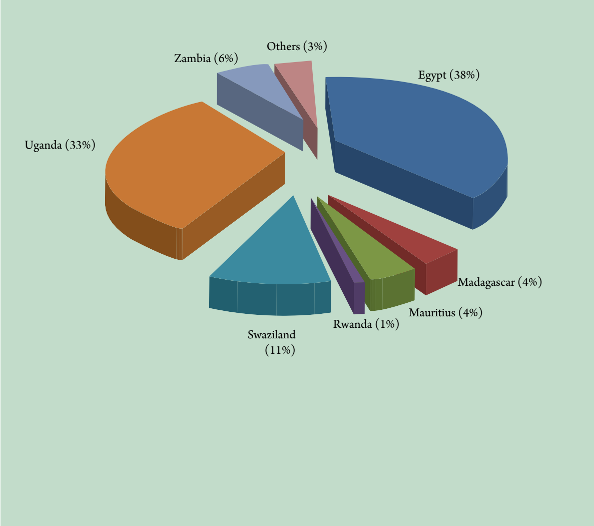
Figure 9.9: Major export destinations in COMESA by Kenya (2014)



Source: KNBS (2016)

Egypt was the main source of Kenya's imports in 2015, accounting for 38.0 per cent of the value of imports as indicated in Figure 9.10. Other major sources of imports included Uganda at 33.0 per cent, Swaziland at 11.0 per cent and Zambia at 6.0 per cent.

Figure 9.10: Major sources of imports in COMESA by Kenya (2014)



Source: KNBS (2016)

Constraints and Challenges

The key challenge facing COMESA integration is the slow pace of implementation by member States. So far, only 14 out of 19 member States have acceded to the FTA level since 2000, and the others have adopted a 'wait-and-see attitude'. The other challenge is the multiple memberships of member States to more than one regional economic bloc. Such a scenario adds to the burden in terms of contributions by member States. If the various trade instruments and programmes are not carefully rationalized, it leads to monitoring and coordination challenges. In addition, there is the emerging issue of how to deal with the new corporate dynamics in which international firms form strategic alliances to exploit economies of scale or synergy, take advantage of differences in comparative advantage, spread the risks of high fixed costs, and gain access to new technologies and new markets. These developments point to a fundamental shift in the way competition and cooperation among regional firms should be viewed.

Besides, COMESA countries face the challenge of how to become more involved in decision-making at the WTO and the implications of implementing existing WTO rules and regulations on the economies of the region. In this regard, COMESA needs to ensure full preparedness and adequate technical negotiation and implementation capacity among member States and also forge and maintain a common stand during negotiations.

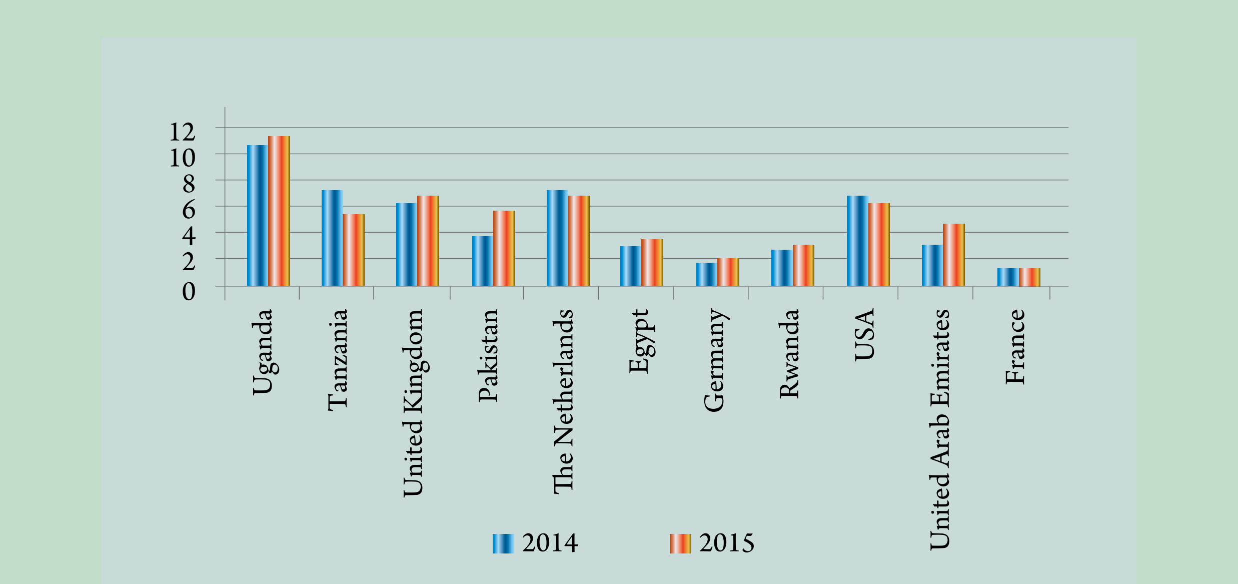
9.4 International Trade

Kenya's economy is widely integrated with the global economies as a result of liberalization of various sectors of her economy and the economic relations it has galvanized with her trading partners at bilateral level. Moreover, the country is a founding member and active participant in the multilateral trading arena or the World Trade Organization (WTO).

9.4.1 Export destinations for Kenya

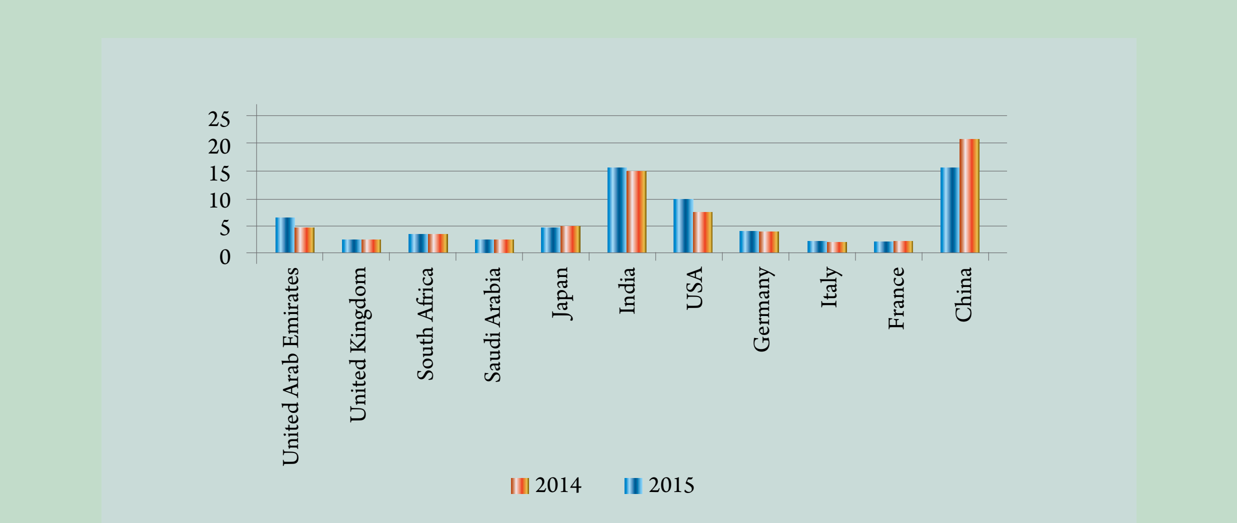
The major destinations for Kenyan exports are shown in Figure 9.11. Uganda is the leading export destination for Kenyan products, accounting for about 11.8 per cent of the total exports in 2015. On the other hand, Tanzania has been overtaken by the Netherlands and USA, which are Kenya's second and third leading export destinations, with Tanzania emerging as number four in 2015. The decline of Kenya's exports to Tanzania could be as a result

Figure 9.11: Leading export destinations (% share in 2014 and 2015)



Source: (KNBS, 2016)

Figure 9.12: Sources of imports for Kenyan (% share), 2014 and 2015



Source: KNBS (2016)

of increased competition from relatively cheaper imports from South Africa, China and India. There was a sizeable increase in exports to Uganda in 2015 relative to 2014. Uganda, Tanzania and Rwanda, which are among the leading export destinations for Kenyan goods, are part of the EAC.

9.4.2 Major sources of imports for Kenya

In 2015, the biggest share of imports into Kenya originated from China, India, USA and Japan (Figure 9.12). The imports from China have shot up in the recent past due to increased importation of materials used in undertaking major infrastructure projects, including the Standard Gauge Railway (SGR) project and other road projects being undertaken by Chinese firms. Even though Saudi Arabia, India and China are major sources of Kenyan imports, they are not major export destinations as revealed by Figure 9.11.

9.4.3 Export and import structure

Kenyan export products are primarily agricultural in nature, as indicated in Table 9.3. For instance, in 2015, 44.7 per cent of exports were food and beverages, a slight increase compared to 40.8 per cent for the year 2014. In 2015, export of non-food industrial supplies was also quite high at 33.3 per cent. These are mainly basic manufactured products that find their way to the regional markets

Table 9.2: Kenya's export and import structure (% share), 2014-2015

	Exports 2014	Exports 2015	Imports 2014	Imports 2015
Food and beverages	40.84	44.68	6.91	7.83
Industrial supplies (non-food)	27.02	25.87	28.56	33.25
Fuel and lubricants	0.71	1.26	21.43	15.04
Machinery and other capital equipment	1.63	1.91	17.22	18.23
Transport equipment	1.57	1.42	17.22	16.92
Consumer goods not elsewhere specified	27.89	24.85	7.02	7.98
Goods not elsewhere specified	0.34	0.01	1.64	0.76

Source: KNBS (2014, 2016)

of the EAC and COMESA. During the period 2015, machinery and other capital equipment, fuels and lubricants, and transport equipment also constituted a large share of imports at 18.2, 15.0 and 16.9 per cent, respectively.

As indicated in Table 9.3, there are no major changes in the structure of export and import products. Structural transformation of the industrial sector is important for sustainable development of the economy. For instance, during economic recessions, a fall in commodity prices of exports adversely affects domestic exchange rates, balance of payments and terms of trade. Thus, there is urgent need to identify constraints hampering development of high productive sectors with a view to enhancing value addition in primary products so as to create more employment opportunities, incomes and improve welfare.

9.4.4 Outcome of the 10th WTO Ministerial Conference

The WTO is an international inter-governmental organization dealing with the formulation and implementation of international trade rules and arbitration of trade disputes between its members. Kenya hosted the 10th WTO Ministerial Conference (MC10) in Nairobi from 15-19 December 2015. The meeting culminated in the adoption of six Ministerial Decisions on agriculture, cotton and issues related to least-developed countries (LDCs), referred to as the 'Nairobi Package' (WTO, 2015). These included:

Agriculture

- Developed countries committed to eliminate export subsidies immediately except for a few agricultural products. On the other hand, developing countries should do the same by 2018. The developing countries will enjoy some flexibility in the area of marketing and transport costs until 2023, and the poorest and food-importing members will be allowed more time to cut export subsidies.

- Member countries agreed to find a permanent solution to public stockholding for food security purposes. Public stockholding programmes are used by some developing countries to purchase food at administered prices and distribute it to poor people. While food security is a legitimate policy objective, public stockholding programmes distort trade when they involve purchases at prices fixed by the governments.

- The issue of establishing a Special Safeguard Mechanism (SSM) for use by developing countries has been pursued in the market access pillar of the Doha agriculture negotiating text. The G-33 group of developing countries is the main proponent of the SSM. The Ministers agreed on a mechanism that would allow developing countries to temporarily raise import tariffs on agriculture products in cases of import surges or price declines.

Cotton

- The Cotton Initiative was originally raised by Benin, Burkina Faso, Chad and Mali in the 2003 General Council. The issue revolved around the damage believed to have been caused by cotton subsidies in richer countries due to subsidies and for compensation to be paid to LDC cotton-exporting countries to cover economic losses caused by the subsidies. In the meeting, developed and developing country members agreed preferential trade arrangements in favour of LDCs, as from 1 January 2016, and duty-free and quota-free market access for exports by LDCs of relevant cotton-related products.

Least Developing Countries Issues

- Enhanced preferential rules of origin. Preference-giving countries should allow non-originating material of up to 75.0 per cent of the final value of the product. In addition, preference giving countries should simplify their procedural and documentary requirements that are related to origin. Besides, consideration should be given for the deduction of any costs associated with the transportation and insurance of inputs from other countries to LDCs.

- Implementation of preferential treatment in favour of services and service suppliers of least developed countries (LDCs) and increasing their participation in services trade. Thus, non-LDC WTO member countries should grant preferential treatment to LDC's services and service suppliers by a period of 15 years to 31st December 2030. The WTO's Trade in Services Council was also encouraged to hold discussions on how technical assistance can be accorded to LDCs to increase their capacity to participate in trade in services.

Another important outcome from the MC10 was the landmark deal to eliminate tariffs on 201 information technology products estimated to be valued at over US$ 1.3 trillion per year. Consumers from all countries of the world are likely to benefit from lower prices of electronic products such as media players, game consoles and global positioning system (GPS).

Conclusion

Although the Nairobi conference offered a less ambitious package against the expectations of developing and least developing countries, it nevertheless provided for establishment of an improved global trading environment in which trade-distorting subsidies have been enormous. It also resolved the issue of public stocking for food security purposes where a special safeguard mechanism is to be developed. The latter are part of the longstanding Doha Issues. However, the progress made falls short of conclusively addressing the outstanding issues. Kenya and other regional bodies should take stock of the implications of the MC10 decisions at domestic levels and strategize on advancing the negotiations.

9.5 Kenya's Foreign Policy

Kenya's foreign policy provides a broad framework on the country's international engagement. The policy aims at upholding the country's sovereignty and territorial integrity, promoting international peace and security, and fostering good relations with regional states, the rest of Africa and the entire community of nations. Kenya's foreign policy objectives are realized through five inter-linked pillars of diplomacy, namely: Economic, Peace, Environmental, Cultural and Diaspora. Over the years, strategies for implementing the country's international relations policy include bilateral relations, regional integration, multilateralism and public diplomacy. Institutions that play a key role in the implementation of Kenya's foreign policy include the Presidency, Parliament, relevant ministries and county governments, among others.

9.5.1 Economic Diplomacy

Deepening regional integration

Kenya hosted the 11th Summit of the Northern Corridor Integration Projects (NCIP) in October 2015, in which the Northern Corridor Summit appraised progress made in various flagship projects including the Mombasa-Nairobi Standard Gauge Railway (SGR), which had attained over 55.0 per cent completion. Further, the summit urged relevant authorities to sign contracts for the Naivasha-Malaba section of the SGR. The completion of the SGR is expected to boost regional trade and fasten transport among regional states. The summit also reviewed the One Area Network and directed relevant regulators to ensure that telecommunication firms in the region comply with its requirements. Other sectors reviewed include Single Customs Territory, and skills audit and promotion of industrialization in the region. The NCIP has identified 16 projects that will be implemented to fast-track regional integration. The NCIP projects include the Standard Gauge Railway (SGR); ICT infrastructure; oil refinery development; fast-tracking political federation; power generation, transmission and interconnectivity; crude oil pipeline development; refined petroleum products pipeline development; commodities exchange; human resource capacity building; land; financing; immigration, tourism, trade, labour and services (ITTLS); single customs territory; defence cooperation; peace and security cooperation; and air space management.

Ethiopia officially joined the Northern Corridor initiative during the 12th NCIP summit held in Rwanda in December 2015. Other NCIP state members are Kenya, Uganda, Rwanda and South Sudan. Other regional states are also keen on joining the Northern Corridor infrastructure projects.

Deeper engagement with external powers

Kenya co-hosted the 6th Global Entrepreneurship Summit (GES) with the United States in July 2015. Leaders from businesses, international organizations and some governments pledged to help young entrepreneurs to start and grow businesses through start-up competitions, awareness and capital mentoring programmes. Currently, the GES focuses on training and mentoring of over a million young entrepreneurs. During the GES in Nairobi, the Governments of Kenya and United States signed several agreements and Memorandum of Understanding (MOU), namely: Security Governance Initiative – Joint County Action Plan, United States Trade and Development Re-opening Agreement, Threats Reduction Biological Engagement Agreement and MoU on visa regime and MoU on assistance to Lamu Port-South Sudan-Ethiopia Transport (LAPSSET) corridor. Other agreements signed after the GES include a Customs Mutual Assistance Agreement. Even though the agreements and MoUs signed cover an array of issues, their implementation is likely to advance the realization of the country's economic diplomacy objectives.

The 3rd India-Africa Forum and the 6th Forum on China Africa Cooperation (FOCAC) held in October and December 2015, respectively, are likely to have impact on Kenya's engagement with Asian economic powers. During the India-Africa Forum, the governments of Kenya and India engaged in bilateral talks aimed at deepening technical cooperation in the health sector. The talks explored the possibility of Indian hospitals setting up health facilities in Kenya. This will not only reduce the cost of seeking treatment abroad but will also make Kenya a medical tourism destination. At the sidelines of FOCAC meeting in South Africa, Kenya and China engaged in bilateral talks to appraise joint development projects, proposed Special Economic Zones, cooperation in agricultural development, and how to address trade imbalance between the two countries through the Joint Committee on Trade, Investment, Economic and Technical Cooperation.

In the current international engagement under the new foreign policy, Nairobi positions itself as the centre of multilateral diplomacy in the region. The presence of United Nations Environmental Programme (UNEP) office, UN-Habitat office and various UN offices in Kenya is significant in raising the country's international diplomacy. It is in this light that the hosting of various regional and international conferences in Kenya becomes imperative in promoting Nairobi as the centre of multilateral diplomacy.

The hosting of the Global Entrepreneurship Summit and the World Trade Organization Ministerial Conference in December 2015 was critical in enhancing the country's reputation as an important regional actor in multilateral diplomacy. Kenya is also expected to host the 6th Tokyo International Conference on African Development (TICAD) in 2016. TICAD was initiated by the Government of Japan in 1993 to promote Africa's development, peace and security by strengthening relations in multilateral cooperation and partnership. TICAD forums are jointly organized by the Government of Japan, World Bank, United Nations Development Programme (UNDP), the African Commission and the United Nations. Over the years, TICAD has become an important forum for the promotion of high-level policy dialogue between African leadership and Africa's development partners on a range of issues, including economic growth and development, trade and investment, sustainable development, human security, peace and stability in the continent. The 6th TICAD in Nairobi will be the first of its kind in Africa. Japan is one of Kenya's key development partners. Other meetings that will be hosted in Nairobi this year include the 14th United Nations Conference on Trade and Development (UNCTAD) and United Nations Environmental Assembly (UNEA).

Challenges in Kenya's economic diplomacy

In the last decade, Kenya has made significant progress in enhancing its economic diplomacy. While increased deepening of economic relations is vital in the realization of the country's development goal, it is important to put in place mechanisms that might help in tracking various treatments and MoUs signed so that there is commitment in realizing the economic diplomacy objectives.

9.5.2 Peace diplomacy

Kenya plays a key role in the search for sustainable peace in the region through mediation, peace support operations, training of diplomats and conflict resolution. Kenyan diplomats have been engaged in the South Sudan peace process through the Inter-Governmental Authority on Development (IGAD)-led mediation to resolve the conflict that erupted in December 2013. In August 2015, the Government of South Sudan and the rebels (also known as the SPLM in Opposition) signed a peace deal to resolve their 20-month armed conflict. Implementation of the accord will benefit Kenya in terms of increased investment and trade with South Sudan, improved security and return of South Sudanese refugees to their homeland.

Kenya is supporting the United Nations peacekeeping missions across the globe. By October 2015, Kenya had peacekeepers in the following missions: United Nations Multidimensional Integrated Stabilization in Central African Republic (MINUSCA), United Nations Multidimensional Integrated Stabilization Mission in Mali (MINUSMA), United Nations Organization Stabilization Mission in Democratic Republic of Congo (MONUSCO), African Union/ United Nations Hybrid Operation in Darfur (UNAMID), United Nations Interim Force in Lebanon (UNMIL) and United Nations Mission in South Sudan (UNMISS).

Kenya has been instrumental in the formation of the Eastern African Standby Force (EASF). The EASF is one of the five sub-regional brigades that form the African Standby Force (ASF), which will be operational in 2016. ASF is one of the key pillars of African Peace and Security Architecture. ASF is being set up to avoid reliance on the outside world in peacekeeping across Africa. The current crisis in Burundi might be a test for the newly created sub-regional brigades as the AU contemplates deployment of peacekeepers to Burundi.

Challenges to Kenya's peace diplomacy

Though Kenya has been instrumental in regional peace processes especially in South Sudan and Somalia, there are certain challenges including lack of commitment to implement fully the peace deals, intricate nature of conflicts in regional states, and internationalization of some conflicts. Regional peace support operations also face challenges such as inadequate resources, lack of cooperation from some parties to conflicts, religious and cultural sensitivities of host countries, coordination of operation among troop-contributing countries, and peacekeepers being accused of siding with one of the parties to the conflict. Moreover, Kenya may face a challenge in using some policy instruments such as sanction in regional conflicts.

9.6 Conclusion and Recommendations

Generally, Kenya is emerging as a regional business hub owing to its strategic location, connectivity and fast growing developments in information technologies. These developments accompanied by improvements in business environment have seen tremendous growth and evolution in wholesale and retail trade across various urban areas in the country. Besides, significant opportunities for further expansion of economic growth and development exist through expansion of trade in the EAC, COMESA and beyond. This, however, requires improvement of the commercial environment by addressing domestic constraints to international business development.

Development of the business environment, together with breaking into regional supply chains, would be vital for attraction of foreign investments and subsequent diversification into new export lines. Furthermore, as Kenya implements the new foreign policy, it is imperative to explore how the country can be an effective leader both at the region and continent levels especially in socio-economic development, investment destination, strengthening Africa's institutional engagement with external development partners, and on security issues.

Kenya's role in peace diplomacy through mediation, peace support operations and capacity building of diplomats and security personnel for some neighbouring states is commendable. However, the country's leadership could be more visible if Kenya's engagement with regional states and wider development partners is enriched by leading by example, inculcating democratic principles and African values in sub-regional and continental institutions. Moreover, Nairobi can become a vibrant centre of multilateral diplomacy. Kenya should exploit its geo-strategic position to become not only an effective pivotal state in Eastern and Central Africa but in the entire continent.

In light of the above, the following recommendations are suggested:

1. Establish a framework for strengthening and rationalizing business-related laws and regulations between the national and county government levels, as well as across various county governments;

2. Continue support to regional trade facilitation programmes to improve domestic and regional commercial environment; and

3. Sustain a proactive approach to economic and geo-political issues to effectively address emerging challenges, including the threats of terrorism through mediations, peace support operations and capacity building of diplomatic and security agents.

Chapter 10

Financial Services

10.1 Introduction

This chapter reviews the performance of the financial services sector from June 2014 to June 2015. The sub-sectors covered are banking, capital markets, insurance, pension schemes, and Savings and Credit Cooperative Societies (SACCOs).

10.2 Structure of the Sector

The financial sector grew by 8.1 per cent in June 2015 compared to 7.2 per cent in June 2014. In the same period, its contribution to GDP increased marginally from 6.8 per cent to 6.9 per cent (KNBS, 2015). The structure of the sector as at June 2015 is shown in Table 10.1. During the period under review, three microfinance banks (MFBs) and one credit reference bureau (CRB) were licensed (Central Bank of Kenya, 2015a). In the same period, there were 49 insurance companies, 211 licensed insurance brokers, 31 medical insurance providers (MIPs) and 5,579 insurance agents. Other insurance players included 129 investigators, 101 motor assessors, 26 loss adjusters, 3 claims settling agents, 7 risk managers and 29 insurance surveyors (Insurance Regulatory Authority, 2015a). The pensions industry had 1,232 retirement benefit schemes, 19 registered fund managers, 29 administrators and 10 custodians (Retirement Benefits Authority, 2015). The Nairobi Securities Exchange (NSE) remained the only stock market in Kenya. In 2015, a total of 181 SACCOs had been licensed as deposit takers (DT SACCOs) as follows: teacher-based (42), government-based (42), farmers-based (58), private institutions- based (16), and community-based (23). While four SACCOs had their licenses revoked due to non-compliance issues, one new SACCO was licensed (SACCO Societies Regulatory Authority, 2015).

Table 10.1: Structure of the financial sector

Sector	Key Players	June 2014	June 2015	Change
Banking	Commercial banks	43	43	0
	Mortgage company	1	1	0
	Micro finance banks	9	12	3
	Credit reference bureaus	2	3	1
Insurance	Companies	49	49	0
SACCOs	DT SACCOs	184	181	(3)
Capital markets	Stock Exchange	1	1	0

Data Source: CBK (2015a); IRA (2015a) and SASRA (2015)

10.3 Policy Changes

The annual licensing of banks by the Central Bank of Kenya (CBK) was removed and instead the CBK was empowered to issue non-renewable perpetual licences to banks. This is in compliance with the best international practice following an adoption of risk-based supervision models by all the financial regulators in Kenya (Government of Kenya, 2015). The CBK, however, retains the power to withdraw the licence if it deems fit. In order to ensure that banks are appropriately and adequately capitalized so as to withstand shocks such as high non-performing loans, the 2013 capital conservation buffer became effective in January 2015. The stability of the sector will now be safeguarded, since banks will now maintain a capital conservation of 2.5 per cent above the minimum regulatory core and total capital ratios of 8.0 per cent and 12.0 per cent (Central Bank of Kenya, 2015b). Further, the exchange of transactions between Rwanda, Kenya, Uganda and Tanzania was boosted when the national bank of Rwanda was integrated into the East African Payment System (EAPS), which was launched in May 2014 as part of East Africa's payment modernization efforts geared towards enhancing cross border payment system across the East African region (CBK, 2014). The system is expected to facilitate trade, increase efficiency through transfer of funds on real time basis, and enhance safety and security of regional payment systems.

The Capital Markets Authority (CMA) signed a Memorandum of Understanding with the Chartered Institute for Securities and Investment for the introduction of international certification standards in the capital markets industry (CMA, 2015a). This development will introduce a certification programme that will ensure that practitioners in the industry have the required skills, operate with high standards, and apply the best practices, thus positioning Kenya as a premier investment destination. These efforts will be extended to the EAC region. Further, to promote investment in the East African region, the East African Securities Regulatory Authority (EASRA) has resolved to develop a framework for minimum requirements for regular and additional disclosures, harmonize regulations on market abuse offences, harmonize the licensing requirements for fund managers, and develop a mechanism for sharing daily trading statistics among members. The regulators also agreed on the minimum capital adequacy requirement for the proposed regional broker licence (NSE, 2015a).

The Nairobi Securities Exchange (NSE) joined the United Nations Sustainable Stock exchanges, becoming the 18th member worldwide and 4th member in Africa after the Egyptian, Nigerian and Johannesburg stock exchanges (NSE, 2015b). The platform provides peer-to-peer learning for the exchanges, geared towards improving the performance of the NSE. Further, to improve liquidity at the NSE, the government removed the 5.0 per cent capital gains tax on sale of shares due to challenges in its implementation (Government of Kenya, 2015). Instead, a 0.3 per cent withholding tax on the transaction value of the shares was introduced (Government of Kenya, 2015a). Also, the efficiency of settlement of equities and corporate bonds traded at the NSE was enhanced after the settlement process was moved to the CBK's Real Time Gross Settlement System (RTGS). RTGS is a secure payment system delivering financial settlement in real time and also aligned to the broader East African Community objective of enhancing the efficiency of settlement system as the region prepares for integration of the financial system (CMA, 2015b).

To unlock capital for the development of affordable housing and other amenities, the government exempted from stamp duty assets transfers and other transactions related to the transfer of assets into Real Estate Investment Trusts (REITs) and Assets Backed Securities (ABS). REITs and ABS are investment vehicles that allow developers, including county governments, to source funds to undertake development projects in infrastructure, housing, healthcare and energy (Government of Kenya, 2015a).

Efforts to broaden the current narrow market for government securities was boosted with the launch of Kenya's first mobile-based Treasury bond with a minimum investment level of Ksh 3,000, dubbed the M-Akiba bond (Government of Kenya, 2015b). The M-Akiba bond will enable many Kenyans to access the government debt securities through their mobile phones and at low amounts. Previously, such Kenyans could not access the securities because of high minimum amounts required. Further, M-Akiba will increase competitiveness and democratize the government securities market by reaching the 26.5 million users of mobile phone financial services. This is expected to structurally shift the "market" and "price" making process towards non-bank public and probably cheapen the rates on securities (which eventually are paid by taxpayers in debt service).

Retirement benefit schemes can now invest up to 10.0 per cent of their assets in private equity funds and venture capital funds (Government of Kenya, 2015a). However, to mitigate potential risks, a per issue limit of 15.0 per cent of assets and per issuer limit of 15.0 per cent of issue was introduced to all classes of assets, except government securities. This move will enable schemes to diversify their investments and optimize returns to members. Further, to improve governance in the retirement benefit schemes, term limits for trustees was capped to a maximum of two terms of three years.

In the SACCOs industry, SASSRA is now allowed to undertake vetting of directors and key officials of SACCOs as a way of strengthening governance in the sector. Also, the SACCOs can now share both negative and positive information of their clients with other financial institutions within the credit information sharing mechanism (Government of Kenya, 2015a). This move is expected to deal with liquidity problems emanating from non-performing loans.

In the insurance industry, the Insurance Regulatory Authority (IRA) was allowed to license agents provided they have attained the Certificate of Proficiency and also met other licensing requirements. Previously, agents had to be recommended by an insurance company in order to be registered. This measure is supposed to improve insurance penetration in the country, which is still low. Further, the insurance framework was harmonized with that of retirement benefits and collective investment sectors. Insurance companies are now required to prepare and submit investment policies subject to prescribed investment guidelines. The minimum capital requirement for the insurance industry was also increased (Government of Kenya, 2015a).

10.4 Banking Sector Performance

10.4.1 Assets, liabilities and profitability

In 2015, commercial banks registered improved growth in assets of 21.4 per cent to Ksh 3.6 trillion from Ksh 2.97 trillion in June 2014 (Table 10.2). Loans and advances and government securities were major components of the assets, accounting for 58.0 per cent and 20.4 per cent of total assets, respectively. Loans and advances grew by 20.5 per cent from Ksh 1.72 trillion to Ksh 2.1 trillion in June 2015. On liabilities, the deposit base increased by 20.3 per cent from Ksh 2,147.9 billion in June 2014 to Ksh 2,583.6 billion in June 2015. In the same period, deposit accounts increased by 24.9 per cent to 31.6 million from 25.3 million. Deposits from customers, which continued to form the major source of funding for the banking sector, accounted for 71.5 per cent of total funding liabilities. Pre-tax profits also increased by 8.0 per cent from Ksh 71.0 billion in 2014 to Ksh 76.7 billion in 2015. The factors driving growth were branch expansion, remittances and agency banking (CBK, 2015a).

Branch expansion and additional licensing of MFBs are factors that contributed to the improved performance of the MFBs. Loans from MFBs increased by 31.6 per cent from Ksh 32.9 billion in June 2014 to Ksh 43.3 billion in June 2015 (Table 10.2). Similarly, the deposit base increased by 0.8 per cent to Ksh 39.7 billion. This was attributed to increase in deposit accounts from 2.1 million to 2.4 million in June 2015 (CBK, 2015a).

Table 10.2: Banking sector indicators

Sector	Indicator	June 2014	June 2015	Change (%)
Banking	Assets (% of GDP)	Ksh 2.97 trillion ((59%)	Ksh 3.6 trillion (64%)	21.4
	Loans & advances (% of GDP)	Ksh 1.72 trillion (34.2%)	Ksh 2.1 trillion (37.5%)	20.5
	Deposit base (% of GDP)	Ksh 2.15 trillion (43%)	Ksh 2.58 trillion (46%)	20.3
	Pretax profits (% of GDP)	Ksh 71 billion (1.4%)	Ksh 76.7 billion (1.4%)	8.3
	Deposit accounts	25.3 million	31.6 million	
MFBs	Loans & advances (% of GDP)	Ksh 32.9 billion (0.7%)	Ksh 43.3 billion (0.7%)	31.6
	Deposit accounts	2.1 million	2.4 million	14.3

Data Source: CBK (2015a)

10.4.2 Access to banking services

The agency banking model by banks continued to enhance access to banking services in Kenya. A total of 17 commercial banks had been authorized by the CBK to offer banking services through contracted third parties. Since the launch of agency banking in 2010, 38,297 agents have been contracted with over 175.4 million transactions valued at Ksh 930.1 billion at the end of June 2015 (CBK, 2015a).

In the card industry, the number of cards grew by 1.57 per cent to 12.9 million cards as at June 2015. While debit cards consisting of 96.9 per cent of total cards grew by 7.76 per cent to 12.5 million, the number of Automated Teller Machines (ATMs) increased by 3.1 per cent to 2,698 in June 2015. The commercial banks' business strategies and the continued shift to non-cash payments by the public contributed to this growth. The value of transactions through cards decreased by 3.96 per cent from Ksh 785 billion to Ksh 754 billion for acquires and by 16.45 per cent to Ksh 1292.71 billion for the issuers. The increased usage of other payment channels, including mobile money transfer services, may have contributed to this decline. Indeed, mobile phone money transfer has continued to grow, with the number of subscribers increasing by 2.2 per cent from 25.9 million to 26.5 million as at June 2015. The number of agents grew by 9.1 per cent to 131,761, the number of transactions grew by 21.6 per cent to 1,002.25 million, and the value of transactions increasing by 19.9 per cent to Ksh 2,575.44 billion (CBK, 2015a).

10.4.3 Cost of credit

The overall commercial banks' (CBs) average lending rates decreased marginally from 16.36 per cent in 2014 to 15.48 per cent in 2015. In the same period, the average deposit rates increased marginally to 6.64 per cent from 6.56 per cent in June 2014. The average commercial banks lending rates and deposit rates to SMEs are also shown in Table 10.3, where marginal changes were witnessed; lending rates declined to 16.57 per cent from 17.22 per cent in 2015, and deposit rates decreased from 10.99 per cent to 10.76 per cent. The average lending rates for SMEs are higher than the overall lending rates.

Table 10.3: Interest rates in Kenya

Indicator	June 2014 (%)	June 2015 (%)	Change
CBs average lending rate	16.36	15.48	(0.88)
CBs average deposit rate	6.56	6.64	0.08
CBs average lending rate) SMEs)*	17.22	16.57	(0.65)
CBs average deposit rate (SMEs)*	10.76	10.99	0.23
MFBs average lending rate*	20.82	18.97	(1.85)

Indicator	June 2014 (%)	June 2015 (%)	Change
MFBs average deposit rate*	8.36	8.36	0
MFBs average lending rate) SMEs)*	19.58	19.29	(0.29)
MFBs average deposit rate (SMEs)*	8.88	9.02	0.14
CBR	8.5	10	1.5
KRBR	9.13 (July)	8.54	(0.59)
Interest rate spread	9.8	8.84	(0.96)

Data Source: CBK (2015a) and CBK (2015c)
*Data is from July 2014-May 2015

The MFBs' overall average lending rates decreased to 18.97 per cent from 20.82 per cent in July 2014, with the deposit rate remaining stable at 8.36 per cent. The MFBs overall lending interest rates remain higher than the overall commercial banks lending rates. The MFBs average lending rates to SMEs decreased to 19.58 per cent from 19.29 per cent in July 2014, with the deposit rate marginally increasing to 9.02 per cent from 8.88 per cent. The MFBs lending interest rates for SMEs remained higher than those of commercial banks. Thus, high cost of credit continues to be a major factor constraining SMEs productivity and growth.

In order to contain inflationary pressures and tame the exchange rate volatility, the CBR was stable at 8.50 per cent during the period under review until June 2015 when it increased to 10.0 per cent (CBK, 2015a). This led to stability of the interest rates. The Kenya Bankers Reference Rate (KBRR) reduced from 9.13 per cent in July 2014 to 8.54 per cent in June 2015. KBRR is a uniform base lending rate across the banking sector, and institutions are supposed to disclose to customers the risk premium levied above it. Despite the stability of interest rates, lending rates are high as evidenced by the interest spread at 8.8 per cent against Vision 2013 target of 6.0 per cent.

At the international level, the interest rate spread in Kenya is still high compared to aspirator countries such as Argentina, Korea, Malaysia, China, South Africa, and Indonesia whose rate is below 4.0 per cent. The low interest rate spread in these countries could be indicative of an efficient banking sector.

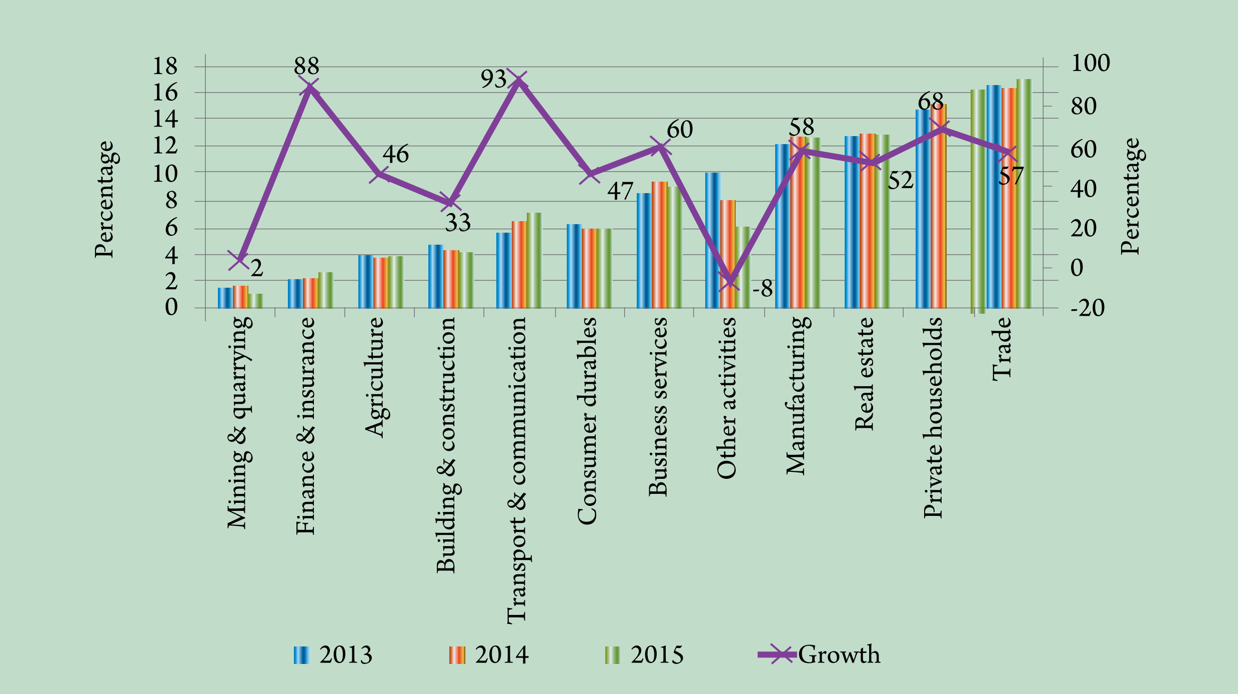
10.4.4 Credit to the private sector

Provision of more credit to the private sector is important in order to support high economic growth and generally the expansion of sectors of the economy. Private sector credit grew by 20.5 per cent from Ksh 1.719 trillion in June 2014 to Ksh 2.072 trillion in June 2015. This was as a result of increased demand for credit from various economic sectors due to increased investment opportunities and stable cost of borrowing (CBK, 2015a). The growth in credit was mainly witnessed in private households, trade, manufacturing, transport and communication, and real estate sectors (Figure 10.1). The private sector continued to dominate banking sector credit, accounting for 78.0 per cent of total lending in June 2015 compared to 84.0 per cent in June 2014. This notwithstanding, business services, transport and communications, finance and insurance, as well as private households have been the three leading sectors with the highest credit growth between 2013 and 2015. The priority sectors of Vision 2030, including agriculture, trade and manufacturing, have continued to achieve a slower credit growth of 46.0 per cent, 57.0 per cent and 58.0 per cent, respectively (Figure 10.1). Kenya's private sector credit, though growing, is still low compared to aspirator middle income countries such as South Africa, Chile, Thailand, and Malaysia, whose credit levels are above 100 per cent of GDP.

10.4.5 Non-performing loans

In 2015, the stock of gross non-performing loans (NPLs) grew by 21.8 per cent from Ksh 101.7 billion in 2014 to Ksh 123.9 billion (Table 10.4). The ratio of gross NPLs to gross loans also increased from 4.7 per cent in 2014 to 4.6 per cent in 2015. The

Figure 10.1: Private sector credit distribution



Data Source: Central Bank of Kenya (2015c)

coverage ratio (a percentage of specific provisions to total NPLs), however, declined from 38.5 per cent in 2014 to 39.1 per cent in 2015. The quality of assets (proportion of net non-performing loans to gross loans) reduced from 2.8 per cent in 2014 to 2.7 per cent in 2015. When compared to aspirator countries, the ratio of NPLs to gross loans in Kenya is high; countries such as Singapore, Malaysia Argentina, Chile, Indonesia, Brazil and South Africa have a ratio of 3.2 per cent and below.

Table 10.4: Non-performing loans

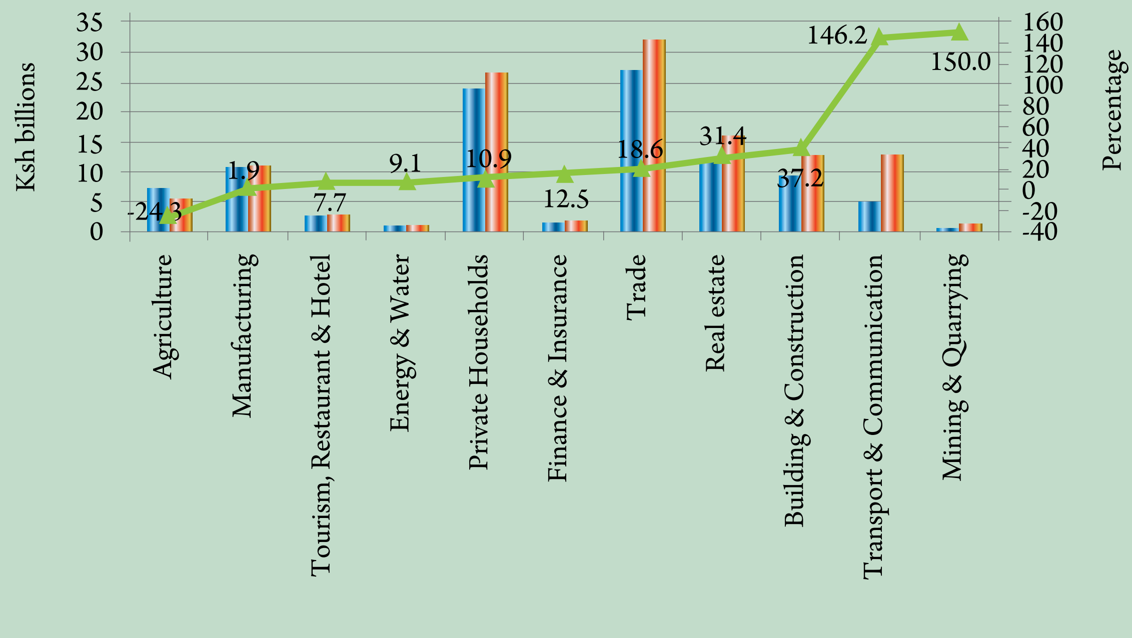
Indicator	June 2014	June 2015	Change (%)
NPLs (Ksh billions)	101.7	123.9	21.8
Gross NPLs/gross loans (%)	4.7	4.6	(0.1)
Coverage ratio (% of specific provisions to total NPLs)	38.5	39.1	0.6
Quality of assets (Net NPLs/gross loans (%)	2.8	2.7	(0.1)

Data source: CBK (2015a)

The sectoral distribution of Gross NPLs is shown in Figure 10.2. The sectors that recorded the highest growth in gross NPLs are mining and quarrying, transport and communication, building and construction, real estate, and trade. The factors responsible for this increase in NPLs in the transport sector could have been the newly introduced transport rules, which may have constrained its activities. The impasse between the Ministry of Lands and the National Land Commission, and slow payments of contractors by the government are some of the factors that may have resulted to increased NPLs in building and construction, and real estate sectors. Uncertainties in the on-going reforms in the mining sector may also have affected the mining sector. The recently experienced insecurity in the country, which led to adverse travel advisories, impacted negatively on the tourism sector (CBK, 2015e). It is likely that these effects could have spread to other sectors such as trade and private households.

Efforts to reduce the NPLs continued to be enhanced. A third credit reference bureau was

Figure 10.2: Sectoral distribution of gross non-performing loans



Data source: CBK (2015a)

licensed, bringing the number of licensed CRBs to three. The use of credit information sharing mechanism launched in 2010 has also continued to grow. The cumulative number of credit reports requested by banks was about 7.5 million as at June 2015, compared to 4.3 million reports in June 2014. The number of reports requested by customers also increased from 67,610 to 111,633 (CBK, 2015a). As banks intensify their credit recovery efforts, they have incorporated credit reference reports in the credit risk appraisal. The newly introduced capital buffers are also expected to enable the banks absorb additional loan loss provisions emanating from increase in NPLs, thus contributing to continued stability of the banking sector.

10.5 Capital Market Performance

The performance of the capital market continued to improve in 2015. High investor gains especially in the stock market are likely to have been the driving factor. The number of listed companies as at June 2015 was 66 compared to 61 in June 2014 (CMA, 2015c). One company was delisted after finalization of a takeover bid. Tradable securities at the NSE, however, remain limited.

13.5.1 Stock indices

In June 2015, all the stock indices increased (Table 10.5). The NSE 20 share index closed at 4,906 points from 4,885 points in June 2014, thereby increasing by 0.4 per cent. Similarly, the Nairobi All Share Index (NASI) initiated in 2008 also recorded an increase of 9.3 per cent to close at 164 points from 150 points in 2013. The FTSE NSE Kenya 15 Index also increased by 10.8 per cent to 216.07 points in June 2015 from 194.99 points in June 2014. The FTSE NSE Kenya 25 Index also increased by 9.10 per cent from 196.88 points in June 2014 to 214.80 points in June 2015. The continued rise in the indices means increased share prices and investor gains.

Table 10.5: Capital market performance indicators

Indicator	June 2014	June 2015	Change
NSE 20 Share Index	4,885 points	4,906 points	0.4%
NASI	150 points	164 points	9.3%
FTSE NSE Kenya 15	194.99 points	216.07 points	10.8%
FTSE NSE Kenya 25	196.88 points	214.8 points	9.1%
Stock market capitalization	Ksh 2.1 trillion	Ksh 2.3 trillion	9.25%
FTSE NSE Kenyan bond index	93.76 points	92.03 Points	1.85%
Total bond turnover	Ksh 418.8 billion	Ksh 467.4 billion	11.6%

Data source: CBK (2015f)

13.5.2 Stock market capitalization

The stock market development in Kenya continued as indicated by the growth of market capitalization. In 2015, market capitalization increased by 9.52 per cent to Ksh 2.3 trillion from Ksh 2.1 trillion in 2014 (Table 10.5). Though increasing, market capitalization in Kenya nevertheless remains at below 50.0 per cent of GDP compared to aspirator countries such as South Africa, Singapore, Malaysia and Thailand, whose market capitalization stands at over 100 per cent of GDP.

10.5.3 Bonds market

Total bonds market turnover was Ksh 467.4 billion in 2015 compared to Ksh 418.8 billion in 2014, an increase of 11.6 per cent (Table 10.5). Treasury bonds continued to dominate the bonds market, accounting for 99.8 per cent of total bonds turnover (CMA, 2014c). The FTSE NSE Kenyan bond index decreased by 1.85 per cent to close at 92.03 points in June 2015 from 93.76 points in June 2014. The bond index tracks the returns of government securities. In the period between July 2014 and June 2015, a total of seven new Treasury Bonds were issued by the government to fund capital investment in the country (CMA, 2014c).

On corporate bonds, the confidence of local investors in economic prospects of the economy and the East African region led to several issues (NSE, 2015a). Centum Investment Company issued a five year bond worth Ksh 6 billion to finance new investments in power plants and real estate. A part of the issue (Ksh 2.1 billion) is equity linked notes, while the fixed rate notes are Ksh 3.9 billion. This was a milestone for the capital markets as this is the first issue to be listed with both the fixed rate notes and the equity linked notes. In order to raise additional capital to strengthen its capital base and finance expansion, Chase Bank issued the first tranche of its Ksh 10 billion bond, where it raised a total of Ksh 4.8 billion after exercising the green shoe option (i.e. accepted extra bids than originally targeted as a result of over-subscription). Commercial Bank of Africa group also raised Ksh 7 billion after exercising a green shoe option of Ksh 2 billion to facilitate expansion within the East African region. CMA also approved British American Investment Company's bond worth Ksh 5 billion to be used in funding strategic business initiatives. Lastly, East African Breweries Ltd issued a Ksh 9.04 billion bond to be used in restructuring its balance sheet, capital expenditure and other general purposes.

10.6 Insurance Sector

The insurance industry's gross written premiums in June 2015 increased by 15.3 per cent to Ksh 88.38 billion compared to Ksh 76.64 billion in 2014. The premium income reported under life insurance business amounted to Ksh 29.74 billion, while general business premiums were Ksh 58.64 billion. The Kenyan insurance industry continues to be non-life business-driven, which accounted for 66.0 per cent of total premiums by end of June 2015. The increased awareness on the importance of insurance, coupled by more innovative products and distribution channels, are some of the factors contributing to the growth in premiums. As a result of rising business volumes over the years, claims incurred in the industry also increased by 19.9 per cent to Ksh 24.39 billion in 2015 from Ksh 20.34 billion in June 2014. The assets of the insurance industry grew by 16.2 per cent to Ksh 412.2 billion as at June 2015 from Ksh 354.8 billion in June 2014. In the same period, liabilities also increased by 19.72 per cent to Ksh 320.2 billion from Ksh 267.5 billion (IRA, 2015b).

10.7 Conclusions and Recommendations

10.7.1 Conclusions

The review and analysis of the financial services sector in 2015 generates several policy concerns.

The interest rate interest spread continues to be high at 8.8 per cent against Vision 2030 target of 6.0 per cent. The commercial banks overall lending rates are lower than MFBs overall interest rates. However, the commercial banks lending rates for SMEs are higher than their overall lending rates. Further, the MFBs lending interest rates for SMEs remain higher than those of commercial banks. Thus, high cost of credit continues to be a major factor constraining SMEs productivity and growth.

The stock of gross NPLs grew by 21.8 per cent, with the mining and quarrying, transport and communication, building and construction, real estate, and trade sectors recording the highest growth.

The capital markets in Kenya have been deepening as indicated by the increase in corporate bond issues. Most of these bonds have been over-subscribed and the issuers have had to exercise the green shoe option to take up the extra bids. Such over-subscription could be as a result of continued limited tradable securities at the capital markets.

10.7.2 Recommendations

Increase competition to lower cost of credit

There is need to disseminate information on interest rates of the banking sector more intensely. Currently, such information is only published in the CBK website. The CBK should publish this information in the mainstream media to enable the public compare the pricing of loan products using the KBBR as base lending rate. This is expected to increase competition and lower the cost of credit.

Deepen the capital markets and expand on the tradable securities

In order to further deepen the capital markets in Kenya and expand on the tradable securities, the establishment of the derivatives market need to be fast-tracked. A derivatives market would provide investors with expanded tradable securities.

Reduce non-performing loans

The mining and quarrying, transport and communication, building and construction, real estate, and trade sectors are recording the highest growth of the gross NPLs as a result of government reforms, uncertainty in these reforms, or a standoff between government institutions. Government reforms, therefore, need to be well designed so as not to impose constraints to the economic sectors. Further, any standoff between government institutions needs to be resolved soonest.

Chapter 11

Building and Construction

11.1 Introduction

The building and construction sector is crucial to attainment of Kenya's development agenda. The Constitution of Kenya explicitly places key expectations of the sector pursuant to the Bill of Rights, and the need for adequate and decent living standards. Kenya Vision 2030 and the Second Medium Term Plan 2013-2017 (MTP II) strategically provide for key flagship projects for implementation. The sector is also critical towards realization of Sustainable Development Goals (SDGs) on making cities and human settlements inclusive, safe, resilient and sustainable. The emphasis in the sector is to: ensure access for all to adequate, safe and affordable housing and basic services and upgrade slums; and to develop quality, reliable, sustainable and resilient infrastructure, including regional and trans-border infrastructure; and to support economic development and human well-being, with a focus on affordable and equitable access for all.

11.2 Sector Performance

The construction sector registered a growth of 14.1 per cent in the third quarter of 2015, which was an improvement from 8.8 per cent growth in 2014 in the same reporting period. The sector GDP in the third quarter of 2015 was Ksh 76,099 million, which was an increase from Ksh 65,791 million recorded in a similar period in 2014. The performance of the sector was the best in the economy comparatively, ahead of traditional sectors such as agriculture, manufacturing, finance and trade.

A review of two important construction sector indicators is shown in Table 11.2. In 2015, the demand for cement, which is a key input in construction, recorded an increase compared to

Table 11.1: Construction sector contribution

	2010	2011	2012	2013	2014	2015 (Q1)	2015 (Q2)	2015 (Q3)
GDP (Ksh millions in 2009 prices)	133,650	139,050	154,816	163,841	185,302	47,550	51,808	53,129
GDP (Ksh millions in current prices)	142,669	164,631	190,851	212,878	259,624	68,109	74,208	76,099
Sector contribution to GDP growth	19.1	4.0	11.3	5.8	13.1	11.2	9.7	14.1

Source: Compiled from Government of Kenya (2015b)

Table 11.2: Selected indicators for the building and construction sector, 2011-2015

Indicators/Years	2011	2012	2013	2014	2015(q3)
Cement consumption ('000 tonnes)	3,870	3,991	4,266	5,196	1,443,544
Loans and advances from commercial banks to the sector (Ksh millions)	50,805	69,183	70,770	80,406	100,827

Source: Compiled from Government of Kenya (2015b)

previous years. Cement consumption grew by 10.7 per cent from 1,304,257 metric tonnes in the third quarter of 2014 to 1,443,544 metric tonnes in the same period of 2015 (Government of Kenya, 2015b). The amount of formal credit advanced to the sector rose from Ksh 78,804 million in the third quarter of 2014 to Ksh 100,827 million in 2015 (KNBS, 2015b).

11.3 Policy Initiatives and Expenditure Allocations

The Second Medium Term Plan 2013-2017 (MTP II) of Kenya Vision 2030 guided the development of various flagship projects that have a bearing on the performance of the sector. For the purpose of analysis, it should be noted that initiatives in the building and construction sector were not explicit, but were rather a factor of expanded expenditure in development of other sectors such as transport, housing, urban development, agriculture, energy and information and communication technology.

In 2015, the sector maintained a robust growth mainly supported by an increased investment in transport and infrastructure development. The expansion and modernisation of aviation facilities, initiation of the Lamu Port Southern Sudan and Ethiopia Transport (LAPSSET) corridor, initiation of the railway expansion programme by developing the Standard Gauge Railway, and expanding Nairobi commuter railway services and initiation of programmes for the upgrading of national and county road networks are some of the most significant projects.

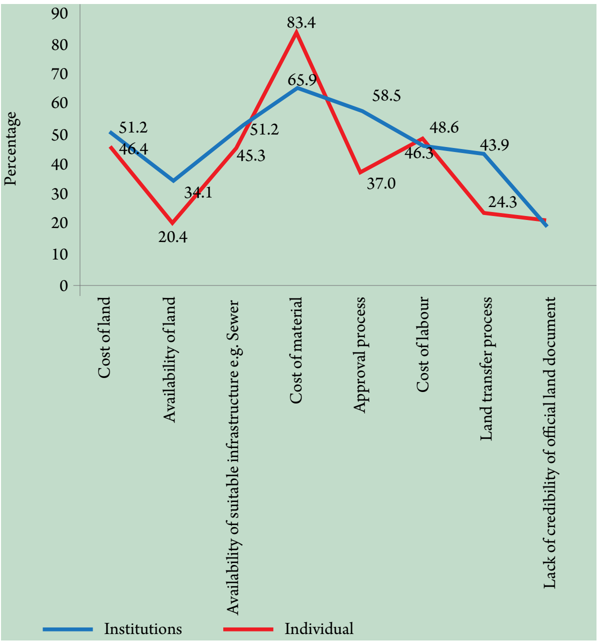
Increased investment in infrastructure contributed significantly to the performance of the sector, especially during the third quarter, contributing 14.1 per cent to GDP growth (Government of Kenya, 2015b). Total expenditure for the State Department of Infrastructure rose substantially by 37.6 per cent to Ksh 120.5 billion in 2014/15. Similarly, total development expenditure on roads for the financial year 2014/15 rose from Ksh 64.4 billion in 2013/14 to Ksh 94.7 billion in 2014/2015. Funds disbursed by the Kenya Roads Board (KRB) for road repair and maintenance activities increased by 11.2 per cent to Ksh 25.8 billion in 2014/15.

Apart from being a basic right, housing contributes greatly to the socio-economic development of the country due to its backward and forward linkages. The housing sector as a sub-set of the building and construction sector is critical towards realization of the Sustainable Development Goal (SDG) of ensuring access for all to adequate, safe and affordable housing and basic services.

Under the social pillar of Vision 2030 MTP II, it is noted that the national population has been increasing steadily by one million people per year, with projections indicating that 50 per cent of the population will reside in urban areas by year 2030 (Government of Kenya, 2013). This poses some challenges in terms of shortage of affordable and decent housing, resulting in the mushrooming of informal and unplanned settlements.

The housing gap in Kenya is estimated at approximately 200,000 housing units annually, with the bulk deficit being in the development of quality and affordable housing for lower income Kenyans. Housing development in Kenya is private-led, with a comparatively low level of public sector investment. According to the Housing Survey (2013), the high cost of building materials, high cost of land and the high cost of labour have been cited as the major challenges facing housing sector development in Kenya (Figure 11.1). Absorption of alternative building materials and technologies, for example use of Stabilized Soil Blocks (SSBs), reinforced concrete panels and prefabricated panels, is still considerably low, partly as a result of stringent regulations prescribed by the Building Code.

Figure 11.1: Challenges of housing development



Source: Kenya National Bureau of Statistics (2013)

The review of programme resource requirements and allocations (Table 11.3) for the sector reveals that housing development has the second highest allocation for capital expenditure at Ksh 7.559 billion for 2016/2017. An allocation of Ksh 800 million has also been set aside for building standards and research for 2016/2017.

Public sector resource allocation, coupled with strengthened private-public partnerships to housing development would support the enhancement of the national housing stock. As at 2015, the Ministry of Lands, Housing and Urban Development had produced a feasibility study report for proposed housing developments at Park Road, Starehe and Shauri Moyo sites for civil servants housing scheme under public-private partnerships with service availability payments (SAP) in Nairobi City County.

Analysis of programme expenditure by economic classification in the building and construction sector (Table 11.4) shows that in 2014/15, urban and metropolitan development recorded the highest capital expenditure of Ksh 7,430 million. This is in line with MTP II requirements for the finalization and implementation of National Urban Development Policy; Metropolitan Policy; Markets Development Policy; Physical Development Plans for Resort Cities of Lamu, Turkana, Isiolo, Kilifi and Diani – Ukunda; and development and implementation of metropolitan branding and

Table 11.3: Real estate, building and construction sector programme resource requirements and allocation 2016/17 (Ksh millions)

Programme	Current (Ksh millions)		Capital (Ksh millions)	
	Requirements	Allocation	Requirements	Allocation
Housing development	160	158	12,405	7,559
Estate management	395	300	9,175	500
Stalled and new government buildings	317	306	4,215	739
Building standards and research	23	22	15	800
Coastline infrastructure development	61	59	531	40
Pedestrian access	0	0	30,793	10,868
Metropolitan planning and infrastructure development	226	202	10,000	4,290
Urban development and planning services	177	95	20,793	6,578

Source: Compiled from National Treasury, MTEF Report 2016/17-2018/19 promotion; metropolitan safety and emergency; metropolitan social infrastructure and quality of life; metropolitan planning; and environmental management of the metropolitan regions identified in Vision 2030, namely: Nairobi, Kitui-Mwingi-Meru, Mombasa, Kisumu-Kakamega, Nakuru-Eldoret, and Wajir-Garissa-Mandera.

Housing development and human settlement recorded the second highest capital expenditure for 2014/15 at 4,341 million, indicative of the commitment to meet the housing supply gap.

At the county level, construction and rehabilitation of county roads and development of critical infrastructure at the various county headquarters influenced the sector's output (KNBS, 2015a). The contribution of the county budgets to land, housing and urban development for 2014/2015 was lower than 5.0 per cent of the overall budget estimates across all counties (Figure 11.2). Most of the counties spent more than 10.0 per cent of their budgets for 2014/2015 on transport, infrastructure and public works.

11.4 Policy Developments and Emerging issues

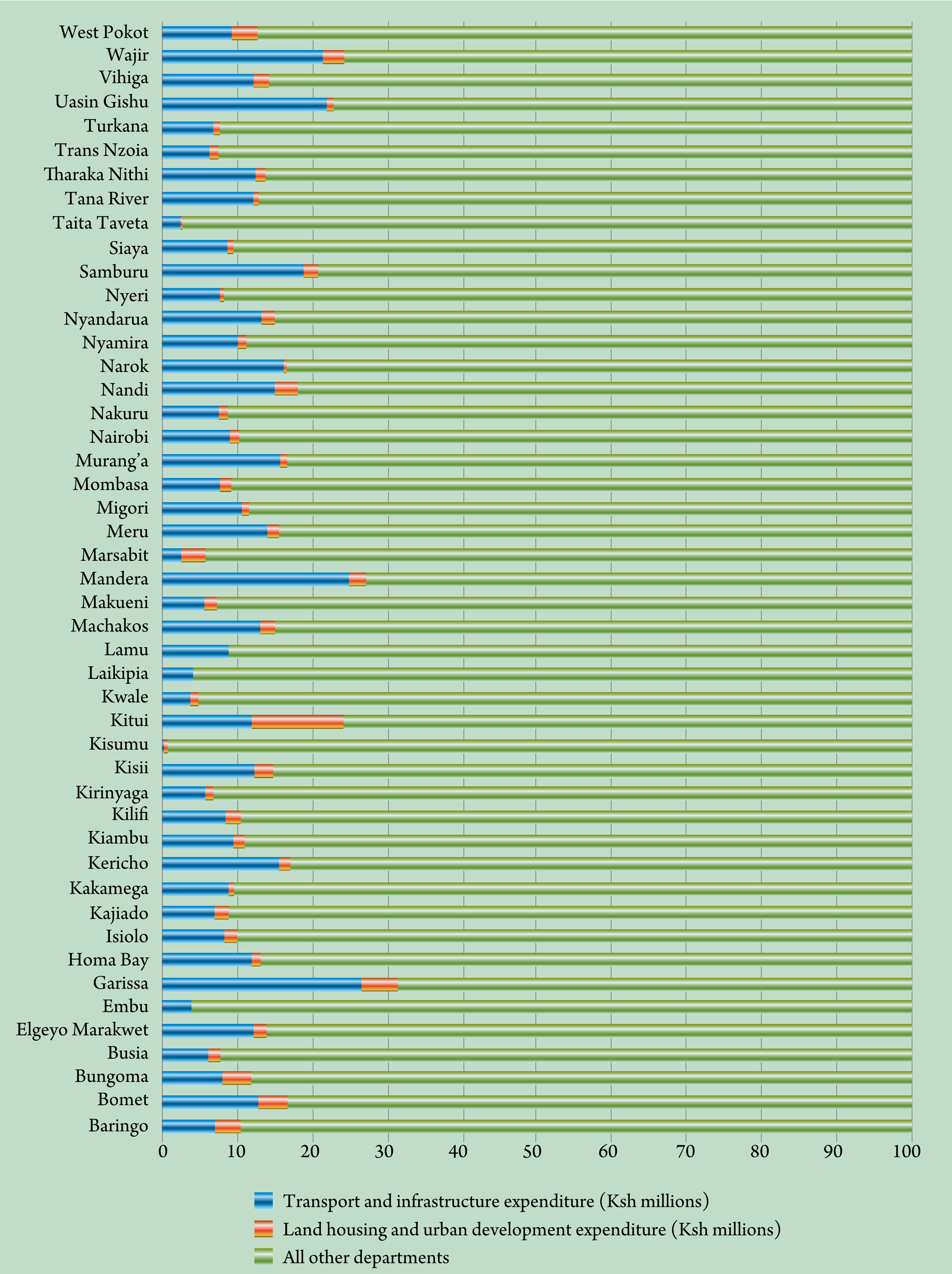
The construction industry is constrained by lack of a robust national construction regulatory framework to address new emerging trends in building and construction, project financing and development, construction business development, materials, and standards. Outdated building regulations curtail the use of alternative building materials. There is need for the development and enactment of the National Building Regulations (2014), National Housing Policy and Housing Bill, Urban Development Policy, and National Spatial Plan for effective regulation.

The sector continued to face high unit costs of construction. Cost benefit analysis of related projects indicates that unit costs could have been inflated with regard to high cost of building materials due to inadequate supply, higher transport costs, increased labour costs, land acquisition and compensation costs, and high costs due to augmented risk allocation factors for credit sources of finance. Towards the third quarter of 2015, the country witnessed a general increase in the cost of credit on account of volatility of interest rates, and this had adverse impacts to the sector by curtailing housing provision for the low income cohort by the private sector.

Furthermore, the sector witnessed severe challenges in 2015 in terms of collapsed buildings that caused loss of life and property. There was a general spike in building collapse incidences in Kenya, with 1996-2011 experiencing 24 cases over the period, 2014 experiencing 13 cases and 2015 up to the month of July experiencing 13 cases. This has mainly been attributed to poor workmanship as a result of lack of trained workmanship in the sector, lack of enforcement in quality control, weak implementation of laws, inadequate geotechnical and materials investigations, lack of professional ethics, and lack of a customized version of building specifications and manuals. The National Construction Authority (NCA) enhanced its efforts in regulating the sector by ensuring formal registration of built environment professionals and undertaking construction supervision. Nevertheless, there is need for rationalization of the plan approval procedures.

The advent of devolution in the Kenyan governance and economic structure had an impact on the sector in 2015. The development of county government offices and residential accommodation and support infrastructure influenced sector indicators such as demand for space, construction labour and services, as well as building materials. The private sector real estate development also witnessed increased demand for residential and commercial space, especially in previously under-developed areas. The county governments rolled out infrastructure projects such as roads and bridges, health facilities, markets, among other amenities. Fiscal performance reports indicate that county governments allocated

Figure 11.2: County expenditures on transport and urban development, 2014/2015



Source: Office of Controller of Budget (2015) resources towards capital expenditure on these infrastructure projects (OCOB, 2015).

County governments also influenced the sector performance through regulation on planning, approval and enforcement of building and construction. County legislation and policy on physical planning and building plan approval fees and procedures led to increased costs of construction and delay in project execution timelines. These, coupled with national government legislation, fees and procedures, such as NCA fees and the National Environment Management Authority (NEMA) charges and licensing process, had the combined effect of adversely affecting investment in the sector. Further, the multi-agency jurisdiction in the sector across the two level of government created a situation of duplicity of action and purpose.

11.5 Policy Recommendations

The foregoing analysis reveals the need for strategic policy intervention to support performance of the building and construction sector.

- The structure of fees and procedures for planning, approval and regulation of building and construction should be harmonized across national and county governments. Nationally applicable guidelines for the procedures of project development approval should be developed and cascaded to the sub-county level. Applicable fees for building and construction approval should also be rationalized across counties to enhance transparency and promote investor confidence. Further, the regulation and enforcement mandates of NCA, NEMA and the county governments should be harmonized to remove duplicity, cost and project lead time escalation.

- The budgetary allocation to capital expenditure on research on affordable building technology and materials should be increased with the aim of reducing the unit cost of building and construction. The investment would spur innovation in pursuit of affordable housing and reduced project costs.

- To address the high cost of credit in the sector, the public sector should review the economic and financial analysis frameworks in partnership with private sector financial institutions, with a view to unbundling the risk factors and risk allocation that escalate the credit costs. Within this initiative, the public sector can incentivize private sector resources by shouldering the higher risk factors and availing guarantees.

- Professional and intermediate skills should be enhanced through sector wide capacity building initiatives. Technical training for artisans and technicians in various skills within the building and construction field should be augmented to improve integrity of building works. With increased demand for real estate development within counties and at mega projects, training and capacity building programmes can strategically ameliorate the challenge of youth unemployment. Continued registration and licensing of professionals within the sector will reduce adverse impacts of misconduct within the sector and safeguard compliance to sector standards and norms.

- The completion and approval of the National Spatial Plan and consequent formulation of multi-scale county spatial plans should be fast-tracked. These plans will provide the long-term framework in space for urban and regional development and guide the allocation of adequate space for construction of critical infrastructure. It is expected that formally approved spatial plans with space for infrastructure development will help to avoid the cost of expensive land acquisition and compensation.

Chapter 12

Transport

12.1 Introduction

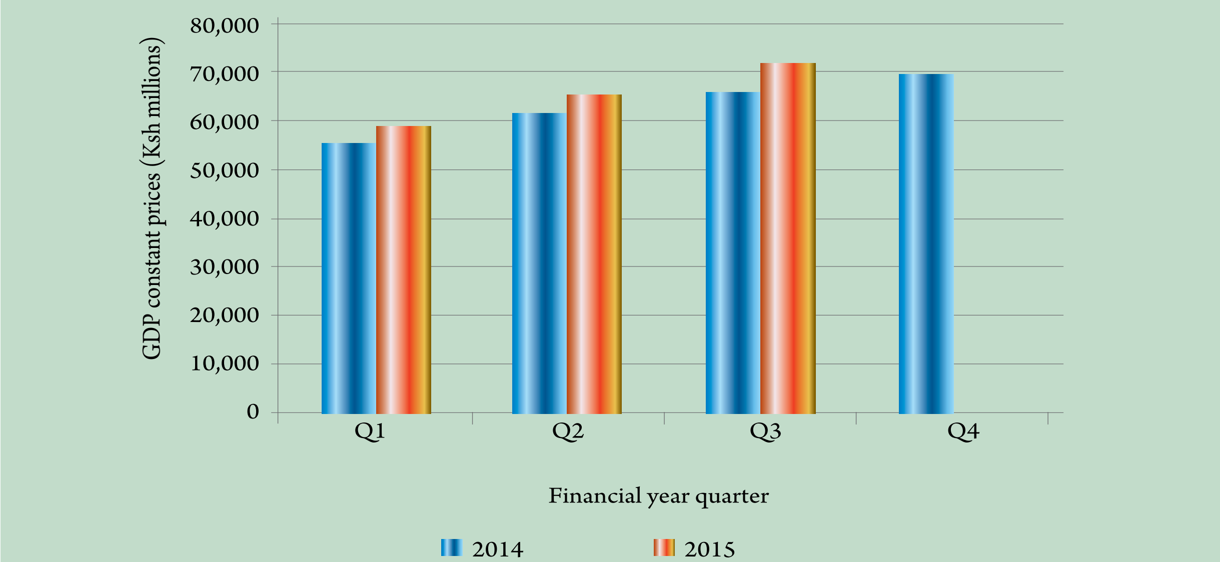
The transport sector comprising land, air and water is a key enabler in meeting the aspirations of Kenya Vision 2030. It is an important component of the nation's economy and tool used for development through its facilitative role. Macroeconomic implications of the sector are associated with the transmitted costs of goods and services; employment contribution to Gross Domestic Product (GDP); competitiveness; and the level of output in the economy. The sector has direct, indirect and induced impacts on other sectors of the economy. Microeconomic assessment of the sector reveals forward and backward linkages to other sectors with implications to household expenditure, inflation and unit costs of production.

12.2 Transport Sector Performance

12.2.1 Output

The transport sector recorded improved performance in the first, second and third quarter of financial year 2015/2016 compared to 2014/2015.

Figure 12.1: GDP performance in the transport sector –constant 2009 prices (Ksh millions)



Source: Compiled from KNBS (2015)

As shown in Figure 12.1, the GDP performance in the transport sector improved to record Ksh 71,686 million in the third quarter of 2015 compared to Ksh 65,933 in 2014. The sector grew by 8.7 per cent in the third quarter of 2015 compared to 7.8 per cent growth in 2014 (KNBS, 2015).

Growth in the sector can be explained by increased investment in transport infrastructure and services. The national government with the assistance of development partners continued to invest strategically in the development and maintenance of transport infrastructure. The road sub-sector increased financing to the sub-sector through an increase of the Road Maintenance Fuel Levy, which increased from Ksh 9 per litre to Ksh 12 per litre. This was intended to address the backlog and shortfall of funds for road maintenance in the country. The launch of the National Road Annuity Programme was further delayed as stakeholders reviewed the economic, financial and technical aspects of the initiative. Within the period under review, the construction of the Arusha-Holili-Mwatate road was launched; it is expected that the road will support regional integration and trade between Kenya and Tanzania.

At the county level, there was enhanced investment in the construction, rehabilitation and maintenance of roads within the period under review. The Annual County Budget Implementation Review Report (CBIRR) for the 2014/2015, prepared by the Office of the Controller of Budget (OCOB), reveals that a significant amount of development expenditure was incurred in the construction of roads, bridges and culverts.

12.2.2 Road transport

The continued investment in the roads sub-sector at the national and county level enhanced the sector's contribution to overall GDP. This was mainly through improved access to raw materials, inputs, markets, labour and agglomeration effects in rural and urban areas. The roads transport sector also availed positive direct, indirect and induced impacts to sectors such as agriculture, manufacturing, retail and trade. The socio-economic impact of the roads sub-sector was manifest in improved accessibility due to better road conditions, and reduced travel times and transport costs.

The roads sector witnessed adverse externalities attributed to road crashes. Between January and November 2015, there were 2,564 road crash fatalities compared to 2,445 in 2014. It is implied that with improved road conditions, there was induced speeding, which could explain the road crash severity. Other negative externalities attributed to the sector include air pollution from automotive greenhouse gas emissions, increased fuel consumption and its implications on increasing the import bill, traffic congestion, and increased public health costs on account of emissions related morbidity.

12.2.3 Rail transport

Performance of the rail transport sub-sector was influenced by the Standard Gauge Rail (SGR) project and investments by the Rift Valley Railways concessionaire. The development of the SGR project recorded significant progress in the establishment of the core civil and physical works. The socio-economic effects of the project were associated with its contribution to youth employment and support to local trade and suppliers within the project environment. Resettlement of the affected persons and commensurate compensation was expected to enhance the welfare of the beneficiaries through improved housing and income.

12.2.4 Maritime transport

In the maritime transport sub-sector, institutional and operational changes at the Port of Mombasa within the period under review reduced delays in clearance of goods. The port continued to record increased throughput compared to 2014 due to enhanced port operations among key stakeholders as well as regional trade growth. Improved physical infrastructure and improvements to the channel made it possible for larger cargo vessels to call at the port, marking enhanced efficiency.

12.2.5 Air transport

The air transport sub-sector recorded mixed monthly performance with regard to passenger volumes, aircraft landings and cargo volumes in 2015. The performance of the sector was largely influenced by global and regional factors prevailing in the air transport industry. Data available from the Kenya Airports Authority (KAA) for the Jomo Kenyatta International Airport (JKIA) shows that passenger traffic witnessed an increase in the months of July (2.5%) and August (1.7%) 2015 compared to 2014 traffic, while passenger traffic declined by 3.2 per cent in October 2015 compared to the same month in 2014. On average, air craft movements recorded a decrease while cargo throughput increased over the three months reviewed.

On the domestic front, Jomo Kenyatta International Airport (JKIA) recorded improved performance over the period under review, driven mainly by increased scheduled flights by budget carriers on the Mombasa, Kisumu, Ukunda and Malindi routes. Performance by the national carrier, Kenya Airways, recorded a loss arising from operational and market factors in the industry. It is proposed that African airline carriers should integrate operations and services while diversifying routes to enhance performance. African countries, through the 1999 Yamoussoukro Decision, committed to deregulate air services and promote regional air markets open to transnational competition in pursuit of principles of air services liberalization. It is expected that liberalizing intra-African air transport markets would promote economic growth, deliver improved safety, lower fares, and increase traffic in Africa. This would make African airlines more resilient to local, regional and global shocks in the industry.

12.3 Key Policy Initiatives and Expenditure Allocations

Kenya Vision 2030 Second Medium Term Plan (MTPII) 2013-2017 identified key flagship projects in the transport sector. In 2015, the flagship projects recorded mixed results in terms of implementation, these included:

- Air transport: Expansion and modernization of aviation facilities was planned to achieve an annual capacity of 45 million passengers. The route network for Kenya Airways and other designated national carriers was to be expanded through bilateral agreements, international conventions and protocols. Majority of the planned targets were achieved, with ongoing works at JKIA and Isiolo. The Greenfield Project was delayed due to funding, while the targets for the development of airstrips were not met due to difficulties in land acquisition. Five new Bilateral Air Service agreements (BASAs) were negotiated and 16 reviewed.

- Maritime and shipping: Expansion of port capacity by 50 million tonnes was planned, including improvement of port efficiency, construction of a second container terminal at the Port of Mombasa, provision of new handling facilities at the Port of Mombasa, development of Dongo Kundu Free Trade Port, and modernization of ferry services to increase passenger capacity per year. Major infrastructure projects achieved success, such as dredging at the Port of Mombasa, which was completed, and construction of the second container terminal, which is ongoing.

- Rail transport: Expansion of rail transport capacity was planned to take up 50.0 per cent of cargo from the Port of Mombasa. The SGR project was implemented towards this objective, and significant progress of the project was recorded in 2015.

Development of the Lamu Port South Sudan Ethiopia Transport (LAPSSET) project was planned to promote trade, integration and development in the region. The project achieved milestones on land acquisition and compensation in 2015.

- Road transport: Construction and rehabilitation of 5,500km of roads was planned, with routine maintenance of 200,000km of road and inclusion of 1,700km for non-motorized transport. The National Road Annuity Programme, targeting construction of 10,000km of roads in five years witnessed delays in off-take in 2015. The National Transport and Safety Authority (NTSA) continued with the development of the Transport Information Management System (TIMS) in 2015. Targets for the construction of new roads and maintenance were achieved, while rehabilitation of roads was not accomplished due to inadequate funds. By 2018, the sector targets to reduce road fatalities by 12.0 per cent.

- Mass rapid transit: Planning and design of Bus Rapid Transit systems (BRTs) in Nairobi City was undertaken in 2015, and BRT corridors were identified for key transit routes within the city and wider metropolitan region. The Nairobi Metropolitan Transport Authority was created in 2015 with an interim secretariat in place, with representation from the five county governments in the region. The sector targets to construct 150km of new light rail transit track by 2018.

Analysis of programme expenditure by economic classification in the transport sector (Table 12.1) shows that rail transport recorded the highest capital expenditure. This could be attributed to the SGR project.

Table 12.1: Transport sector programme expenditure analysis, 2014/15(Ksh millions)

Programme	Current expenditure		Capital expenditure	
	Approved estimates	Actual expenditure	Approved estimates	Actual expenditure
Roads transport infrastructure	22,843	22,448	111,366	76,985
Road transport services	23	13	-	-
Rail transport services	-	-	159,782	153,729
Maritime transport services	50	35	-	-
Air transport services	64	26	2,285	2,228
Government clearing services	122	81	20	20

Source: Compiled from The National Treasury, MTEF Report 2016/17-2018/19

Review of programme resource requirements and allocations (Table 12.2) for the sector reveals that the roads infrastructure sub-sector was allocated the highest amount of Ksh 105,571 million. The huge allocation can be attributed to the planned Annuity Programme to construct and rehabilitate roads in 2016/2017. The rail transport sub-sector received the second highest allocation of Ksh 83,844 million for capital purposes, which can be attributed to enhanced investment for the SGR project.

Table 12.2: Transport sector programme resource requirements and allocation 2016/17 (Ksh millions)

Programme	Current		Capital	
	Require-ments	Alloca-tion	Require-ments	Alloca-tion
Roads transport infrastructure	39,000	31,617	130,000	105,571
Road trans-port services (safety)	455	451	4,214	300
Rail transport services	-	-	60,750	83,844

Programme	Current		Capital	
	Requirements	Allocation	Requirements	Allocation
Maritime transport services	540	502	21,941	12,100
Air transport services	4,402	4,378	4,489	3,889
Government clearing services	150	65	-	-

Source: Compiled from National Treasury, MTEF Report 2016/17-2018/19

12.4 Transport Sector Comparative Indicators

Review of selected transport sector indicators across comparator countries (Table 12.3) shows mixed performance for Kenya. In terms of road crash fatalities per 100,000 population, Kenya was ranked 11 out of 13 countries reviewed. The low ranking could be attributed to the increased severity of road crashes, coupled with inadequate emergency response and post-crash care. In terms of exposure to road-based air pollution (PM 2.5), Kenya recorded good performance with a ranking of 3 out of 13 countries reviewed. Within the air transport sub-sector, the country recorded an average comparative performance with a rank of 6 out of the 13 countries reviewed. However, this figure is low compared to the 720,000 departures recorded in India. With regard to maritime transport, the country recorded a low performance of 7 out of 11 countries with ports reviewed. This is reflected in the logistics performance index where Kenya recorded a below average performance of 2.81.

12.5 Policy and Legal Developments

- The fuel price component for Road Maintenance Fuel Levy Fund was increased by Ksh 3 to provide additional resources for road maintenance.

- The excise duty regime was also revised, thereby affecting the cost of vehicle and motor cycle acquisition. The basis of the duty on vehicle age may influence consumer behaviour towards new vehicle fleets that have less adverse impacts to emissions and fuel economy.

- To address the challenge of greenhouse gas emissions and fuel economy in the transport sector, the government with the assistance of development partners, is exploring implementation of fees and rebates based on locally designed fuel economy benchmarks. It is expected that these policy instruments, including vehicle labelling, scrappage and buy-back schemes will have an impact in addressing the climate change agenda for the sector.

- The Kenya Roads Bill 2015 was formulated with the objective of giving effect to the Fourth Schedule to the Constitution in relation to the roads sub-sector. It provides for the classification, management construction and maintenance of public roads, to establish the Kenya National Highways Authority and Kenya National Secondary Roads Authority, to provide for their functions and powers, and for connected purposes. Part IX provides for the responsibilities of county governments.

12.6 Emerging Issues and Challenges

There are a number of transport sector issues that relate to the current devolved system of government:

- Transfer of the county roads function as stipulated in the Fourth Schedule of the Constitution has not taken place effectively. There are legal disputes between the national and county governments as regards the transfer of roads to counties, with the matter being subjected to a court process. The issue of capacity constraints to develop and manage roads at the county level was observed.

Table 12.3: Transport sector indicators: comparator country review

Country	GDP per capita (current US$)	Registered vehicles	Road crash fatalities*	Road crash fatalities per 100,000 population *	Estimated GDP lost due to road traffic crashes (%)	Ambient PM2.5 air pollution, mean annual exposure, micrograms per cubic metre	Pump price for diesel fuel (US$ per litre)	Pump price for gasoline (US$ per litre)	Air transport, registered carrier departures worldwide	Container port traffic (TEU: 20 foot equivalent units)	Lead time to export, median case (days)	Lead time to import, median case (days)	Logistics performance index: Overall (1=low to 5=high)
Egypt	3,198.7	7,037,954	10,466	13.0		36	0.25	0.88	90,784	7,143,083	2	3	2.97
Ethiopia	573.6	478,244	23837	25.3	0.9	18	0.89	0.99	69,397	*	14	13	2.59
Ghana	1,441.6	1,532,080	6,789	26.2	1.6	27	1.03	1.06	16,736	793,312	4	5	2.63
India	1,581.5	159,490,578	207,511	16.6	3.0	47	0.91	1.10	720,050	10,653,343	2	2	3.08
Kenya	1,358.3	2,011,972	12,891	29.1		11	1.07	1.21	96,780	853,324	3	4	2.81
Korea, Rep.	27,970.5	23,150,619	5,931	12.0	1.0	29	1.37	1.55	377,749	22,582,700	1	1	3.67
Mauritius	10,016.6	443,495	152	12.2		10	1.38	1.65	12,739	621,917	1	3	2.51
Singapore	56,284.6	974,170	197	3.6		17	1.16	1.58		33,516,343	2	2	4.00
South Africa	6,482.8	9,909,923	13,273	25.1	7.8	14	1.17	1.19	195,714	4,595,000	2	2	3.43
Tanzania	955.1	1,509,786	16,211	32.9	3.4	9	1.20	1.29	26,032	526,321	7	1	2.33
Thailand	5,977.4	32,476,977	24,237	36.2	3.0	22	0.90	1.29	322,950	7,702,476	1	1	3.43
Tunisia	4,420.7	1,735,339	2,679	24.4		16	0.68	0.91	45,132	571,823	1	2	2.55
Uganda	714.6	1,228,425	10,280	27.4		18	1.11	1.40	6,846	*	*	81	*

Source: World Bank (2014) and WHO (2013)

- The management, operation and maintenance of road construction machinery taken up by the county governments is a challenge due to limited capacity in various counties.

- In the port and maritime sector, the major issues revolve around management of the Port of Mombasa and the planned levying of fees to cargo by the county. The operation of the Likoni ferry and the development of the Likoni channel bridge is also an issue under attention by both the national and county government.

- Development and operation of airstrips by counties commenced, but the big challenge is to ensure that these conform to national standards for civil aviation and safety.

- The development of the SGR project was affected by disputes in relation to resettlement and compensation of the persons affected by the facility.

- Vandalism of infrastructural facilities has been on the increase in the recent past.

12.7 Sustainable Development Goals in the Transport Sector

The Sustainable Development Goals (SDGs) provide targets that relate to the transport sector directly and indirectly. Goal 11 addresses the issue of making cities and human settlements inclusive, safe, resilient and sustainable. Target 11.2 of this goal states that "by 2030, provide access to safe, affordable, accessible and sustainable transport systems for all, improving road safety, notably by expanding public transport, with special attention to the needs of those in vulnerable situations, women, children, persons with disabilities and older persons".

The Integrated National Transport Policy of Kenya alludes to the targets of Goal 11. However, the transport system, which includes the physical infrastructure and services, currently does not meet the expectations of the SDGs. The main modes of transport (roads and rail) do not provide adequate access to users both in urban and rural areas. Urban Transport Systems are neither accessible nor affordable to those in vulnerable situations, leading to exclusion, while most commuters are captive to unsustainable modes of transport. The public transport system in Kenya is characterized by informal practices, lack of planning and standards in service delivery, making it unsustainable. In order to achieve the SDGs, there is need to realign the public transport sector to focus on Public Service Obligations (PSOs) and adaptive levels of service (LoS) that take into account the local context.

SDG Goal 9 focuses on building resilient infrastructure, promoting inclusive and sustainable industrialization and fostering innovation. Target 9.1 addresses the development of quality, reliable, sustainable and resilient infrastructure, including regional and trans-border infrastructure, to support economic development and human well-being, with a focus on affordable and equitable access for all. Within the East African Community (EAC), significant investment has been put in place towards development of cross border and regional infrastructure. The Northern Corridor and LAPSSET, road, rail and maritime sector projects are seen as strategic initiatives towards the achievement of this SDG. Target 9(a) further supports deployment of resources in support of these projects by stating the need to: facilitate sustainable and resilient infrastructure development in developing countries through enhanced financial, technological and technical support to African countries, least developed countries, landlocked developing countries and Small Island developing states.

The SDGs Goals No. 7, 12 and 13 indirectly relate to the transport sector with regard to energy demand; energy efficiency of vehicles and other transport modes; transport sector consumption of land and energy resources; and transport sector contribution to Green House Gas (GHG) emissions and climate change. The Government of Kenya has undertaken initiatives towards addressing some of these issues. For instance, the Global Fuel Economy Initiative (GFEI) pilot study by the Energy Regulatory Commission (ERC) in 2015 provided recommendations and policy instruments to manage the national vehicle fleet and imports with regard to vehicle fuel economy (consumption litres per 100km), and vehicle emissions (gCO_2/Km) in the country (ERC, 2015).

12.8 Policy Recommendations

- A robust assessment of the economic unit cost and benefits of constructing a kilometre of road should be undertaken. Decomposition of cost items should be rigorously studied across different environments with mitigation measures for factors that escalate costs. The public-private partnership framework of project execution should be reviewed to establish value for money.

- The level of participation by local suppliers and contractors in the SGR project should be enhanced to enable attainment of the redistributive objectives of the project. This can be enhanced through capacity building and support in technical and financial aspects. Focus should also be placed on technical transfer for sustainability of the project across its life cycle.

- In pursuit of the recently adopted Sustainable Development Goals, the government and sector stakeholders should expedite the implementation and completion of transport projects identified as being sustainable. These include the Mass Transit Options for Nairobi, Mombasa and Kisumu. The government can leverage on global and local Climate Fund resources to supplement the investment requirements for these projects.

- Finally, there is need to enhance the road crash data surveillance system in support of the road safety initiatives being undertaken by the National Transport and Safety Authority. Accurate data systems will help in the design, planning and decision making of road safety initiatives.

Chapter 13

Energy

13.1 Introduction

Energy is critical to any economy. Goal 7 of the Sustainable Development Goals (SDGs) is to ensure access to affordable, reliable, sustainable and modern energy for all. The goal envisages that by 2030, there will be universal access to affordable, reliable and modern energy services; the share of renewable energy in the global energy mix will increase substantially; and the global rate of improvement in energy efficiency will double. The Government of Kenya through various policy documents such as the Constitution of Kenya and Vision 2030 aligns itself to this goal.

Kenya consumes a mix of renewable energy (hydro, wind, solar, geothermal and cogeneration) and non-renewable energy (coal and petroleum products). The overall expenditure for the energy and petroleum sector increased from Ksh 73,664 million in 2013/14 to Ksh 90,779 million in 2014/15. This was prompted by government policy to diversify and go green by investing on renewable energy (Government of Kenya, 2015a). Though the actual expenditure for the same period increased from about Ksh 54,655 million to Ksh 55,654 million, respectively, the absorption capacity dropped from an estimate of 74 per cent to 61 per cent. The sector funding targeted to increase power generation, transmission and distribution; increase investment in alternative energy technologies; and increase exploration and distribution of oil and gas.

Though a number of key projects in Vision 2030 Medium Term Plan I (2008-2012) had been completed by end of 2012, a number of projects are still pending. These include the construction of 6,000 tonne and 2,000 tonne common user LPG import handling facility in Mombasa and Nairobi, respectively, that was aimed at reducing freight costs and making LPG cheaper to Kenyans (Government of Kenya, 2008). In addition, among the flagship programmes and projects for Medium Term Plan II (2013-2017) include the development of an oil pipeline, crude oil pipeline and refined oil pipeline from Lamu to Juba and Ethiopia, and an additional oil refinery at Lamu with capacity of 120,000 barrels per day. These projects are key under the Lamu Port-South Sudan-Ethiopia Transport (LAPSSET) corridor, but have not commenced (Government of Kenya, 2013). In addition, it was also expected that by end of 2014, wind and cogeneration power generation will be about 150MW and 120MW, respectively. However, the electricity generation from these sources as at end of 2014 was 20.5MW and 38MW, respectively (Kenya Power and Lighting Company, 2014).

13.2 Functions of the County Government in Relation to Energy Sector

According to the Draft National Energy and Petroleum Policy 2015, the functions of the county governments are: energy planning, regulation, operations and development. The policy provides detailed functions for the county which, if adopted, will bring major developments in the energy sector. Nonetheless, these functions are yet to be fully operationalized at the county level. For instance, the county energy regulation has not yet been devolved to the county levels. The Energy Regulatory Commission (ERC) currently oversees the regulation of electrical energy, petroleum and related products, renewable energy and other forms of energy both at the national and county levels. However, some counties are slowly devolving; for example, the county government of Busia has come up with Electricity Reticulation Bills for the county.

Apart from the Draft National Energy and Petroleum Policy, a number of other energy policy documents have realigned their policies to the mandates of devolution. For instance, the Energy Bill 2015 also articulates the functions of the county government (Government of Kenya, 2015c). In the bill, part II on energy policy and integrated energy plan, each county government is required to develop and submit a county energy plan to the Cabinet Secretary, Ministry of Energy and Petroleum in respect of its energy requirements. In regard to promotion of energy investments, relevant counties are expected to partner with the national government to develop guidelines on development of energy projects and to disseminate them among potential investors.

Through the Energy Bill (part IX on energy efficiency and conservation), each county government is required to enforce efficient use of energy and its conservation. The bill also stipulates that the Rural Electrification and Renewable Energy Corporation will be required to develop and update the rural electrification master plans in consultation with county governments. In addition, country governments are required to develop and update the renewable energy master plan, taking into account county-specific needs, and the principle of equity in the development of renewable energy resources.

Some of the challenges facing devolution in the energy sector are:

(i) Lack of coordinated planning between the national and county governments;

(ii) Lack of a clear framework for sharing of benefits from exploitation of energy and petroleum resources with the local communities;

(iii) Community land problems identified for renewable energy investments;

(iv) Failure to develop policies and regulation that would anchor the legislation both at the national and county levels (for instance Energy Bill 2015 and Draft National Energy and Petroleum Policy 2015 have not yet been passed into laws); and

(v) Inadequate legislative capacity in the county governments, and hence slow development of policies and regulations.

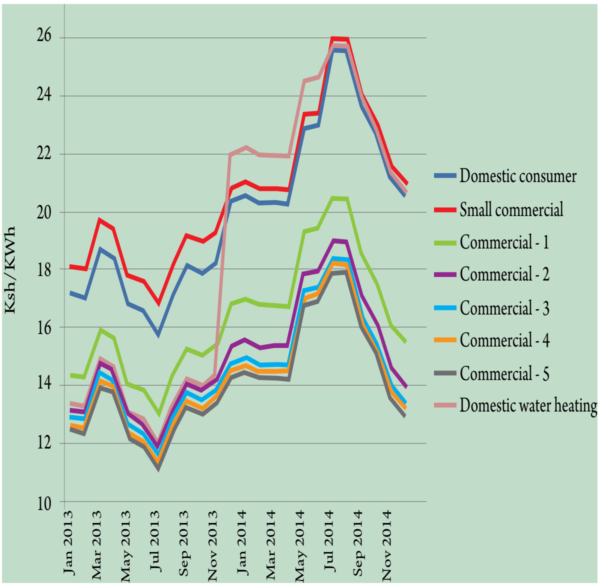
13.3 Energy Indicators

Energy access and affordability

In Kenya, 68.3 per cent and 63.3 per cent of households used firewood in 2005/6 and 2010, respectively (KIHBS, KDHS). In addition, 13.2 per cent and 8.1 per cent of households used Kerosene over the same period.

In terms of electricity access, the government currently estimates that about 65 per cent of Kenyans are not connected to electricity due to high cost of connection, wiring and monthly usage. However, with the launch of the Last Mile Connectivity project, connection fee has been halved to Ksh 15,000 and can be paid in monthly instalments for a maximum period of five years. Affordability is critical, as 20-30 per cent of income is spent by the world's poor on fuel alone (Flavein and Aeck, 2004). Affordability also depends on the level of electricity tariffs. In Kenya, electricity tariffs have been rising for different categories of consumers as shown in Figure 13.1. For example, tariffs for domestic consumers rose from 20.33 Ksh/KWh at end of 2013 to 20.55 Ksh/KWh in 2014.

Figure 13.1: Electricity prices for different consumers, 2013-2014



Source: EREC website, November 2015

Electricity prices faced by the consumers are considered to be high compared to other countries such as Ghana. This is because most of the burden/cost associated with production and distribution is directly passed on to the consumer. Some of these charges include inflation adjustments; foreign exchange fluctuation adjustments; and the water, energy regulation commission and rural electrification authority levies.

Energy disparities and health outcomes from energy use

Energy disparities are even larger; for example, of the 15.6 per cent who use electricity for lighting, only 3.9 per cent are from rural areas (KIHBS, 2005/6). In regard to the energy indicators related to health outcomes, exposure to indoor air pollution is a major cause of respiratory illness and even death. The World Health Organization (WHO, 2014) reports that 7 million people die each year from indoor smoke due to inefficient cooking fires (the deaths from indoor air pollution are more than twice as many as malaria).

Electricity generation

Total electricity generation increased from 8,447.9GWh in 2013 to 9,138.7GWh in 2014 (Table 13.1). This was attributed to increased investment in renewable energy and government policy to diversify electricity sources from hydro and thermal power to geothermal, wind, and cogeneration power. This was important for two reasons; first was to avoid over-reliance on hydro power, which highly depends on weather conditions; and second because thermal generation relies on fossil fuels, which are expensive and erratic.

In addition, renewable energy technologies have lower Levelized Cost of Electricity (LCOE). For instance, the LCOE at 8 per cent is cheaper for geothermal (9.1 USc/KWh) and wind (9.1 USc/KWh) when compared to non-renewables such as gas turbines and coal, respectively (6.9 USc/KWh and 12.7 USc/KWh), as reported by the Least Cost Power Development Plan 2011-2030. Therefore, investing in renewable energy such as wind and geothermal implies lower electricity prices in the long run. The government aims to achieve access to affordable, sustainable, and modern energy mainly through investments in renewable energy, and ensuring that the energy supplied is secure and reliable by making investments in non-renewable energy.

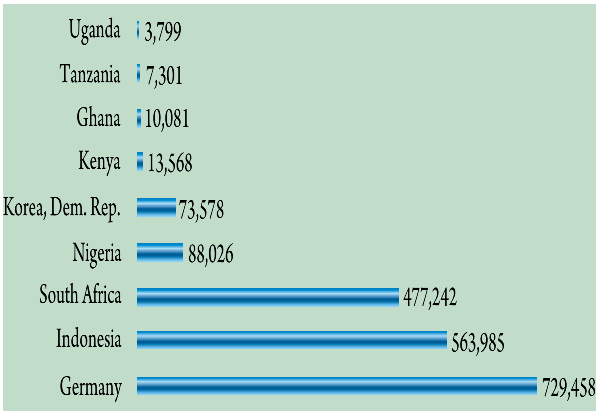
The number of public institutions connected with solar energy through the alternative energy technologies programme in 2013/14 increased from 322 to 380. The government plans to increase the number by 1,200 in 2018/19. In addition, during the same period, the number of megawatts of power generated from small hydro power projects increased from 5MW to 7MW. At the household level, the government through the Directorate of Renewable Energy seeks to increase the current number of domestic household biogas digesters by 4,000 by 2018/19 from 250 in 2014/15. It is important to note that most solar, wind and hydro power projects are mainly undertaken by the government. Low Feed-in-Tariffs (FiTs), high resettlement costs, and long delays in issuing of permits and licenses are the main hindrance for investments in these technologies by the private sector.

Table 13.1 shows that total electricity generation from renewable energy increased by 22.4 per cent from 6,237.2GWh in 2013 to 6,553GWh in 2015. However, the share of renewable energy generation from total generation increased from 73.8 per cent in 2013 to 84.5 per cent in 2015. This was attributed to a decline (13.5%) in thermal generation in the same period. It is expected that for 2018/19, the largest share of total electricity will still be from renewable energy as the government plans to inject 286MW of geothermal power in the same period (Government of Kenya, 2015a).

Carbon dioxide emissions

As most countries increase their level of electricity generation to meet their energy demand, it has become important to pursue those sources of electricity generation associated with less emissions. In terms of carbon dioxide emissions from energy, Kenya is among the least emitters among the comparator countries as shown in Figure 13.2.

Figure 13.2: Carbon dioxide emissions, 2011 (in thousand metric tonnes)



Source: World Bank (2015)

The highest emitters of carbon dioxide emission are Germany, Indonesia, South Africa, Nigeria and Korea Democratic Republic.

Table 13.1: Electricity generation by source, 2013-2014(GWh)

	2013	%	2014	%	2015	%
Hydro	4,386.0	51.9	3,410.6	37.3	3,463.3	36.4
Geothermal	1,780.9	21.1	2,917.4	31.9	4,520.7	47.5
Cogeneration	55.6	0.7	50.0	0.5	0.0	0.0
Wind	14.7	0.2	17.0	0.2	59.7	0.6
Sub-total: Renewable energy	**6,237.2**	**73.8**	**6,395.0**	**69.9**	**8,043.7**	**84.5**
Thermal	2,161.7	25.6	2,585.2	28.3	1,412.1	14.8
Imports	49.0	0.6	158.4	1.7	9,514.6	100.0
Total	8,447.9	100.0	9,138.7	100.0	58.8	0.6

Source: KNBS (2016)

Electricity demand and supply

The total electricity demand rose by 10.8 per cent from 6,928 million KWh in 2013 to 7,768 million KWh in 2014 as shown in Table 13.2. The total electricity supplied also increased by 11.5 per cent from 8,447 million KWh in 2013 to 9,514.6 million KWh in 2015. However, the total electricity supplied outstrips demand by about 17.9 per cent in 2013 and 17.7 per cent in 2015. The slight decline in the gap between supply and demand is as a result of increased electricity consumption brought about by increase in electricity connection through rural electrification programme, and reduced cost of electricity. For instance, through the Rural Electrification Programme, 9,535 public primary schools were connected to electricity in 2014/15 compared to 5,231 in 2013/14 (Government of Kenya, 2015a).

The gap between electricity supplied and electricity demanded is explained largely by the transmission losses and unallocated demand The transmission losses and unallocated demand rose by about 10 per cent from 1,476.1 million KWh in 2013 to 1,641.5 million KWh in 2015. Power loses are reducing due to improvement in existing grid lines and construction of new grid lines. According to the Sector Medium Term Expenditure Framework (MTEF) budget report for year 2016/17-2018/19, the number of transmission lines constructed increased by 34.3 per cent from 435km in 2013/14 to 663km in 2014/15. It is expected that power losses will also drop as the government plans to develop 2,879km of transmission lines by 2018/19. Also, the demand is expected to rise as the government plans to increase the number of new connections by 5,000 in the same period (Government of Kenya, 2015a).

On the demand side, the potential demand (65% of Kenyans not connected) is greater than the actual demand (35% of Kenyans connected) while at the supply side, the current effective capacity is about 1,798MW. The government needs to hasten the electricity connection programme to meet the target for energy for all. With the growing potential demand, the government also needs to fast-track the implementation of the 5,0000+ MW power plan.

Table 13.2: Electricity demand and supply, 2013-2014 (million KWh)

	2013	2014	2015
Total electricity demand	6,928.10	7,415.4	7,826.4
Export to Uganda and Tanzania	43.7	30.8	46.7
Transmission losses and unallocated demand	1,476.1	1,692.5	1,641.5
Total electricity supply	8,447.9	9,138.7	9,514.6
Less imports from Uganda and Tanzania	49.0	158.4	58.8
Net generation	8,398.9	8,980.3	9,455.8

Source: KNBS (2015)

Total domestic demand for petroleum products in Kenya increased by about 5.0 per cent from 3.7 million tonnes in 2013 to 3.9 million tonnes in 2014 (KNBS, 2015). The general increase in consumption could be explained by the drop in prices of domestic petroleum products due to the fall in the price of crude oil from 113.85 US$/BBL in 2013 to 60.65 US$/BBL in 2014. In the first two weeks of 2016, crude oil dropped further to 30 US$/BBL, and there have been signals that oil prices could fall even further. With the decline in prices of oil internationally, it is always expected that the domestic price will fall at least by the same margin but this is not the case. In the Energy Act 2006, the Energy (Petroleum) Regulations 2010 provides regulation for the maximum wholesale and retail pump prices. The maximum determined prices become effective on the 15th day of every calendar month and remain in force until the 14th day of the following calendar month. The wholesale pump price incorporates the weighted average cost in shillings per litre charges on the Kenya Petroleum Refineries Limited (KPRL) and Kipevu Oil Storage Facility (KOSF); transportation cost from Mombasa to the nearest wholesale depot; allowed losses in pipeline and depot; and allowed oil marketing company's gross wholesale margin.

At the retail pump prices, the formula considers allowed maximum retail gross margin and the delivery rate from the nearest wholesale depot to a retail dispensing site in shillings per litre. The KPRL and KOSF charges incorporate the volume in litres and unit cost of cargo of a refined petroleum product imported through the open tender system for the previous three months; the volume in litres and unit cost of a petroleum product yielded from crude refined at the KPRL per month for the previous three calendar months in shillings per litre; and the total taxes and levies for petroleum products in shillings per litre (which captures the excise duty, road maintenance levy; petroleum regulation levy, KOSF charges, and excise duty remission). The prices determined using the formula are aimed at protecting the consumers from facing exorbitant prices and ensure oil marketing companies stay in business by earning some profit.

The formula has not yet been reviewed since it was enacted in 2006. It still incorporates the KPRL charges and yet KPRL was closed in 2013. Also, the formula covers a three months lag in all their imports, which implies that the current international market prices cannot be reflected immediately in the domestic market. The formula allows losses in the pipeline and depot instead of encouraging the companies to be efficient so at to minimize on loses. The oil marketers are also allowed to set their gross margin; however, it is not clear on how they arrive at the set gross margin, and this provides a window for companies to form cartels and collude on the margins set. There is need to review the formula and specifically drop the KPRL charges, avoid the three months lag, and gradually reduce the allowed losses to meet sustainable levels that coincide with the global standards.

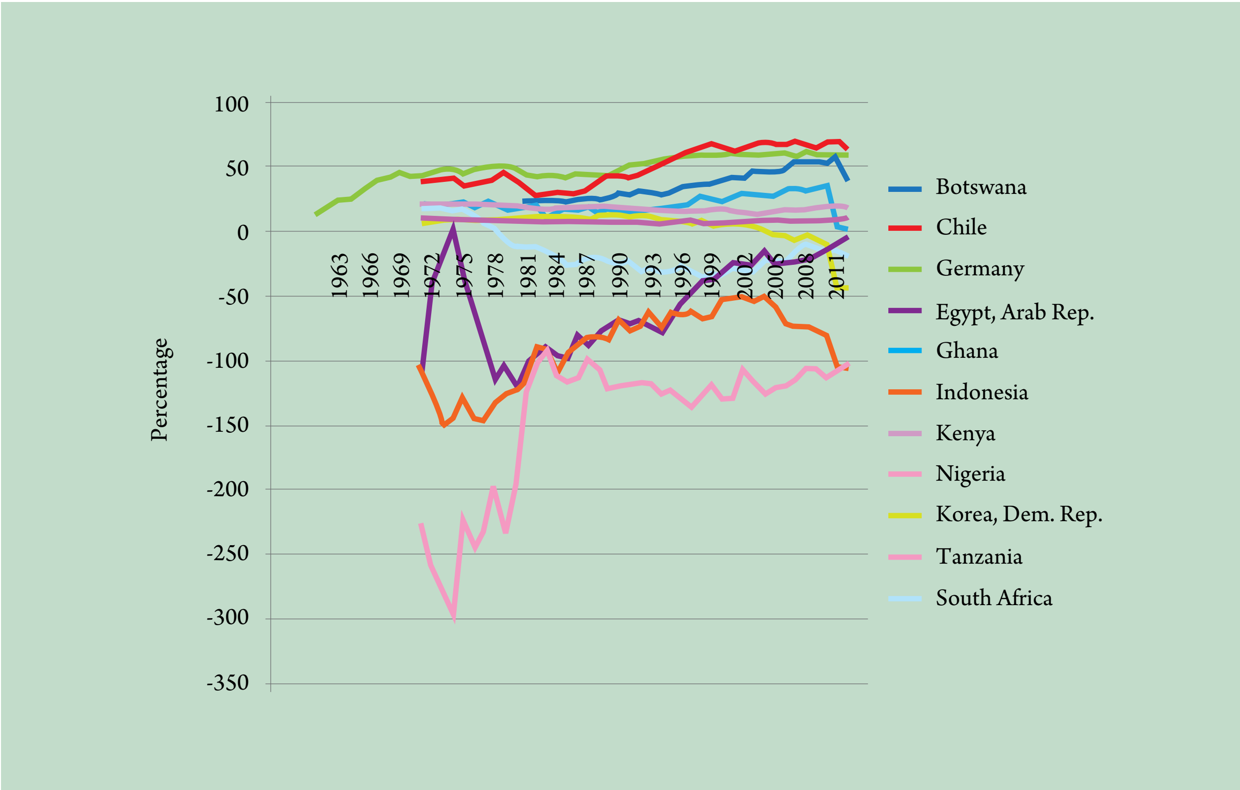
LPG consumption increased by 37.9 per cent from 92,900 tonnes in 2013 to 149,700 tonnes in 2014. In addition, there was increased consumption in motor gasoline petroleum product and kerosene products from 774,500 tonnes in 2013 to 903,800 tonnes in 2014 (representing 14.3% increase) and 296,100 tonnes in 2013 to 300,300 tonnes in 2014 (representing 4.2% increase), respectively (KNBS, 2015). This implies that between 2013 and 2014, some consumers were better off in terms of income and were able to purchase LPG appliances such as gas cookers and import vehicles that resulted to increased consumption of LPG and motor gasoline petroleum products, respectively. On the other hand, it could mean that some consumers were worse off in the same period, and this led to increase in kerosene consumption.

Kenya relies heavily on imports of petroleum products. Among the possible substitutes for petroleum fuels are bioethanol and biodiesel that are produced mainly from sugar and jatropha plants, respectively. The production of bioethanol and biodiesel for fuel can reduce the country's import bill burden resulting from importation of petroleum products and save consumers from erratic price of petroleum products. However, the competition for land for food and for fuel production threatens the measures in place to increase food security. Gradual introduction of bioethanol and biodiesel fuels as blends to the petroleum fuels, especially bioethanol for transport, could reduce the country's dependence on petroleum products.

Energy security

Energy security is measured by level of import and strategic fuel stock (IAEA, 2015). Table 13.2 also shows that the level of imports rose from 49.0 million KWh in 2013 to 158.4 million KWh in 2014. However, the amount of imports only contributed to 1.7 per cent to the total electricity supplied, while the amount of exports is about 31 million KWh, which is supplied to Uganda and Tanzania. In addition, Kenya has over 1,000 million KWh of unallocated demand, implying there is energy security as regards supply of electricity in the country. The electricity imported is not because of lack of electricity supply domestically, but rather it makes economic sense to transmit and distribute the imported electricity to the western region.

Figure 13.3: Net energy imports (as % of energy use)



Source: World Bank (2015)

Kenya relies heavily on importation of petroleum products; in 2014, the level of imports increased to 4.5 million tonnes from 4.0 million tonnes (KNBS, 2015). This was mainly because of the closure of the Kenya Petroleum Refineries Limited (KPRL), which used to handle 40 per cent of LPG from crude oil refining. Figure 13.3 shows net energy imports for Kenya and comparator countries. Net energy imports are estimated as energy use less production, both measured in oil equivalents. A negative value indicates that the country is a net exporter. Nigeria, Indonesia, Egypt, Korea Democratic Republic and South Africa are net exporters of energy while Germany, Chile, Botswana, Kenya and Ghana are net importers of energy.

The price of some of the petroleum products are presented in Table 13.3. Prices for the premium motor gasoline and kerosene products dropped by 15.6 per cent and 31.0 per cent, respectively, between 2013 and 2015. However, the price of LPG dropped by 6.2 per cent within the same period. The drop in Kerosene prices is higher compared to that of LPG because Kerosene is exempted from excise duty. In addition, LPGs face higher storage costs due to lack of adequate storage capacity for handling imported LPG. The government had planned to construct 6,000 tonnes and 2,000 tonnes of LPG handling facility in Mombasa and Nairobi, respectively, but this has not been achieved.

Table 13.3: Petroleum product prices, 2013-2015

	2013	2014
Premium	113.3	112.4
Kerosene	84.3	82.5
LPG	2,688.5	3,062.4

Source: KNBS (2015)

Consumption of petroleum in the economy

The energy sector provides power that enables well-functioning of the other economic sectors. However, annual data showing the contribution of these sectors over time is lacking. Table 13.4 presents the consumption of petroleum fuels by different consumers. Retail pump outlets and road transport had the largest share of petroleum fuels consumption by about 72.0 per cent. This was followed by aviation and industrial, commercial and other consumers with 13.5 per cent and 12.1 per cent, respectively.

Table 13.4: consumption of petroleum fuels by different consumers

	2013	2014	2015
Agriculture	28.5	36.4	29.7
Retail pump outlets and road transport	2,573.7	2,791.0	3,414.7
Rail transport	14.2	15.6	36.9
Tourism	5.5	5.1	4.8
Marine (excluding naval forces)	25.4	18.6	2.9
Aviation (excluding government)	552.4	530.4	637.7
Power generation	64.1	98.9	32.3
Industrial, commercial and other	462.3	451.2	572.1
Government	7.2	9.3	7.7
Balancing item	-25.4	-18.6	0.3
Total	3,707.9	3,937.9	4,738.5

Source: KNBS (2016)

13.4 Policy Recommendations

In order to enhance and sustain growth in the energy sector, the following are some of the recommendations proposed:

- In order to encourage private sector investment in renewable energy technologies, the government needs to undertake regular review of Feed-in-Tariffs (FiTs) to attract and facilitate acquisition of land.
- Regular review of the petroleum products pricing formula is needed to ensure that petroleum products reflect the global market.
- Fast-track the construction of the LPG import handing facility in Mombasa and Nairobi.
- There is need to increase both access to electricity and supply of electricity to match the growing demand.

Chapter 14

Water and Sanitation

14.1 Introduction

The Government of Kenya is keen to realize universal access to quality water and sanitation services. This is because water and sanitation are basic economic and social rights to which all humans are entitled. Articles 43d and 46b of the Constitution of Kenya underline that every Kenyan has a right to, "… reasonable standards of sanitation" and "clean and safe water in adequate quantities", respectively. The government, through the Jubilee Coalition Manifesto of 2013, equally recognizes that access to water and sanitation is low in Kenya. The government promises to steer the country towards safe and clean water for all by 2020 at controlled tariffs while ensuring subsidized access by population in informal settlements (Jubilee Coalition, 2013).

In the year 2015, the Government of Kenya separated the Ministry of Environment, Water and Natural Resources (MEWNR) into two ministries, namely: Ministry of Water and Irrigation (MWI) and Ministry of Environment and Natural Resources (MENR), as one strategy towards improving government service delivery in the water sector. There are also efforts towards improving the policy framework through the Water Bill 2014, Natural Resources Benefits Sharing Bill 2014, National Irrigation Bill 2015, and the Health Bill 2015. Among the key indicators that map the country's progress with respect to water and sanitation are accessibility and quality.

This chapter assesses the performance of water and sanitation utilities by looking at their service delivery, operational efficiency, commercial viability and sustainability.

14.2 Contribution of Water and Sanitation to GDP

The sector contribution to Gross Domestic Product (GDP) in 2015 is estimated at 0.8 per cent. This translates to a nominal value of GDP of about Ksh 42 billion and Ksh 31 billion in real value. The sector grew by 4.1 per cent in 2014 but slowed to 1.9 per cent in 2015. In terms of employment, the sector contribution to formal employment reached 10,400 up from 9,400 between 2013 and 2014. Of this, the public and private sectors contributed 87.0 and 13.0 per cent, respectively, compared to the previous year when the public and private sectors contributed 85.0 and 15.0 per cent of employment, respectively (Table 14.1).

Table 14.1: Contribution to Gross Domestic Product

Contribution to GDP by water supply, sewerage, and waste management	2013	2014	Changes in 2014 (%)
Percentage contribution to GDP	0.9	0.8	-11.1
Gross Domestic Product, current prices (Ksh millions)	40,406	42,072	4.1
Gross Domestic Product, constant 2009 prices (Ksh millions)	29,616	30,690	3.6
Wage employment by public sector ('000')	8.1	9.0	11.1
Wage employment by private sector ('000')	1.4	1.4	0

Source of Data: KNBS (2015)

14.3 Access to Improved Water for Domestic Use

Water accessibility refers to connectivity to supply line or improved water source. The population of Kenyans accessing improved water sources reached 63.2 per cent by 2015. This was 0.1 per cent improvement from the previous year. This disaggregates to 81.6 per cent and 56.8 per cent of urban and rural population, respectively. The increment is mainly due to completion of water projects by various Water Service Boards (WSBs) across the country. The national achievement is below the 2015 MDG target of 74.0 per cent and is dragged behind by the performance in rural areas (Table 14.2).

Table 14.2: Key performance indicators on water

Key Performance Indicators on Water	Sector Benchmarks	2014	2015	Change in 2015
Water coverage, % at national level	> 74	63.1	63.2	+0.1
Water coverage, % at urban level	> 80	82.1	81.6	+0.5
Water coverage, % at rural level	> 75	55.8	56.8	+1

Source of data: JMP (2015)

The population covered by water utilities, thus accessing safe water, improved by 2.6 per cent, reaching 55.9 per cent in 2015. This translates to an additional 1.9 million people having access to safe water, 1.1 million for urban population and 804,206 for rural population. Water coverage in urban areas increased from 61.7 per cent in 2014 to 65.4 per cent by 2015, while coverage for rural areas increased from 47.1 per cent in 2014 to 48.8 per cent by 2015. This improvement can be attributed to completion of water projects by Water Service Boards (WSBs) and Water Service Trust Fund (WSTF) whose cost is estimated at about Ksh 11 billion (MEWNR, 2015).

Hours of supply of water by water utilities improved from 17 hours to 18 hours, but the quality of water reduced by one per cent to reach 91.0 per cent in 2015. Water rationing continued in most of the urban areas, with zoning strategy whereby a zone could receive water between one to two days per week. Water losses in terms of non-revenue water reduced from 43.0 per cent to 42.0 per cent. However, this is still under-performance compared to average sector target of 20.0 per cent. The number of connections fixed with water metres increased by 2.0 per cent to reach 89.0 per cent. This is good for monitoring water consumption, water losses as well as for efficient collection of water revenue. However, this means that the sector has 11.0 per cent more to cover in order to reach the sector target of 100 per cent of metering ratio (WASREB, 2014; 2015).

Expenditure on personnel remained above the sector target of less than 30.0 per cent to stand at 42.0 per cent in 2015 (WASREB, 2014; 2015). This means that the utilities are still committing more funds for recurrent expenditure at the expense of development expenditure. Though revenue collection efficiency increased from 85.0 per cent in 2014 to 93.0 per cent, the utilities still had low coverage of operations and maintenance costs, which became worse from 113.0 per cent to 100.0 per cent by 2015 (Table 14.3).

Compliance to data submission by water institutions dropped from 99.0 per cent to 92.0 per cent. The problem is compounded with low integration of state and non-state actors. This hinders data sharing and reporting, especially by non-state actors. This does not only affect monitoring and evaluation of progress, but also reflects a decline in adherence to principles of corporate governance, management and disclosure of information by the utilities.

At global level, Kenya was rated among the African countries that had made good progress towards the attainment of the Millennium Development Goals by 2015 (MDGs 2015) with respect to access to water. In order to benchmark Kenya's performance with the rest of the world, one critical factor to be considered is initial state of the country, which is the performance as at 2000 when the MDGs were set. A further analysis shows that Kenya also performed progressively well in terms of effort met towards attainment of MDGs by 2015. The level of effort since 2000 was an increment in access to quality water by more than 11.4 per cent of the population, making it position 21 out of 54 countries in Africa and position 44 out of 196 countries in the world (Figures 14.1 and 14.2).

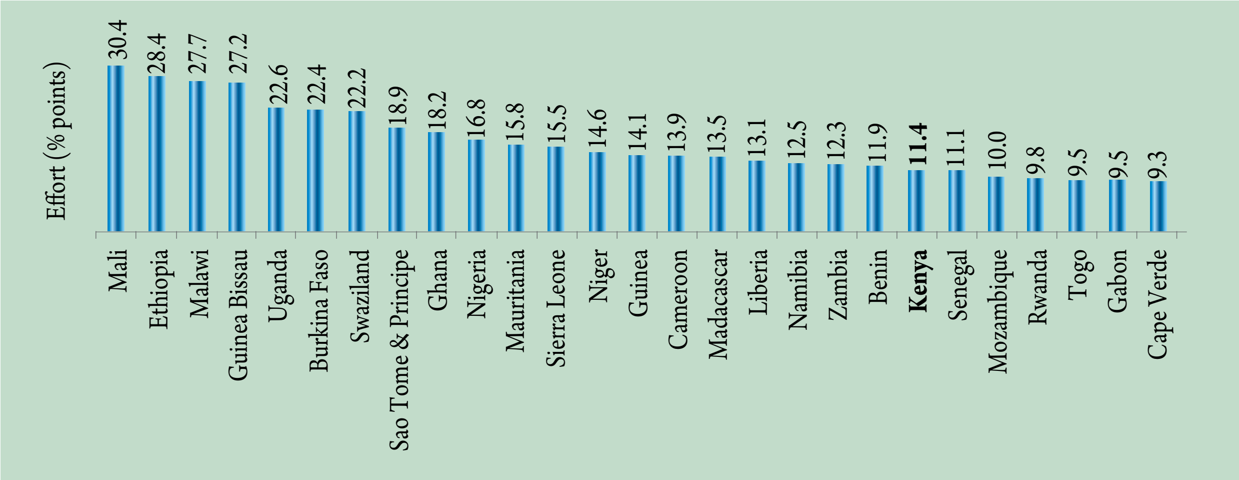
However, according to JMP (2015), Kenya fell behind a number of countries in Africa with respect to progress made towards the attainment of the MDG targets. In Africa, the countries that met the targets were Mali, Ethiopia, Malawi, Guinea-Bissau, Uganda, Burkina Faso, Swaziland, Sao Tome and Principe, Ghana, Nigeria, Guinea, Cameroon, Namibia, Benin, Senegal, Gabon, Cape Verde, Tunisia, Djibouti, Gambia, Morocco, South Africa,

Table 14.3: Performance of key water indicators by water utilities

Key performance indicators on water	Sector benchmarks	2014	2015	% change in 2015
Water coverage, % at utilities level	> 90	53.3	55.9	2.6
Drinking water quality (%)	> 95	92	91	-1
Hours of supply, hrs/day	> 17	17	18	1
Non-revenue water (%)	< 20	43	42	-1
Metering ratio (%)	= 100	87	89	+2
Staff productivity, staff per 1000 connections	< 7	7	7	0
Personnel expenditure as % of O+M costs (%)	< 30	43	42	-1
Revenue collection efficiency (%)	> 95	85	93	+8
O+M cost coverage (%)	≥ 150	113	100	-13
Sewerage (%)	> 40	17	16	-1
Production, M^3 '('000)	NA	407.434	425.772	+18
Turnover (Ksh million)	NA	15,321	15,729	+408
Employment	NA	8,509	9,104	+595
Compliance to data submission (%)		99	92	-7

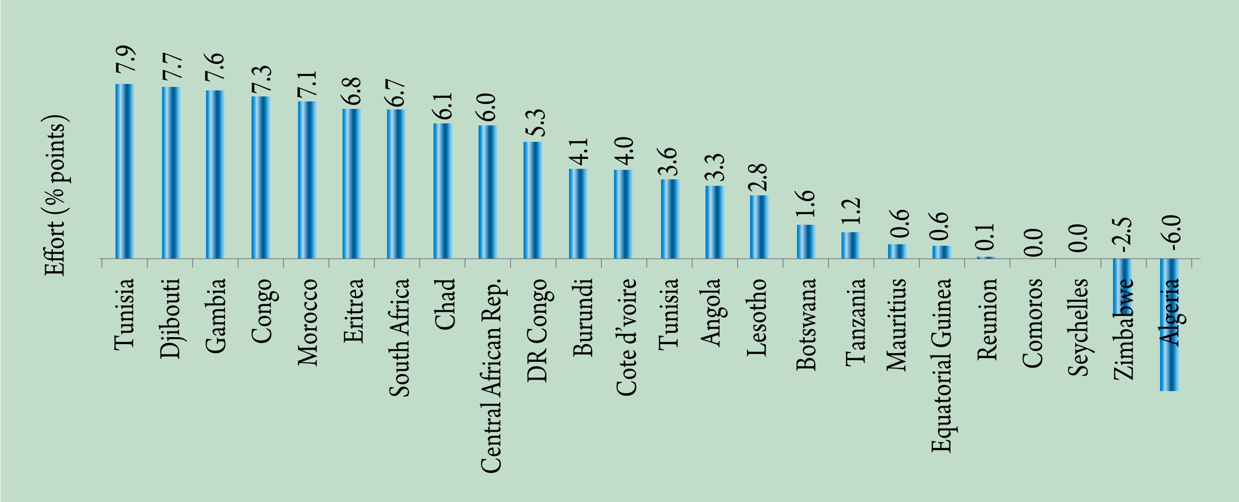
Source of data: JMP (2015); MEWNR (2014;2015); WASREB (2014; 2015)

Figure 14.1: Benchmarking Kenya on the status of MDG on access to safe water



Source of data: JMP (2015)

Figure 14.2: Benchmarking Kenya on the status of MDG on access to safe water



Source of data: JMP (2015)

Egypt, Botswana, Mauritius and Réunion. Those which had good progress were Mauritania, Sierra Leone, Niger, Liberia, Kenya and Rwanda. However, Democratic Republic of the Congo, Angola, United Republic of Tanzania, Equatorial Guinea, Comoros, Seychelles, Zimbabwe, Algeria recorded limited or no progress. Those with moderate progress were Madagascar, Zambia, Mozambique, Togo, Eritrea, Chad, Central African Republic, Burundi, Côte d'Ivoire, and Lesotho (JMP, 2015).

14.4 Access to Adequate Water for Irrigation

The Government of Kenya has identified irrigation for agriculture as one strategy towards the realization of food security. Between 2014 and 2015, land under irrigation increased to 202,502 hectares up from 189,584 hectares. This was an increment of 6.8 per cent, which came mainly from expansion of existing irrigation schemes and completion of some new schemes. Water harvesting and storage capacity increased from 124 million M^3 to 138 million M^3 (Table 14.4). This increment is attributed to the completion of two new medium size dams, 72 small dams and 647 pans. In order to mitigate flood disasters on agriculture, property and humans, the country added an additional 6.1km of flood control dykes, built along Nyando and Daua rivers.

Table 14.4: Water irrigation, storage and land reclamation indicators

Indicators	2013	2014	Change in 2014
Land under irrigation (ha)	189,584	202,502	12,917
Additional reclaimed land (ha)	5250	5163	-87
No. of Large dams	26	28	2
No. of small dams and water pans	3,090	3,790	701
Water storage (million m^3)	124	138	14

Source of data: MEWNR (2014; 2015)

14.5 Access to Improved Sanitation

The national level of access to improved sanitation is estimated at 30.2 per cent. This means that over 70 per cent of Kenya's population is using unimproved sanitation facilities. The level of open defecation is at 12 per cent at national level, which disaggregates to 2.6 per cent among the urban population and 15.3 per cent among the rural population (Table 14.5).

The performance of water utilities on sanitation improved (MEWNR, 2015). Coverage of the population within their service area increased by 1.9 per cent to reach 68.6 per cent in 2015 up from 66.7 per cent in the previous year. Urban water utilities improved their coverage from 70.6 per cent to 72.2 per cent, and the rural utilities increased their coverage from 63.8 per cent to 66.0 per cent. Sewerage coverage increased by 1.6 per cent, which is from 20.6 per cent to 22.1 per cent. Sewerage coverage is only applicable to urban areas (MEWNR, 2015).

Waste management has remained a major problem especially among the urban population in Kenya. Poor waste management leads to water pollution through rain water washing down the waste into near watercourse and finally polluting rivers or water dams. Besides, waste disposal points become saturated and turn into health risks. Incidences of diarrheoa and other waterborne diseases are bound to increase in residential areas that have poor waste collection strategies. Management of waste water and solid waste in urban areas and cities needs improvement. Sewerage coverage is 21.0 per cent of urban population, while dumping sites are overwhelmed. For instance, the dumping site in Dandora in Nairobi is saturated and its relocation to Ruai is yet to be concluded. Garbage collection in urban areas and cities is below the expectations of residents.

Flood control is another challenge that the sector has taken initiatives to tackle. For instance, one way of handling floods is by digging of dykes (MEWNR, 2015). However, the flooding witnessed in urban areas and cities is a function of the ministry in charge of roads and public works, as well as the county government depending on the class of roads. Clogging of drainage systems is a main hindrance to preparedness against floods.

Table 14.5: Key performance indicators on sanitation

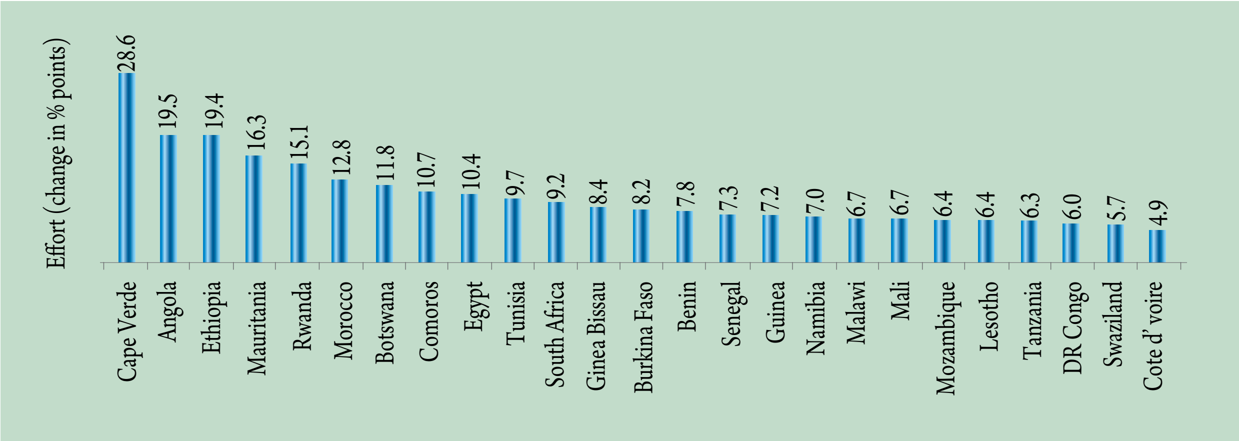
	2013	2014	Change in 2014 (%)
Access to improved sanitation facilities, national (% of population with access)	30.1	30.2	0.1
Access to improved sanitation facilities, urban (% of population with access)	31.0	31.2	+0.2
Access to improved sanitation facilities, rural (% of population with access)	29.5	29.7	+0.2
Access to improved sanitation (% by utilities, national)	66.7	68.6	+1.9
Access to improved sanitation (% by utilities, urban)	70.6	72.2	+1.7

	2013	2014	Change in 2014 (%)
Access to improved sanitation (% by utilities, rural)	63.8	66.0	+2.2
Sewerage coverage (urban only)	20.6	22.1	+1.6

Source of data: JMP (2015) and MEWNR (2014; 2015) and WASREB (2014; 2015)

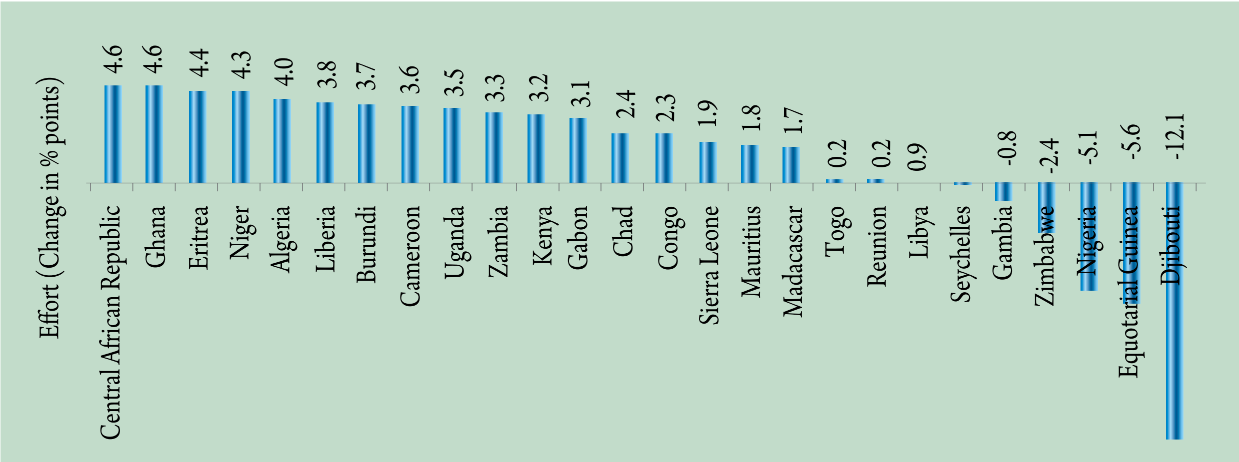
Globally, Kenya was among the countries that had made limited progress towards attainment of MDG with respect to access to improved sanitation (Table 14.3 and 14.4). In terms of effort, Kenya recorded slight improvement in access to improved sanitation, increasing by 3.2 per cent. However, this was too low compared to other countries in the world, making Kenya position 111 out of 196 countries. In Africa, Kenya was 37 out of 54 countries in terms of effort towards attainment of MDG on access to improved sanitation. Whereas 52.0 per cent of the world managed to reduce by half the population not accessing improved sanitation, in Africa only 8.0 per cent met the target. Majority of the countries in Africa (63%) had limited or no progress (JMP, 2015).

Figure 14.3: Benchmarking Kenya on the status of MDG on access to improved sanitation



Source of data: JMP (2015)

Figure 14.4: Benchmarking Kenya on the status of MDG on access to improved sanitation



Source of data: JMP (2015)

14.6 Sector Funding

Budget allocation for the water sector reduced in the year 2014. Actual receipts reduced from Ksh 29.9 billion in 2014 to Ksh 21.4 billion. This decline of about Ksh 8.5 billion was attributed to low absorption of allocated funds in the previous year. In fact, the sector budget had already reflected this reduction from the previous year, from Ksh 41.8 billion to Ksh 29.3 billion. The actual funding for 2014 fell short of the budget by about Ksh 8.1 billion (Table 14.6).

The level of effort by the government and donors towards funding the sector in 2014 was relatively the same as 2013, with government to donor funding ratio being 50:50. Donor funding in terms of loans reduced by Ksh 1.2 billion from Ksh 11.5 billion in 2014 to Ksh 10.3 billion for 2014, while grants reduced by Ksh 1 billion in the same period. The decline was associated with delayed disbursement of government contribution to the projects, which the donor community needs to confirm before commitment and eventual disbursement of their pledges. Donor funding is largely in terms of loans as opposed to grants, with ratio of loans to grants being 1:4 (Table 14.6). These collaborative efforts between government and donor community should be encouraged and improved. To reduce the burden of external funding on the taxpayer and absorbing institutions, the government should seek to negotiate for more grants and low interest loans.

In terms of balancing recurrent expenditure to development expenditure, the ratio remained relatively the same in 2014 as it was in 2013, and

Table 14.6: Water and sanitation sector funding

		2013 (Ksh billions)	2014 (Ksh billions)	Change in 2014 (Ksh billions)	2013 (%)	2014 (%)
Water Sector Budget	Recurrent Expenditure	6.1	4.4	-1.7	14	15
	Development Expenditure	35.8	24.9	-10.9	86	85
	Total	41.8	29.3	-12.5	-	-
Water Sector Actual Receipts	Recurrent Expenditure	5.3	4.2	-1.1	18	20
	Development Expenditure	24.6	17.2	-7.4	82	80
	Total	29.9	21.4	-8.5	-	-
Stakeholders Funding	Government of Kenya	15.9	9.6	-6.3	53	45
	Donor	14.0	11.8	-2.2	47	55
	Total	29.9	21.4	-8.5	-	-
Donor Funding	Loans	11.5	10.3	-1.2	82	87
	Grants	2.5	1.5	-1.0	18	13
	Total	14.0	11.8	-2.2	-	-
Sub-sector Funding	Water Supply and Sanitation	30.0	18.9	-11.1	72	65
	Storage	4.4	4.0	-0.4	10	13
	Regional Development Authorities	4.2	4.2	0.01	10	14
	Water Resources Management	2.4	1.9	-0.5	6	6
	Ministry Headquarters	0.6	0.3	-0.3	1	1
	Land Reclamation	0.1	0.1	-0.05	0.3	0.3
	Total	41.7	29.3	-12.3	-	-

Source of data: MEWNR (2014; 2015)

this was estimated at 1:4, respectively. However, in 2014, development expenditure dropped by Ksh 7.4 billion and recurrent expenditure also dropped by Ksh 1.1 billion (Table 14.6).

A large proportion of the sector budget goes to fund water supply and sanitation, which claims over 65.0 per cent of the budget as indicated in Table 14.6. The rest of the sub-sectors share the remaining 35.0 per cent as follows: storage (10), regional development (10), water resources management (6), Ministry headquarters (1), and land reclamation (0.3). Storage and regional development funds are largely targeted to irrigation. Although water supply and sanitation received the highest share of funds, it was also highest hit in terms of budget cuts by over Ksh 11 billion. The low uptake of resources demonstrates the low growth rate in access to water, which stagnated at 53.0 per cent in areas served by water utilities.

Table 14.7: Relevant bills on water and sanitation

Bill	Key policy issues with respect to water and sanitation
Water Bill 2014	1. Embeds the function of water and sanitation service delivery to county governments 2. Provides that county governments will be in charge of water service providers 3. The function of licensing a water service provider is reserved for county government but that of accreditation is given to the Water Resources Regulatory Authority 4. Provisions over regulations on water rights and water works 5. Establishes a number of institutions, namely: Water Resources Regulatory Authority to succeed Water Resources Management Authority; Water Services Regulatory Authority to succeed Water Service Regulatory Board; National Water Harvesting and Storage Authority to succeed the National Conservation and Pipeline Corporation; Water Works Development Boards to succeed Water Service Boards; Water Sector Trust Fund to succeed Water Services Trust Fund; Water Tribunal to succeed the Water Appeals Board, among others
Natural Resources Benefits Sharing Bill 2014	1. Identifies water resources as one of the natural resources that will require benefits sharing among national government, county government and locals among petroleum, natural gas, minerals, forest resources, wildlife resources and fishery resources 2. Seeks to resolve the inter-county water disputes on water sourcing, usage and benefits 3. Seeks to establish a Benefits Sharing Authority to oversee determination of royalties and fees chargeable among other charges on exploitation of resources as well as modalities and applicable ratios of sharing of the benefits from natural resources among legitimate groups, as well as coordinating and monitoring benefits sharing agreements 4. Bestows the function of agreements with interest groups on county governments, vide County Benefits Sharing Committees whose functions are outlined 5. Establishes County Benefits Sharing Committee to negotiate agreements on behalf of county government, monitor implementation of community projects courtesy of benefits sharing agreements, determine amount to be allocated to communities and ensure public participation in the entire process
Health Bill 2015	1. Mainstreams the requirements of the Fourth Schedule of the Constitution of Kenya by transferring the function of sanitation to county government 2. Spells out the need for the county government to maintain standards of environmental health and sanitation as laid down in applicable law 3. In advancement of public and environmental health national health system is called upon to reduce disease burden associated with sanitation 4. Requires national government to ensure houses, institutions, hospitals and other public places maintain the environment to the highest level of sanitation attainable to prevent, reduce or eliminate environmental health risks 5. National government to protect citizens from sanitation risks from outside Kenya 6. National government to provide guidelines to county governments on matters related to sanitation 7. National government to promote disease surveillance and prevention of environmental, food, water and sanitation related diseases

Bill	Key policy issues with respect to water and sanitation
National Irrigation Bill 2015 Draft	1. Align existing irrigation laws to the Constitution of Kenya 2010 2. Entrenches the spirit of consultation, collaboration and cooperation among national and county governments in irrigation and development and management 3. Calls for putting in place of a national irrigation services strategy 4. Creation of a National Irrigation Development Service to succeed the current National Irrigation Board 5. Sets out responsibilities of county governments in recognition of provisions of Part 2 of Fourth Schedule to the Constitution 6. Contemplates the establishment of Irrigation and Drainage Research Centre to carry out research, innovation and training on irrigation matters 7. Creates an irrigation development fund to be sourced from government and non-government sources 8. Sets legal foundation for farmers involved in an irrigation scheme to form associations

Operations on sanitation are largely based on the Public Health Act (2012) and the National Environmental Sanitation and Hygiene Policy of 2007. For instance, the policy recognizes improved sanitation as pour-flush latrine, simple latrine pit latrine, ventilated improved pit latrine, and connection to sewer line or septic system. It also considers adequate sanitation as one that provides privacy and separates human excreta from human contact. Though the policy envisaged universal awareness and access to improved sanitation by 2015, the target was not met. This calls for review of the policy and strategies that were put in place to learn from the strengths, weaknesses, opportunities and threats that led to the current status.

In addition, the country has continued to experience a number of challenges that slow down progress especially in meeting Vision 2030 targets. Some of the challenges are financing (especially on sourcing, disbursement, absorption, accountability and coordination), illegal abstraction of water resources, cross-county water sharing and interference, limited skills, low performance of water service providers, and delayed policy processes. There are also weaknesses in research especially on resources, collaboration and cooperation.

Global policy developments

Globally, the Sustainable Development Goals (SDGs) passed in 2015 spell out a vision for water which is desirous of "A world where we reaffirm our commitments regarding the human right to safe drinking water and sanitation and where there is improved hygiene; and where food is sufficient, safe, affordable and nutritious."

Towards achievement of this vision, the SDGs mark to tackle water scarcity, pollution, waste water and efficiency. Table 14.8 shows the specific goals touching on water and sanitation together with the earmarked key policy issues.

The World Economic Forum (2016) ranked water crises among the top three global risks with high impact on humanity. This was behind climate change and weapons of mass destruction, which were ranked first and second, respectively. Water crises took different dimensions, including intensity of water shortages, floods and storms worldwide. The report by the forum shows that water supply crises has evolved over time from being viewed as an environmental problem to being a societal problem. It is least seen as an economic, geopolitical and technological challenge. It also links water risk to food insecurity. The report also indicates that water scarcity is on the rise globally. This is a clear mark that Kenya should take the issues of water seriously and be strategic enough to gain from global efforts towards mitigation of water risks. Water and sanitation is expected to receive major funding under Goal 6 of the Sustainable Development Goals.

Table 14.8: Sustainable Development Goals on water and sanitation

SDG Goals	Key Policy Issues Specific to Water and Sanitation	Key Implications
Goal 3: Ensure healthy lives and promote well-being for all at all ages	1. Reduce water-borne diseases, illness and deaths 2. Reduce water pollution and contamination	1. This will reduce mortality rates related to water 2. This will reduce the cost of treating water for consumption
Goal 6: Ensure availability and sustainable management of water and sanitation for all	3. Universal and equitable access to water and sanitation services 4. Reduce gender bias and effects on women and girls 5. Eliminate open defecation 6. Improve water quality 7. Reduce water pollution, untreated waste water 8. Encourage water use efficiency (reduce, recycle, reuse) 9. Adopt integrated water resources management systems 10. Protect and conserve water ecosystem 11. Improve on water harvesting and desalination 12. Encourage international cooperation 13. Build capacity 14. Mobilize communities	3. Fulfilling human right to water and sanitation 4. Reduce water sourcing burden on women and girls 5. Reduce water pollution and health risks 6. Enhance water safety 7. Reduce cost of treating water 8. Tackle water scarcity 9. Inculcate good governance and management principles in water, reduce water conflicts and ensure sustainable development 10. Build generational responsibility and sustainable development 11. Reduce water stress 12. Resource mobilization and monitoring of progress 13. Transfer of technology 14. Promote ownership and participation
Goal 11: Make cities and human settlements inclusive, safe, resilient and sustainable	15. Deaths and other losses related to water disasters	16. Reduce mortality related to water especially floods and storms

Source: Authors

The agenda for sanitation for post-2015 period is to target 100 per cent access to sanitation at schools, health centres, market centres, recreational areas and other public places. This will need to be monitored in terms of number of public facilities within and in the neighbourhoods of these places, as well as the distance between such facilities. It will be important also to estimate the cost of accessing these facilities, by assessing charges for use of public sanitation facilities.

14.8 Conclusions and Recommendations

14.8.1 Conclusions

The water and sanitation sector showed improvement in the year 2015. The population accessing improved water and sanitation reached 63.2 per cent and 30.1 per cent, respectively. It is apparent that Kenya needs to invest more in the sector in order to achieve universal access to improved water and sanitation. It is also clear that the sector has systemic risks, which have gone on for long with little concerted effort to mitigate them. The policy on sanitation should be clear on the line ministry to spearhead the docket and those which are supportive. As it is, the ministries responsible for health, and water and irrigation seem to overlap on their mandates. An inter-ministerial taskforce, together with the Ministry of Devolution and Planning, should harmonize and monitor this overlapping mandate.

The global scene is promising in terms of concerted effort towards realization of universal access to improved water and sanitation. Africa lagged behind in the achievement of the Millennium Development Goals. Goal 6 of the Sustainable Development Goals offers Africa, and Kenya in particular, a platform to lobby for adequate support to achieve the goal.

14.9 Policy Recommendations

In order to speed up the progress of the water and sanitation sector towards attainment of 100 per cent access to improved water and sanitation, there is need to address the critical challenges. These challenges can be classified broadly into two categories: mobilization of resources, and management of such resources. The issues under mobilization of resources are mainly funding, skills, and conservation while those related to management of resources are allocation, efficiency, monitoring and evaluation framework.

Mobilization of water and sanitation resources

The funding challenge can be tackled by lobbying for more allocation in the government budget, increasing absorption of allocated funds, increasing self-financing through internally generated funds and ring-fencing of water revenues.

Water and sanitation is expected to receive major funding under Goal 6 of the Sustainable Development Goals. Therefore, Kenya should position herself to benefit from this anticipated global funding to complement local investment plans in the sector.

Skills can be enhanced through on-job training and enhancing of curriculum used in training of water professionals. The institutions offering water and sanitation courses should be supported and strengthened. Development partners should also support skills and technology exchange programmes for the sector.

Management of water resources

The budgeting, monitoring and evaluation challenge can be tackled through capacity building on principles of planning, budgeting, coordination and communication. Data and reporting issues will require sensitization programmes. An integrated sector reporting framework will be important to bring on board progress made by each and every investor in the sector.

Water availability could be improved and sustained through protection of riparian zones, wetlands and by increasing water harvesting and storage.

Water resource conflicts could be minimized through negotiated policies and in observance of the aspirations of the Constitution of Kenya. Institutional mandate conflicts could be minimized through cooperation and collaboration to build on synergies or by review of mandates. However, it is often difficult to eliminate overlaps of mandates, because this requires designing of policy frameworks to finest details ever. There must be increased visibility and branding of the institutions in charge of the sector.

Pricing of water could be enhanced by conducting proper costing and cost recovery mapping, while low coverage could be enhanced by expansion of the existing utilities as well as encouraging formation of new utilities. There is also need to encourage establishment of water utilities by the private sector. The utilities should also improve on operational efficiency.

Conflicts between national and county government with respect to mandates should be negotiated while respecting the aspirations of the Constitution. In order for the sector to make full benefit of the sector potential, government agencies should enhance uptake of available funding especially in expansion and maintenance of infrastructure.

The existing policies and strategies (such as the water services strategy and the national sanitation strategy) should be finalized into working policy documents, and pending bills enacted into law. This should be able to bring on board new ideas to fast-track the progress of the sector while developing successful policies and strategies.

Regarding irrigation, there is need to establish new irrigation schemes and expand existing schemes. This will entail investing in water harvesting and storage dams, identification of more land for irrigation, and adoption of efficient irrigation technologies with respect to water uptake and land yield.

Management of waste water and solid waste needs upgrading. This will require expansion of sewerage systems and solid waste disposal points. Saturated dumping sites need to be relocated, as well as those violating environmental standards. This translates to the need to increase budget allocations for this purpose, and improve management of service delivery.

Mapping of flood-prone areas should be reviewed and zoned, such that a local flood management unit is established for the zones. Construction of more dykes and ensuring continuous unclogging of the drainage system in the urban areas and cities are necessities in control of floods.

Chapter 15

Information and Communication Technology

15.1 Introduction

The Information and Communication Technology (ICT) sector is a key enabler in transforming Kenya into a knowledge and information-based economy (Vision 2030). The sector plays an important role in addressing social, economic and environmental challenges and, therefore, impacting on society at both micro and macro levels. Over the last few years, the ICT sector has received prominence in the eyes of the public and decision makers in improving service delivery as evidently seen in Huduma Centres that are now spread in different parts of the country. It is critical to note that ICT has facilitated the national government to devolve its operations and economic activities to the county governments. The Integrated Financial Management Information Systems (IFMIS) is an example of a successful project that illustrates how technology facilitates payment in terms of time, accountability and efficiency in government offices both at national and county levels. The Government of Kenya has initiated several programmes and developed policies and strategies to streamline the sector. As a result, Kenya has produced global innovations such as M-Pesa, and the country is regarded as a global technology centre and the Silicon Valley of Africa (*The Guardian*, 2012).

This chapter highlights the performance of the ICT sector, recent initiatives and policy developments, emerging issues and challenges facing the sector and policy recommendations.

15.2 Sector Performance

The selected indicators measuring performance of the ICT sector for 2015 paint a positive picture as highlighted in Table 15.1.

15.2.1 Mobile cellular subscriptions

The ICT sector recorded a significant growth of 12.1 per cent in 2014/15 compared to 2013/14 financial year in terms of mobile cellular subscriptions. This growth is attributed to wide adoption of ICT in service delivery both in public and private sectors. For instance, the provision of government services through technology, such as renewal of driving licenses, application of passports and i-Tax have led to increased demand for mobile phone services. Services such as online shopping through digital

Table 15.1: Selected indicators in ICT sector

Type of Indicator	Indicator Name	2013-14	2014-15	Variation (% change)
Cellular Mobile Services	Mobile subscriptions (millions)	32.2	36.1	12.1
	Mobile money transfer subscriptions (millions)	26.6	27.7	3.4
	Mobile money transfer (Agents)	109,296	129,357	18.3
	Voice traffic in minutes (local outgoing traffic) (millions)	30.4	34.0	11.6
	Voice traffic in minutes (local incoming traffic) (millions)	30.7	34.2	11.5
	Minute of use (minutes per user per month)	80.4	81.5	1.4
	Short message service (sms) (billions)	24.4	27.4	12.5
Mobile Revenue and Investment	Mobile revenue (Ksh millions)	140,233	172,501	23
	Mobile investment (Ksh millions)	30,387	32,133	5.7
Data/Internet	Internet users (millions)	22.3	29.6	32.9
	Domain names	32,508	47,704	46.7
Postal and Courier Traffic	Postal outlets	622	623	0.16
	Private courier outlets	707	2,117	199.4

Source: Communication Authority of Kenya (2015), Statistical Report

platforms–OLX and Jumia; and M-Banking services have led to increased ownership of mobile devices. In addition, the growth can be attributed to the entry of new providers such as Finserve Africa Limited (Equitel) - a Mobile Virtual Network Operator - that are offering exciting mobile products and services. It is important to note that Safaricom has 67.0 per cent of the total subscribers due to its huge infrastructural investment done locally, such as the recent launch of the high speed Long Term Evolution (LTE) based network to offer better services.

15.2.2 Mobile money transfer services

The ICT sector recorded 3.4 per cent growth in terms of new subscribers for money transfer services in 2014/15. This growth in numbers can be partly explained by huge demand for electronic transactions to support e-services such as e-government services offered by Huduma centres. Services such as online shopping through digital platforms –OLX and Jumia; and M-Banking services have led to increased subscriptions of mobile money transfer services. In addition, the recent entry of several players in mobile money services such as Finserve Africa Limited (Equitel), Mobikash Africa and Mobile Pay limited joining players such as Safaricom, Airtel, Essar and Telkom Ltd have contributed to the growth in subscriptions. Similarly, the number of agents serving the providers increased by 18.3 per cent in 2014/15 financial year and, therefore, positively influencing the number of subscriptions of mobile money transfer services. It should be noted that the amount of money transferred increased significantly in 2015 because of the aforementioned reasons.

15.2.3 Voice traffic (local outgoing traffic)

The sector recorded a growth of 11.6 per cent in local outgoing traffic in 2014/15. This impressive growth is largely explained by increased availability and affordability of voice services. The recent entry of players such as Finserve Africa Limited (Equitel) has compelled mobile operators to revise their calling rates downwards. In addition, several providers have come up with special offers and promotions. The sector has invested in better technologies on fiber optic-based network such as LTE to offer superior performance in handling voice traffic. Likewise, the total local incoming traffic increased by 11.5 per cent in 2014/15 primarily because of the aforementioned reasons. It should be noted that minutes of use (per user) per month slightly increased by 1.14 per cent in 2014/15.

15.2.4 Short message service (SMS)

The sector recorded a significant growth of 12.5 per cent in SMS in 2014/15. Though the service encountered stiff competition from social media services such as WhatsApp, SMS has continued to be a preferred mode of communication partly because of reduction of cost per SMS and very attractive SMS bundles offered by mobile operators. In addition, the service does not require the presence of Internet and hence a preferred mode of communication as it is accessible by all. The entry of new mobile operator, Finserve Africa Limited (Equitel) also had a positive influence in explaining the growth of numbers of SMSs.

15.2.5 Mobile revenue and investment

The ICT sector recorded an impressive growth in revenue for 2014/15 due to wide usage of mobile money transfer service, increased usage of Internet/ Data service as well as increased telecommunication services provided by content service providers. It is important to note that revenue generated from voice and SMS services has continued to decline because of equally better services offered by social media such as WhatsApp. Likewise, the sector recorded 5.7 per cent growth in investment. This growth can largely be attributed to the entry of Equitel into the sector. In addition, the growth is attributed to the quest for better technologies to offer better services as recently seen in the sector. For example, Safaricom has invested in fibre optic technology that has seen the recent launch of LTE (4G) network in order to offer better data services.

15.2.6 Internet users

The sector recorded significant growth of 32.9 per cent in terms of Internet users in 2014/15 due to efforts that are already underway initiated by both the public and private sectors, such as investment in fibre optic technology that offers better data connectivity at reduced costs. In July 2015, the Government of Kenya was able to complete 969km of 2,100km under the National Optic Fibre Backbone and about 28 county offices were connected under the county connectivity project. The wide adoption of Internet technology to offer government e-services has driven the growth of Internet. The data market has continued to expand as reflected by increase in number of users accessing data services, such as online shopping and entertainment services. It is expected that the growth in the sector will lead to the growth of new industries such as mobile content delivery service providers as well as mobile virtual network operators.

15.2.7 Domain names

The sector recorded a significant growth in domain names in 2014/15 due to the efforts made by the government in offering e-services across government offices. Majority of the county governments have websites that are managed by respective counties. Several institutions of higher learning have continued to register domains in order to attract more students and particularly because of E-learning based technologies. Likewise, companies have also taken up web technology after realizing the competitive advantage the technology offers. In addition, the lucrative domain name offers provided by Internet Service Providers (ISPs) has attracted more companies and individuals.

15.2.8 Postal and courier traffic

The sector recorded significant growth in private courier outlets in 2014/15 due to more friendly flexible, reliable and convenient services introduced by private courier outlets. The growth of postal

Table 15.6: Domains registered

Sub domain	Users	2011	2012	2013	2014
.ac.ke	Institutions of higher education	341	603	737	792
.co.ke	Companies	12,798	22,607	27,643	35,274
.go.ke	Government entities	157	278	339	314
Total domains	14,160	25,013	30,585	38,533	

Source: KNBS (2015)

outlets was not significant partly because of the aforementioned reasons.

15.2.9 Internet servers

Table 15.2: Secure Internet servers per 1 million people

Country/Year	2010	2011	2012	2013	2014
Kenya	3	3	4	5	8
Ghana	2	2	3	3	4
Rwanda	1	1	2	3	4
South Africa	61	72	82	86	116
Korea Republic	1,128	2,496	2,752	1,995	2,177

Source: World Bank (2015)

Kenya, like many other African countries, has continued to perform poorly in terms of securing its digital platforms. The recent report by Serianu (2015) indicates that Kenya loses more than Ksh 15 billion annually through cyber crime. It is estimated that this figure could be higher because most of the cyber-related frauds are either under-reported or undetected. The report has ranked government data resources top list because of financial systems such as IFMIS, i-tax and e-procurement. The report indicates that Kenya has one security professional for every 200,000 Internet users. Despite initiatives such as formation of the national Computer Incident Response Teams (CIRTs) and revision of cyber security masterplan as well as the Cyber Security Bill, Kenya continues to perform poorly in terms of detecting and responding to different computer crimes. It is observed that the rate of securing the computing services has not matched the significant growth seen in the sector. Cyber security is a critical issue that must be prioritized to safeguard the provision of services in the country. The World Bank (2015) indicates that Kenya has recorded a slight growth in terms of secured Internet servers per 1 million Internet users.

15.3 Recent Initiatives and Policy Developments

Kenya has recently initiated several programmes and developed strategies and policies to foster development and promote wide adoption of ICT. For instance, the government has embarked on using technology to improve and transform public service delivery. There are more than 16 Huduma centres across the country offering more than 25 government services from one-stop shops and serving more than 2,500 Kenyans daily. Other recent initiatives include: Completion of 969km of 2,100km under the National Optic Fibre Backbone; connecting 28 county offices under the County Connectivity Project; recruitment of 100 youth under the Presidential Digital Talent; Establishment of Konza phase 1A horizontal infrastructure; Successful rolling out of the Digital TV migration project; Formation of one area network within East Africa Community that has reduced roaming charges to Ksh 10; Implementation of Kenya Communications (Amendment) Act 2013; Preparation of Standard One laptop programme to be implemented in 2017; aggressive plan by Rural Electrification Authority (REA) to connect all the 22,175 public primary schools by December 2016; Preparation of Critical Infrastructure Protection Bill; and Digitizing of government records and operations.

Despite having invested heavily and making efforts to streamline the sector, the country has been experiencing several challenges from policy issues to technical challenges. Securing the Kenyan cyber space has always been a challenge primarily because of lack of appropriate legal framework to handle cyber-related crimes as well as low public awareness on safety and privacy of data. Other key challenges include: digital divide leading to widening gap between demographics and regions that have access to technology; cyber bullying - cyber stalking and cyber harassment; hacktivism and hate speech; increasing use of crypto currency such as bitcoins; sharing of key ICT infrastructure has not been embraced by service providers in the sector; high incidences of abuse of intellectual properties; and weak policies on e-transactions and e-payments on emerging platforms such as OLX, which are likely to lead to poor revenue collection by Kenya Revenue Authority.

15.4 Policy Recommendations

Based on the aforementioned challenges and trends discussed above, there are a number of policy recommendations that need to be considered. Some of the existing policies require to be clearly and appropriately revised to regulate, improve and safeguard the fast growth of the sector.

- The Ministry of Information and Communication Technology should work closely with the private sector to formulate and implement appropriate measures to promote public awareness on safety and security matters of technology.

- The current Bill on Critical Infrastructure Protection should be fast-tracked, revised clearly and appropriately to cover all the emerging issues such as unlawful usage of digital currencies; privacy of data; cyber terrorism; cyber bullying and hacktivism. The Bill should promote safe adoption and use of the emerging technologies such as mobile and cloud computing, and telecommuting in work places.

- The Ministry of Information and Communication Technology should develop appropriate legal framework to encourage the PPP initiatives in investing in technology in order to reduce the ever-growing digital divide.

- The National Treasury, Kenya Revenue Authority and Ministry of Information and Communication Technology should develop or strengthen the existing policies on how to manage the digital payment methods and e-transactions. This effort should be directed to guiding the development of the sector as well as establishing effective ways of collecting revenue from e-transactions.

- The Ministry of Information and Communication Technology should develop a comprehensive legal framework that involves all the relevant bodies such as Communication Authority and Competition Authority in order to address the regulatory issues faced by the sector, such as competition, monopoly, pricing and mergers and acquisition.

- In addition to the aforementioned recommendations, the sector has to strategically focus on how to deal with the emerging and ever changing technological issues. It is critical that the Communications Authority of Kenya spearheads the adoption of best practices when dealing with different issues such as sharing of key infrastructure, adoption of a liberalized gateway, improving quality of service, improving Internet governance, and promoting growth and innovation in the sector.

PART III

Kenya's Medium Term Economic Prospects

Chapter 16

Kenya's Medium Term Economic Prospects

16.1 Introduction

The Kenyan economy has been experiencing positive economic growth though at low levels, with GDP growth registering levels of slightly above 5.0 per cent for 2014 and 2015. The development in oil prices towards stabilisation, and the low inflation levels give an impetus for economic growth to improve in the medium term. Growth in Kenya's mineral sector, coupled with the huge infrastructural investments, is expected to support higher economic growth in the medium term.

16.2 Economic Projections for 2016-2018

Given the current stable macroeconomic conditions, the medium term growth prospects are expected to be strong and positive, premised on the following assumptions:

(i) Structural reforms and public investment in infrastructure will continue as planned, thus improving the business environment and the potential GDP of the economy;

(ii) The political climate, including smooth transition to devolved system, will be stable and growth-oriented, and that the 2017 general elections will be peaceful;

(iii) Favourable weather conditions will continue to sustain improvements in agricultural output; and

(iv) There will be a stable regional and global economic environment.

The projections in Table 16.1 show that economic growth in Kenya in the medium term will be gradual and is likely to reach 6.5 per cent by 2018. Private investments as well as government investments are both expected to continue growing at higher levels, leading to improved economic growth rates. However, slow adoption of public-private partnerships (PPPs) in implementing the MTP II projects, as envisaged in Vision 2030, may lead to a slower rate of economic expansion. In addition, weak implementation of the budget could adversely affect growth in the medium term. Therefore, in the event that the expected outcomes are not realized, the alternative scenario presented hereafter reflects the downside risks.

Table 16.1: Economic projections for 2016-2018

Selected Economic Indicators/Year	2013	2014	2015	2016	2017	2018
GDP growth (%)	5.8	5.3	5.6	5.9	6.2	6.5
Inflation (%)	5.7	6.9	6.6	5.8	5.6	5.0
Private consumption (%)	6.3	5.8	3.3	4.5	6.2	6.3
Government consumption (%)	5.5	6.0	8.4	5.5	6.8	6.2
Private investments (%)	-5.3	11.8	2.5	5.3	5.3	6.5
Government investments (%)	18.2	10.3	4.2	6.5	4.0	7.2
Exports of goods and services (%)	0.5	5.3	-0.9	3.8	7.4	6.8
Imports goods and services (%)	-0.8	10.6	-1.2	5.2	5.3	6.1
Current account balance (%)	-8.9	-9.8	-6.8	-7.6	-7.6	-7.3
Fiscal Deficit (%)	-7.1	-6.4	-6.0	-5.6	-5.4	-5.1
Public expenditure (% GDP)	27.0	27.2	26.6	25.3	24.6	24.0
Interest Rate (%)	8.9	8.9	10.8	10.0	10.1	10.1

Source: KIPPRA Estimates based on the KIPPRA-Treasury Macro Model (KTMM)

16.3 Alternative Scenario

The alternative scenario presented in Table 16.2 shows a more conservative growth path for the economy. This scenario is based on the assumption of less than optimal implementation of the process of devolved government, and the economy experiencing adverse external shocks. In this case, the country could experience higher inflation, weakening of the exchange rate and higher interest rates. These would constrain the growth rate of Kenya's economy.

16.4 Scenario for Vision 2030

The Vision 2030 objective in the economic pillar is to attain economic growth rate of 10.0 per cent by the year 2012. This was not achieved due to a number of factors at the domestic and international level, especially the crisis that were never envisaged. However, that high growth rate in Vision 2030 can be achieved but at a later date. The scenario in Table 16.3 gives projections for economic growth rates that show a profile for up to 10.0 percent in year 2017. The key assumptions in this scenario are stable macroeconomic conditions, prudent fiscal and monetary policies, improvement in productivity and competitiveness, steady contribution by county governments to overall development, well performing investments and exports, and proper governance system with zero tolerance to corruption.

Foreign direct investment is expected to increase with the discovery of oil, gas and minerals; and coal in Kitui. Other major investments include the development of the Lamu Port and Southern Sudan-Ethiopia Transport (LAPSSET) corridor, modernization of the Port of Mombasa, construction of the Mombasa–Malaba standard gauge railway, expansion of Jomo Kenyatta International Airport (JKIA), power connectivity with Ethiopia, and implementation of the 5,000+ MW project.

16.5 Policy Recommendations

A number of policy measures are required to improve the performance of the economy over the medium term. These include:

- Maintaining a stable political environment, implementing the Constitution, adhering to the rule of law, and ensuring better coordination in the different arms of government. This should

Table 16.2: Alternative scenario for selected economic indicators

	2013	2014	2015	2016	2017	2018
GDP growth (%)	5.8	5.3	5.6	5.6	5.9	6.1
Inflation (%)	5.7	6.9	6.6	7.1	7.0	7.1
Private consumption (%)	6.3	5.8	3.3	4.5	5.2	5.4
Government consumption (%)	5.5	6.0	8.4	5.1	5.0	5.2
Private investments (%)	-5.3	11.8	2.5	5.0	5.0	4.0
Government investments (%)	18.2	10.3	4.2	5.1	4.0	3.3
Exports of goods and services (%)	0.5	5.3	-0.9	3.0	3.5	4.2
Imports of goods and services (%)	-0.8	10.6	-1.2	6.1	7.4	6.5
Current account balance (%)	-8.9	-9.8	-6.8	-7.6	-7.6	-7.3
Fiscal deficit (%)	-7.1	-6.4	-6.0	-7.9	-7.8	-7.3
Public expenditure (% GDP)	27.0	27.2	26.6	26.3	25.6	26.1
Interest rate (%)	8.9	8.9	10.8	11.3	12.7	12.8

Source: KIPPRA Estimates based on the KIPPRA-Treasury Macro Model (KTMM)

Table 16.3: Real GDP and sectoral growth targets 2012-2017

	2012	2013	2014	2015	2016	2017
Overall GDP	4.6	6.1	7.2	8.7	9.1	10.1
Agriculture	3.8	5.1	6.5	6.8	7.1	6.7
Industry	4.5	6.0	7.6	8.6	10.1	10.2
Services	4.8	6.5	7.3	9.4	10.0	10.1

Source: MTP II

also be accompanied with improvement in governance structure, which calls for revision of the Public Officers Ethics Act to include, among other requirements, a mandatory lifestyle audit before one assumes any public office, and during the period of service;

- Mitigating any adverse weather conditions by fully implementing the irrigation initiatives outlined in MTP II;

- Reducing the size of the public sector especially through comprehensive parastatal reforms, in order to ensure fiscal stability and prudence. The government should further enhance tax revenue collection especially through efficiency in tax administration and collection while capturing more income tax and corporate tax.

- Expediting the establishment of Special Economic Zones, and minimizing supply side constraints in order to boost exports through productivity and efficiency; and

- Fast-tracking the implementation of public-private partnerships (PPPs) through reforms in tendering and approval process, in order to boost investments. This would also reduce the need for government borrowing to finance infrastructure and, therefore, reduce further growth of public debt.

PART IV

Fiscal Decentralization in Support of Devolution

Chapter 17

Making Fiscal Decentralization Work

17.1 Introduction

The objectives of Kenya's devolution are clearly outlined in Article 175 of the Constitution, and include the democratization of self-management while championing national unity alongside the rights of minorities and marginalized groups. A further objective of devolution is the realization of the Constitution's very elaborate Bill of Rights by, among other things, decentralizing the State to ensure access to equitably shared resources.

An important principle of devolution is that county governments should have reliable revenue sources to enable them deliver the functions assigned (Article 175), with the Constitution specifying both the functions (Fourth Schedule) and revenue sources (Articles 202 and 209). These objectives and principles have been amplified in legislation, notably the County Government Act, Transition to Devolved Government Act 2012, Public Finance Management Act, Intergovernmental Relations Act 2012 and the Coordination of the National Government Act 2013.

The Constitution establishes the Commission on Revenue Allocation (CRA) is mandated to consult with Parliament on the sharing of ordinary national revenue between the National Government and the 47 county governments through an established formula. Meanwhile, the County Government Act outlines the principles of planning and development at the county level.

The Public Finance Management Act outlines the County Governments' responsibilities with respect to the management and control of public finances. The relevant institutional arrangements are also provided for to facilitate sound public finance management.

This part of the Kenya Economic Report 2016 reviews the trends in the fiscal performance of counties between fiscal years 2013/14 and 2014/15. It focuses on the revenue and expenditure performance during the review period, and on their linkage to service delivery. The analytical or survey data used was obtained from Kenya Economic Surveys and Office of Controller of Budget (OCOB) documents, unless otherwise specified. Further, an effort is made to identify emerging issues affecting effective fiscal decentralization in Kenya over the last two years to ensure a sound basis for proposing feasible policy reforms.

Before presenting the levels of County service delivery and fiscal performance, it is important to present an overview of devolution in Kenyan context.

17.2 Devolution in the Constitution

Article 1 of the Constitution declares that sovereign power belongs to the people of Kenya, and is exercised at the national and county levels. Such power is delegated to Parliament and County Assemblies, the national and county level executives, and to the Judiciary and independent tribunals. Article 6 of the Constitution creates 47 County Governments, which are distinct and interdependent with the National Government with whom they have mutual relations on the basis of consultation and cooperation (also see Articles 189 to 191). The Constitution also specifies National Values and Principles of Governance, which bind all State and non-state officers and organs, as well as the general population. Besides Article 10, these governance ideals are also well articulated in Chapter Six and Article 232, and provide the context within which the respective levels of government deliver their functions specified in the Fourth Schedule of the Constitution.

In order to improve socio-economic welfare, Chapter Four of the Constitution provides an elaborate Basic Rights framework to protect human rights and fundamental freedoms, and to foster dignity and social justice. The rights and fundamental freedoms belong to individuals and are not granted by the State (Article 19), and include the 'first generation' civil and political rights, 'second generation' social, economic and cultural rights, and 'third generation' collective rights. Given the genesis of Kenya's devolution, the most notable among the rights could be non-discrimination, economic and social rights for children, persons with disabilities, youth, minorities and marginalized groups, and the elderly, respectively covered by Articles 27, 43, 53, 54, 55, 56, and 57. The nature of these rights is such that their delivery is best situated at lower levels of government, among intended beneficiaries, hence the importance of fiscal decentralization.

The devolution framework is elaborated upon in Chapter Eleven, Article 174 listing its objectives to include:

(i) Promotion (of) democratic and accountable exercise of power;

(ii) Fostering national unity by recognizing diversity;

(iii) Giving powers of self-governance to the people and enhancing the participation of the people in the exercise of the powers of the State and in making decisions affecting them;

(iv) Recognizing the right of communities to manage their own affairs and to further their development;

(v) Protecting and promoting the interests and rights of minorities and marginalized communities;

(vi) Promoting social and economic development and the provision of proximate, easily accessible services throughout Kenya;

(vii) Ensuring equitable sharing of national and local resources throughout Kenya;

(viii) Facilitating the decentralization of State organs, their functions and services, from the capital of Kenya; and

(ix) Enhancing checks and balances and the separation of powers.

The realization of the foregoing objectives will be in the context of principles that include democracy and the separation of powers, reliability of resource inflows, gender sensitivity (Article 175), and sound public finance management. Article 177 and 185 create elected County Assemblies with equitable representation across population groups, while executive power is vested in the County Executive Committee (Article 179), the whole County Government being headed by an elected Governor and deputy (Article 180). The Constitution envisages public participation in county governance – see Article 196.

Chapter 12 of the Constitution provides the financing structures for devolution, whose principles include openness, accountability, public participation, equity in revenue generation, sharing and promotion of development, including inter-generationally. Finally, Public Finance Management (PFM) shall be transparent and prudent. Articles 202 and 203 elaborate on equitable PFM, while Article 204 provides for the Equalization Fund, with which to uplift marginalized areas 'to the level generally enjoyed by the rest of the nation'. Further, the Constitution provides the sources on which taxes and charges may be imposed by the National and County Governments (Articles 209) on powers to impose taxes and charges:

(1) Only the national government may impose –

(a) Income tax

(b) Value added tax;

(c) Customs duties and oher duties on import and export goods; and

(d) Excise tax.

(2) An Act of Parliament may authorize the national government to impose any other tax or duty, except a tax specified in clause (3) (a) or (b).

(3) A county may impose –

(a) Property rates;

(b) Entertainment taxes; and

(c) Any other tax that it is authorized to impose by an Act of Parliament.

(4) The National and County governments may impose charges for the services they provide.

(5) The taxation and other revenue-raising powers of a county shall not be exercised in a way that prejudices national economic policies, economic activities across county boundaries or the national mobility of goods, services, capital or labour, and Article 210 on imposition of tax and for borrowing by the national and county governments (Articles 211 and 212 respectively) and managing debt (Articles 213 and 214): All revenues must be deposited in the Consolidated Fund and the County Revenue Fund, respectively, provided by Articles 206 and 207.

With respect to the equitable sharing of revenues, Articles 215 and 217 create the Commission on Revenue Allocation, which recommends the annual division and allocation of revenues (Article 218, 221, 223 and 224), with each county's share transferred "without undue delay and without deduction" (Article 219). Article 226 and 229 provide for audits, while 227 covers procurement. Another important PFM office is that of Controller of Budget who alone may authorize the lawful withdrawal of money from the Consolidated Fund and the County Revenue Fund (Article 228). Finally, section 5 of the Sixth Schedule establishes the Commission on the Implementation of the Constitution (CIC), which is mandated to monitor, facilitate and oversee the development of legislation and administrative procedures required to implement the Constitution, within the timeframes of the Fifth Schedule to 2015.

Pursuant to the CIC work in conjunction with various government and non-government bodies, various legislation, policies and strategies were completed as means of implementing the Constitution. Among the most important legislation for implementing the constitutional provisions for devolution was the Transition to Devolved Government Act, which established the Transition Authority whose core function, is to "facilitate the analysis and the phased transfer of the functions provided under the Fourth Schedule of the Constitution to the national and county governments".

The operationalisation of Chapter 11 of the Constitution is effected through the County Government Act, which expounds on the management of County Governments, including the County Executive, County Assembly and County Public Service Board. The Act also covers Citizen Participation, Civic Education, Public Communication, County Planning, and Delivery of County Services. Finally, it provides for the circumstances under which a County Government maybe suspended and re-instated.

The other important legislation is the expansive Public Finance Management Act, whose Part IV addresses the 'County Government Responsibilities with respect to Management and Control of Public Finance'. This Part establishes the County Treasury, County Revenue Fund and other funds of the government, the provisions also being similar for urban areas and cities under County Governments. It addresses the county budget and development planning processes, legislation for local revenue generation, and consultations through the County Budget and Economic Forum. It also addresses county borrowing, lending, joint county projects, the establishment of county corporations, and accounting and auditing procedures.

In an end of term assessment, however, the CIC felt that the National Assembly conduct had not adhered to the spirit of the Constitution due to its disregard of the remuneration recommendations of the Salaries and Remuneration Commission. The CIC also felt that the tensions between the National Assembly and Senate, and between the Council of Governors and the National Government, have also undermined fidelity to the Constitution (CIC, 2015).

Delays in the establishment and operationalisation of the Transition Authority in 2013 had also meant that it was winding up three years after the first election under Constitution (2010) as provided by law, without completing much of its agenda. Political interference had also undermined the Authority's performance, such as through a decree that transferred functions lumpsum, instead of the asymmetric process provided for by legislation that allowed capacity building ahead of counties' assumption of devolved responsibilities. However, the Inter-governmental Relations Technical Committee established under the Intergovernmental Relation Act is expected to take over the devolution functions of the Transitional Authority.

17.3 Linking Fiscal Decentralization and Service Delivery Performance

17.3.1 Overview

One of the objects of devolution of Government is to promote social and economic development and the provision of proximate, easily accessible services throughout the Country (Article 174 (f)). The Commission on Revenue Allocation (CRA) developed a formula to ensure equitable resource distribution across the counties. Consequently, the CRA recommended Ksh 224 billion as equitable share to county governments for the financial year 2013/14, up from Ksh 190 billion in 2012/2013. The commission has for the last three years used the first generation revenue sharing formula that was approved by Parliament in 2012, which was reviewed at the end of the 2014/15 financial year. In addition to the basic equal revenue share allocated to all counties, the parameters used for sharing revenue include poverty, population density, land and fiscal responsibility.

The approved budget spending of counties in 2014/15 amounts to 5.6 per cent of GDP. About 18.9 per cent of all public expenditure is being undertaken by counties. The local spending at counties is funded by national transfers covering almost 89.0 per cent of the counties total approved budget, and local revenues accounting for 11.0 per cent.

This section presents a detailed analysis of selected service delivery indicators. These indicators include: poverty head count, life expectancy, literacy, access to improved water, electricity and paved roads.

Effective fiscal decentralization is expected to contribute to socio-economic development and stability.

17.3.2 Poverty

Poverty, one of the key socio-economic indicators, remains relatively high and there are also wide regional differences. The national average headcount poverty was in 2013 estimated at 53.3 per cent and ranged from Kajiado's 16 per cent to Turkana's 94.5 per cent. The wide spatial variation in the state of poverty and developmental outcomes in general is widely viewed as a systemic issue that could be addressed by fiscal devolution. Thus, the ongoing fiscal decentralization is expected to reduce poverty by enhancing a more equitable distribution of fiscal resources.

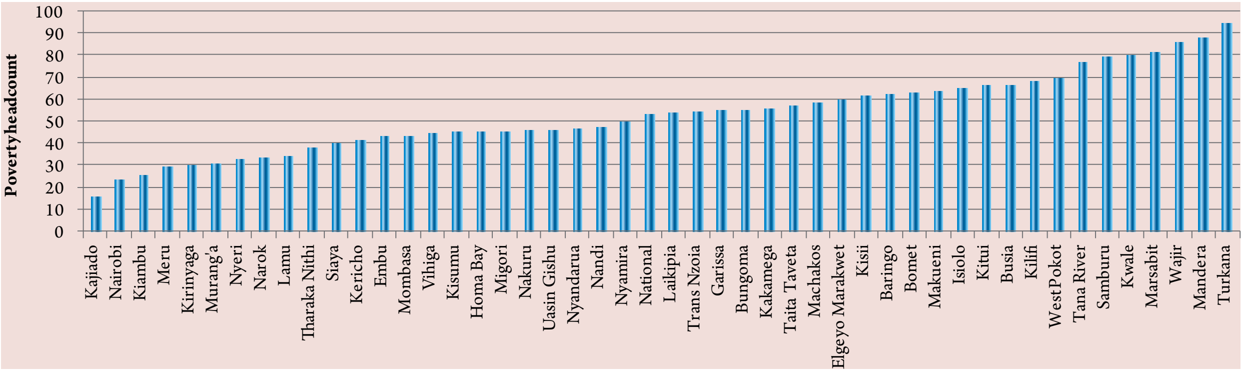
The Equalization fund is one of the tools meant to overcome the challenge of uneven development. Indeed, ensuring prosperity across all areas will require that counties or areas within counties with relatively high poverty rates such as Turkana (94.5%), Mandera (88.3%) and Wajir (86.5%) are provided commensurately larger fiscal resources (see Figure 17.1). The equalization fund is meant to "provide basic services" such as "water, roads, health facilities and electricity to marginalized areas to the extent necessary to bring the quality of those services in those areas to the level generally enjoyed by the rest of the nation." Although these basic services are important for a more equitable society, it is highly unlikely that the fund, which is only half a per cent of total nationally generated revenue, would be adequate to bring about rapid change in the marginalized areas.

Up until now, much of the focus has been on "marginalized counties." One of the weaknesses of this focus is that counties have diverse developmental outcomes within them. This implies there is need to develop county-based institutional frameworks that can identify marginalized areas within the counties for a more equitable county distribution of resources. The frameworks should mitigate possibilities of elite capture that may perpetuate marginalization.

17.3.3 Health

Health function is one of the devolved functions in the country, and the performance of the sector hinges on effective decentralization. Life expectancy is one of the many indicators of the health status and general development of a population. The national life expectancy is estimated at about 58 years, which is just about equal to the SSA average but lower than that of middle income countries of 70 years (World Bank, 2015). However, there are wide regional variations in life expectancy across the counties, ranging from about 40 years for Homa Bay, Kisumu and Siaya counties to 66 years for Bomet

Figure 17.1: County poverty headcount, 2013 (%)



County (Figure 17.2). The relatively low level of life expectancy in Homa Bay, Kisumu, Siaya and Migori counties can be partly explained by their relatively heavy disease burden. These counties have relatively higher incidences of Malaria and HIV, which are the leading causes of death in Kenya. A move towards a more equitable realization of health outcomes will require counties to allocate their fiscal resources (across sectors such as health) through a more evidence-based approach. Less attention should be paid to the historical incremental approach to resource allocation. The diversity in health outcomes also implies that counties need to take into account contextual realities. This will be possible if counties invest in the capture and analyses of health-related data and information besides other sectoral data.

17.3.4 Literacy rate

Kenya's adult literacy rates of 78.0 and 67.0 per cent for males and females, respectively, compares favourably with the Sub-Saharan Africa (SSA) average of 69.0 and 52.0 per cent for males and females, respectively (World Bank, 2015). Even so, regional differences are quite evident, with Nairobi County (highest) having a score of about 88.0 per cent while Mandera county has the lowest with a score of 13.0 per cent (Figure 17.3). Greater effort will be required from both the national and county governments to enhance equity in access to education at all levels. Counties will need to enhance access in the formative years of education through the devolved ECDE function, among other policy interventions.

17.3.5 Access to improved water

Kenya is a water scarce country; renewable fresh water endowments currently stand at less than 1,000 cubic metres per capita. Water resources are also unequally distributed across the country. As an example, while access to improved water averaged 45.0 per cent nationally, Nairobi and Migori had access rates of 76.0 per cent and 15.0 per cent, respectively. Specific challenges include: low water storage capacity and allocation of inadequate resources to water infrastructure. Although water is one of the devolved functions, some counties might not have prioritized spending on water provision (Figure 17.4).

17.3.6 Access to electricity

Overall, the most urbanized counties have better access to electricity. On the other hand, counties that lag behind in terms of access to electricity, such as Samburu and Isiolo, have relatively low levels of urbanization.

Access to paved road network

The development and maintenance of physical infrastructure on a sustainable basis is a key prerequisite for rapid and sustainable economic

Figure 17.2: County life expectancy, 2009

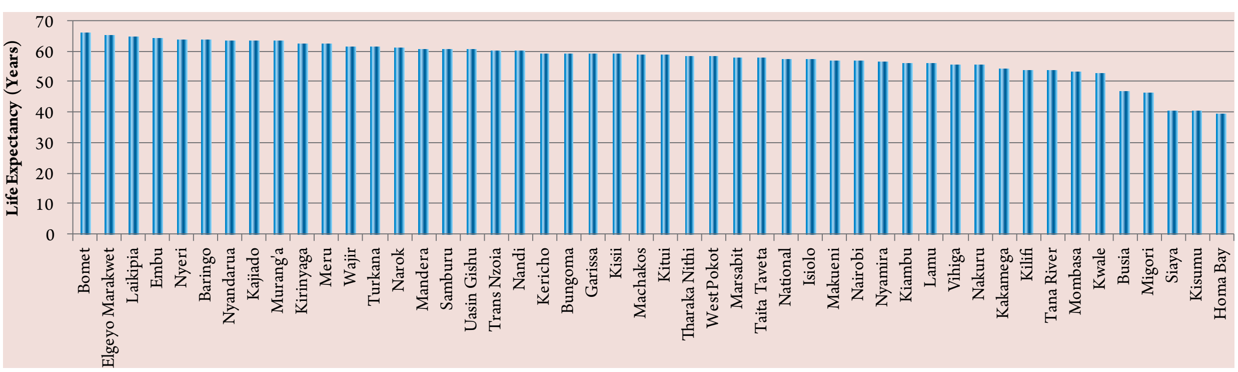


Figure 17.3: Literacy levels (%)

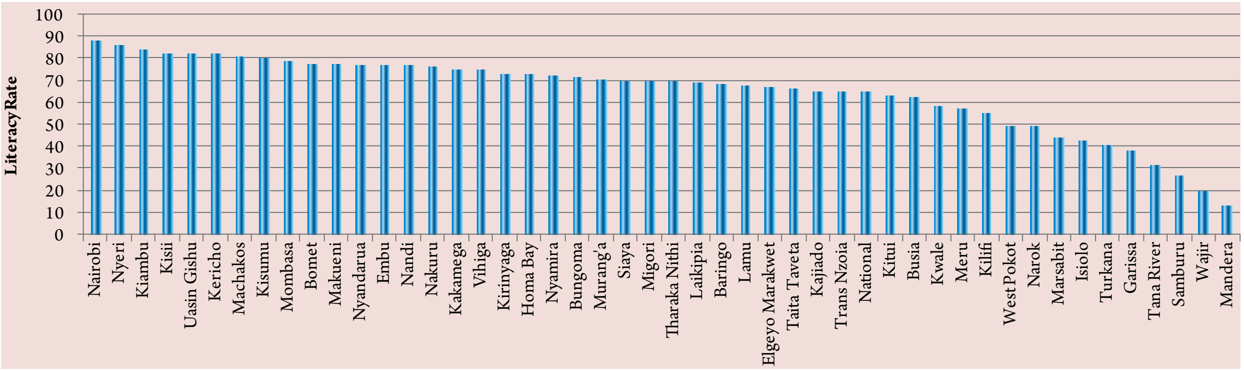
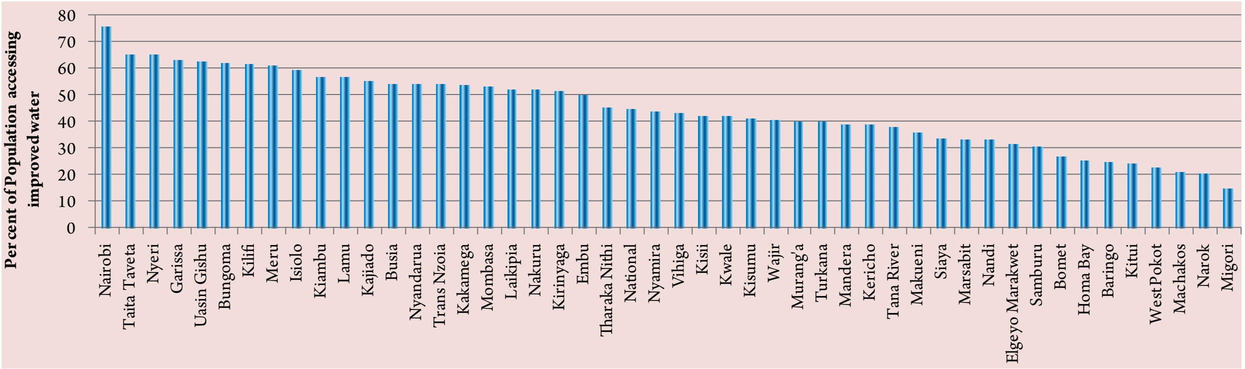


Figure 17.4: Access to improved water by county (%)



growth and prosperity. Despite this, all the counties with the exception of Nairobi, had less than 30.0 per cent of paved access roads (Figure 17.6). Lack of adequate fiscal resources is one of the primary challenges faced in improving road infrastructure. Other challenges include low absorption for road construction projects partly as a result of poor work progress and inefficient procurement. Improvements in the development of physical infrastructure should go beyond provision of fiscal resources to embrace improvements in procurement systems and enhancing execution of projects.

17.4 County Fiscal Performance

In line with the Constitution of Kenya 2010, the Commission on Revenue Allocation (CRA) recommends Parliament to allocate at least 15.0 per cent of national revenues to a county government revenue pool from which resources would be equitably shared across the counties using a formula developed by CRA. Counties also get conditional grants depending on whether they have donor projects and/or 'Level 5' hospitals (the former provincial hospitals and upgraded district hospitals). County governments may also receive other grants, and will eventually be eligible for loan financing subject to conditions under preparation by the National Treasury. Further, CRA has developed a criteria for sharing the Equalization Fund among some 14 most marginalized counties. Additionally, the Public Finance Management Act 2012 provides that any unutilized budget resources in a fiscal year be carried forward to the succeeding year, and is consequently re-voted into that year's resources.

As shown in Table 17.1, aggregate actual County Government budgetary resources for 2013/14 totalled Ksh 224 billion, or 3.4 per cent of GDP. In 2014/15, the total resources were estimated at Ksh 318.3 billion, having increased by 42.1 per cent from the previous year. The rapid revenue growth is due to the transition to devolution, and the national

Figure 17.5: Access to electricity by county, 2009

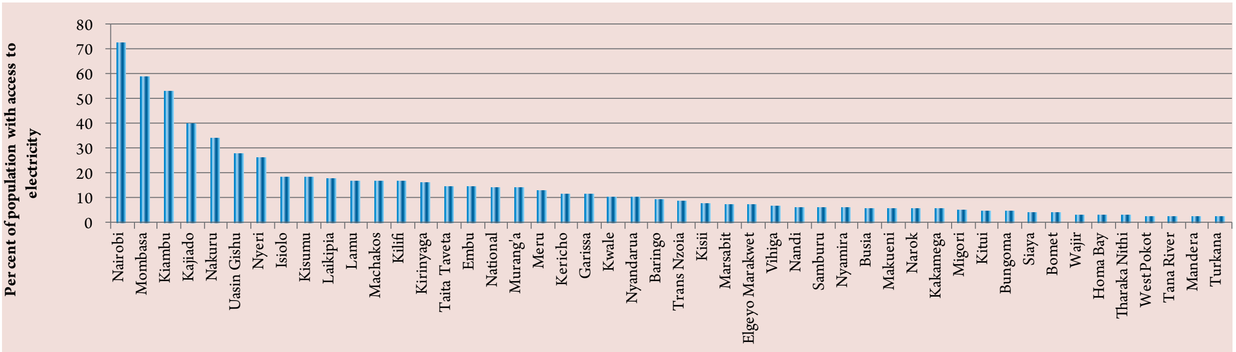
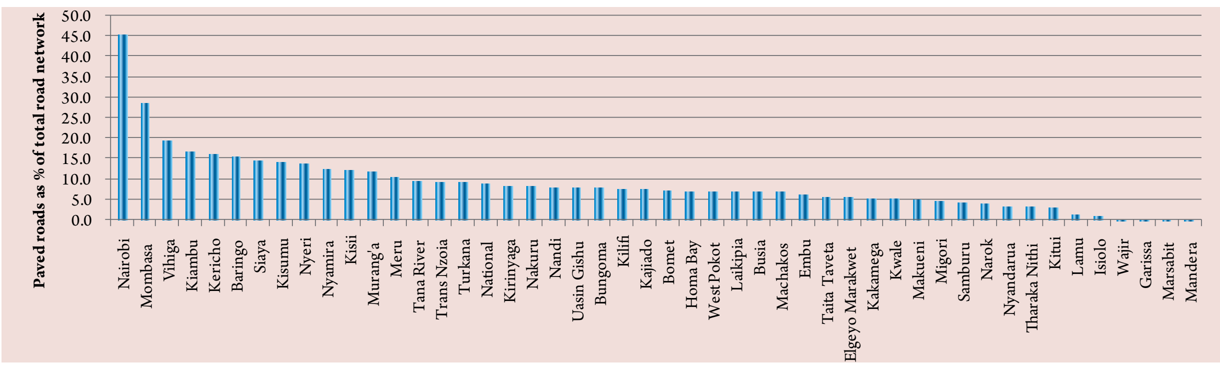


Figure 17.6: Access to paved road network by County (%)



commitment to improve service delivery across counties. The equitable share resources constitute about 89.0 per cent of county revenues while locally generated revenues constitute 11.0 per cent (Table 17.1).

The sharing of revenues has met the constitutional threshold of at least 15.0 per cent of ordinary revenues being transferred to the county level. Overall, county resource allocation increased from 19.9 per cent of total ordinary revenue in 2013/14 to about 24.2 per cent in 2014/15. County expenditure as a percentage of GDP and of the national debt were estimated at 5.6 per cent and 13.7 per cent, respectively.

During 2014/5, 18.9 per cent of total government expenditure was spent at the county level, which is close to the level of the other East African Community countries' spending at their sub-national levels (Figure 17.7). The Kenyan share of county level expenditure closely mirrors the levels in the region, with Uganda and Tanzania expenditures by sub-national governments accounting for 20.0 per cent and 22.0 per cent, respectively. However, for Ethiopia, it accounts for 46.0 per cent of total expenditure, probably because it has been implementing devolution for longer than Kenya. The share of devolved funds is higher in federal countries, with Nigeria, Brazil and Ethiopia as examples.

17.4 County Revenue Performance

The process of revenue governance entails determination of tax revenue policy and administration of tax and non-tax revenue collection, including fiscal capacity and citizen's voluntary compliance. In 2014/15, county resources were estimated at Ksh 318.3 billion comprising

Table 17 1: Aggregate county government fiscal indicators, 2013/14 and 2014/15

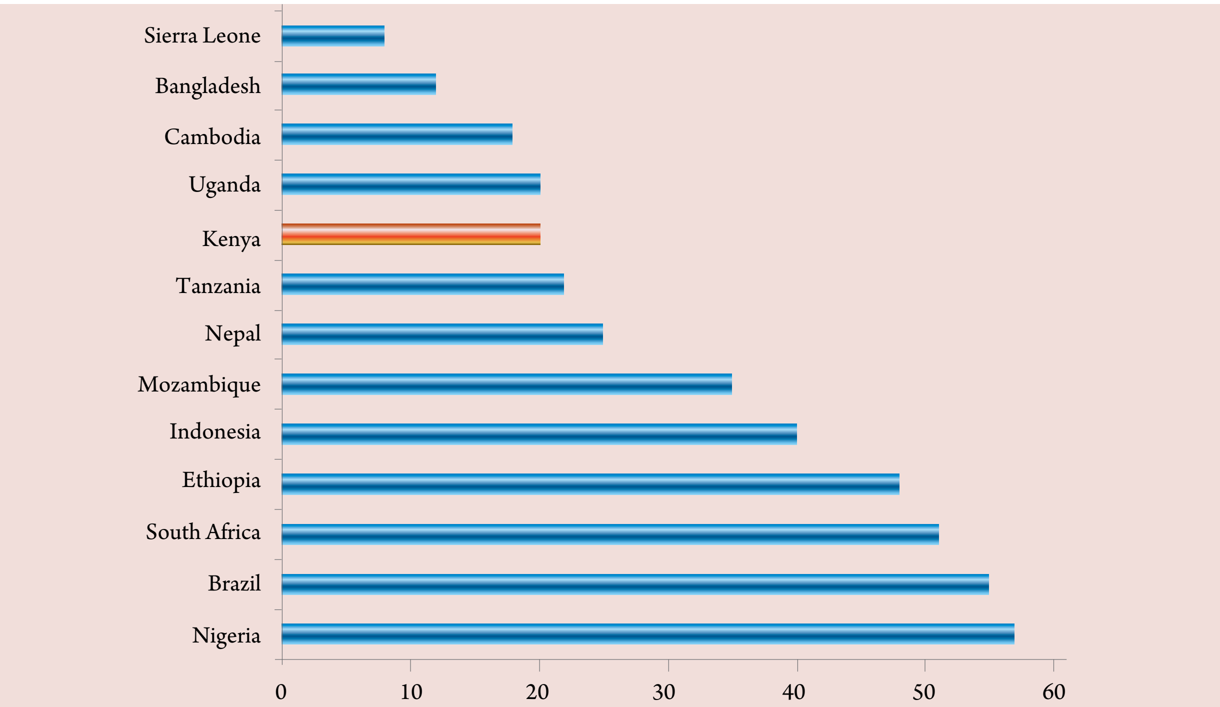
	2013/14	2014/15
Gross Domestic Product (at market prices) - Ksh millions	4,730,800.50	5,357,671.70
National Government Revenue and Grants - Ksh millions	991,870.60	1,176,224.80
Total Government Outlays - Ksh millions	1,532,993.00	1,924,885.90
Total Government Outlays (Net Debt Repayment) - Ksh millions	1,187,213.74	1,599,965.72
Recurrent - Ksh millions	1,021,922.89	1,069,204.86
Development - Ksh millions	511,070.16	855,681.01
Public Debt Transactions (Repayments) - Ksh millions	345,779.26	324,920.18
Debt - Ksh millions	1,732,743.00	2,217,312.00
External Debt - Ksh millions	843,562.20	1,138,504.70
Internal Debt - Ksh millions	889,180.80	1,078,807.30
County Resources - Ksh millions	224,045.00	318,257.00
Transfers of General Character between Levels of Government - Ksh millions	197,749.00	284,408.00
Local Revenues - Ksh millions	26,296.00	33,849.00
County Expenditure - Ksh millions	161,397.47	302,817.34
County Allocation as % of Revenue	19.94	24.18
County Expenditure as % of GDP	3.41	5.65
County Expenditure as % of National Debt	9.31	13.66
County Expenditure as % of Total Government Outlays	13.59	18.93
Local Revenue as % of Total Revenue	11.70	10.60
Government Transfers as % of Total Revenue	88.30	89.40

Source: Government of Kenya (2015)

of national transfers (Ksh 284.4 billion) and local revenue (Ksh 33.8 billion), which is drawn from counties discretionary power to impose taxation.[3] Article 209 allows counties to raise rates and fees at their discretion, but taxes must be authorized by an Act of Parliament. Local revenue is collected from property rates, entertainment taxes, county service charges, and taxation legislated by Parliament. Second, equitable share is part of the national vertical allocation, which is distributed among the counties based on CRA's formulation. Additionally, county governments may receive conditional grants, such as the Equalization Fund, and unconditional grants. Finally, the balance of resources from one fiscal year may be carried forward – re-voted – into the next year.

The Commission for Revenue Allocation has in the last three years used the first generation revenue sharing formula that was approved by Parliament in 2012. This formulae is currently under review. The formulae review process is in line with Article 16 of the Sixth Schedule to the Constitution of Kenya 2010. As part of the review, the Commission for Revenue Allocation (CRA) conducted forums with counties, experts and received memoranda from experts and the public. It is hoped that after review and adoption, the second formula will be used for sharing revenue from 2016/17 to 2018/19 financial year. The parameters, weights and allocations as used in the current formula are shown in Table 17.2.

Figure 17.7: Share of devolved funds for selected countries (%)



Source: Kenya Public Expenditure Review, 2014

Table 17.2: Revenue allocations as used in the current formula

Parameter	Weight (%)	Amount 2013/14 (Ksh billions)	Amount 2014/15 (Ksh billions)
Population	45	85.5	102
Basic Equal Share	25	47.5	57
Poverty Index	20	38	45
Land	8	15.2	18
Fiscal Responsibility	2	3.8	5
Total	100	190	227

Source: CRA, 2015

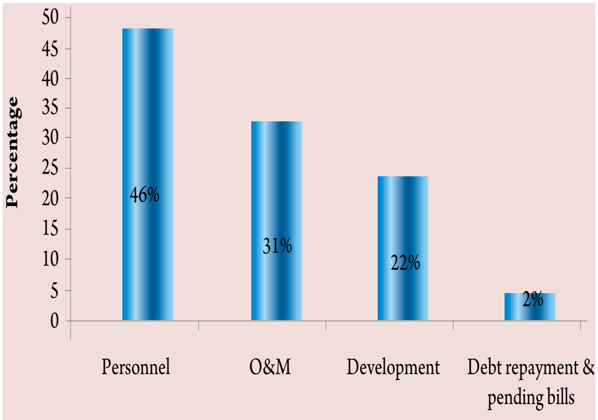
Statutorily, all revenue raised or received on behalf of county governments must be paid into the County Revenue Fund (CRF), except where exemption is provided through an Act of Parliament.[4] No withdrawal is allowed from CRF without the Controller of Budget's approval and supporting County Assembly appropriation legislation.[5]

17.5 County Expenditure Performance

17.5.1 Overview

County expenditure patterns in the initial years of devolution show that recurrent expenditure by far exceeds spending on development. The approved budget allocation on recurrent and development was 62.0 per cent and 38.0 per cent, respectively, in 2014/15 and by the end of that fiscal year, only 22.0 per cent of actual spending took place on development areas as shown in Figure 17.8. Recurrent expenditure has grown much faster, reflecting high administrative costs related to County Executives and County Assemblies.

Figure 17.8: Recurrent expenditure 2014/15



Source CoB Quartly Reports

Only 10 counties reached the targeted 30.0 per cent threshold of development spending. These are Wajir, Turkana, Bomet, Machakos, Murang'a, Homa Bay, West Pokot, Trans Nzoia, Kisii and Nyamira. Development spending is therefore low and counties will largely depend on the national government to initiate development activities. The low development expenditure is of concern given the need to enhance provision of basic services to citizens in most counties. Figure 17.9 shows that almost half of the counties are spending less than the average 22.0 percent of actual spending on development, which might affect counties' delivery of core services.

In the 2013/14, the total revenue available to the county government was about Ksh 224 billion, which is a summation of about Ksh 197 billion of vertical allocation of equitable share, and about Ksh 26 of conditional grant (Government of Kenya, 2014). On the other hand, the total expenditure was Ksh 169.4 billion, made up of Ksh 132.8 billion and Ksh 36.6 billion of recurrent and development expenditure, respectively. This translates into a utilization rate of about 72.0 per cent.

In 2014/15, total revenue stood at Ksh 318 billion, which included Ksh 284 billion, Ksh 1.87 billion, Ksh 32 billion, Ksh 0.7 billion, respectively, of equitable share, conditional grant, local revenue, and donor grants, and Ksh 4.2 billion carried forward. The total expenditure amounted to Ksh 258 billion, with Ksh 168 billion and Ksh 90 billion going to recurrent and development, respectively, a utilization rate of 81.0 per cent.

The 2013/14 data reveals important emerging trends on expenditure as shown by Figure 17.10. There is an overall approved budget execution gap estimated at 1.0 per cent of GDP; county expenditure has built up and under-spending is reported on the development budget. Only a few counties allocated at least one third of their budget for development projects.

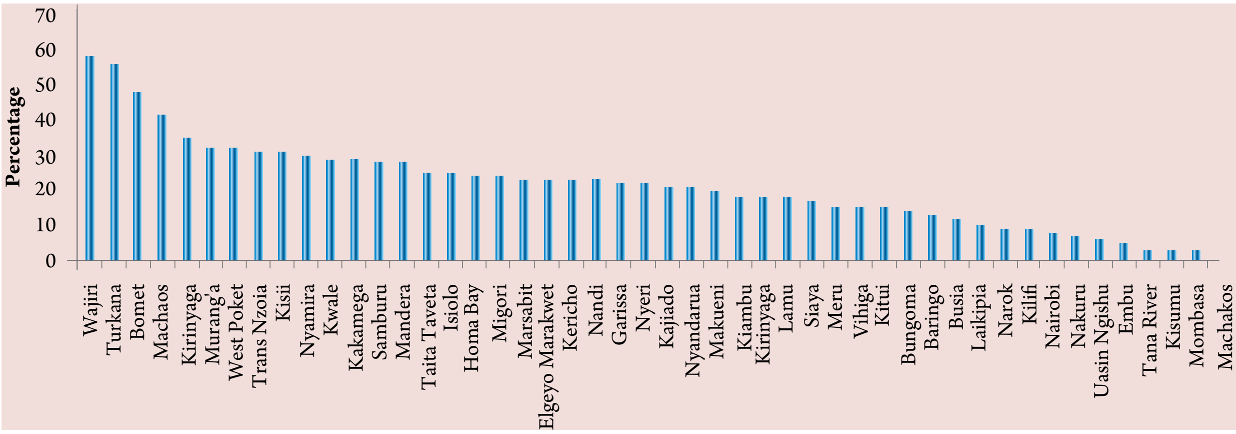
The approved budget allocations on service delivery shows that prioritization at the county level did not match the budget allocations on the devolved functions at the time when expenditures were part of national government budget.

But under the counties' budget in 2013/14, the total allocation for health services, for example, stood at Ksh 54 billion. Other devolved areas such as agriculture were allocated Ksh 11 billion. Figure 17.11 also show that counties expenditure patterns cover recurrent expenditure than development expenditure. Recurrent expenditures have built up much faster over time, reflecting to some extent the administrative costs of the County Executive and the County Assemblies.

17.5.2 County expenditure by functional classification

The OCOB's constitutional powers to issue quarterly reports on implementation of budgets of county governments and publish the same has incentivized the county governments to improve on budget utilization. This assertion is attributable to OCOB's 2014 recommendation that called for better planning and increased capacity (Government of Kenya, 2015). This is also reinforced by OCOB's constitutional independence as well as its power to approve withdrawals from County Revenue Fund.

Figure 17.9: County development spending as % of total spending, 2013/14



Source: CoB Quartely Reports

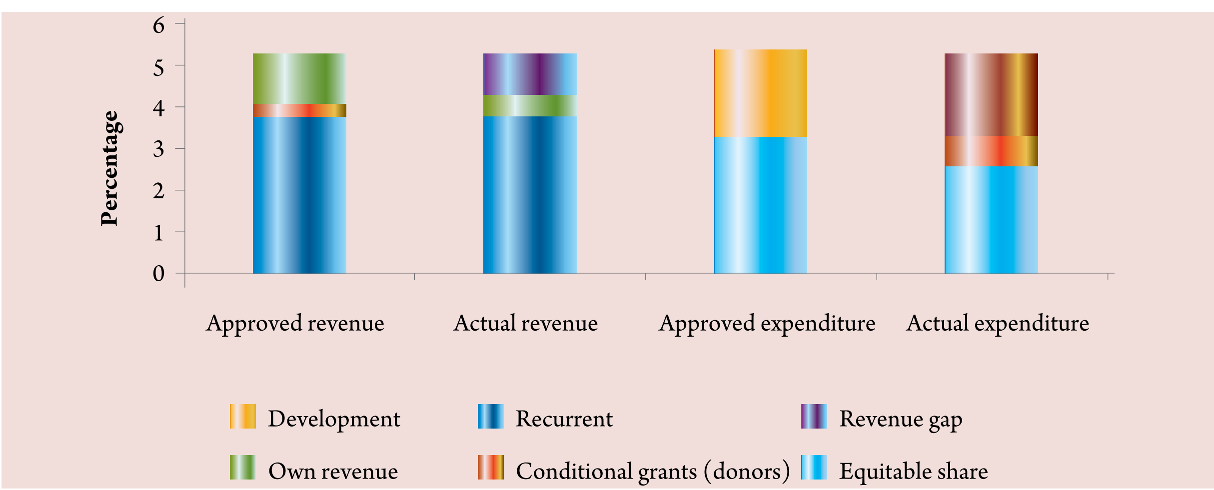
The County Executives' statutory compliance[6] by devoting at least 30.0 per cent of total expenditure to development in 2013/14 and slightly better in 2014/15 can be inferred as an improvement in compliance with principles of fiscal responsibility.

Table 17.3 shows that county expenditure increased by 26.0 per cent between 2013/14 and 2014/15 from Ksh 161.4 billion to Ksh 302.8 billion. A functional analysis of county expenditure suggests an improvement in allocative efficiency as expenditure on general public services fell significantly. However, there has been improved allocation in agriculture, economic affairs, transport, health, environmental protection, among other services.

17.5.3 County expenditure by economic classification

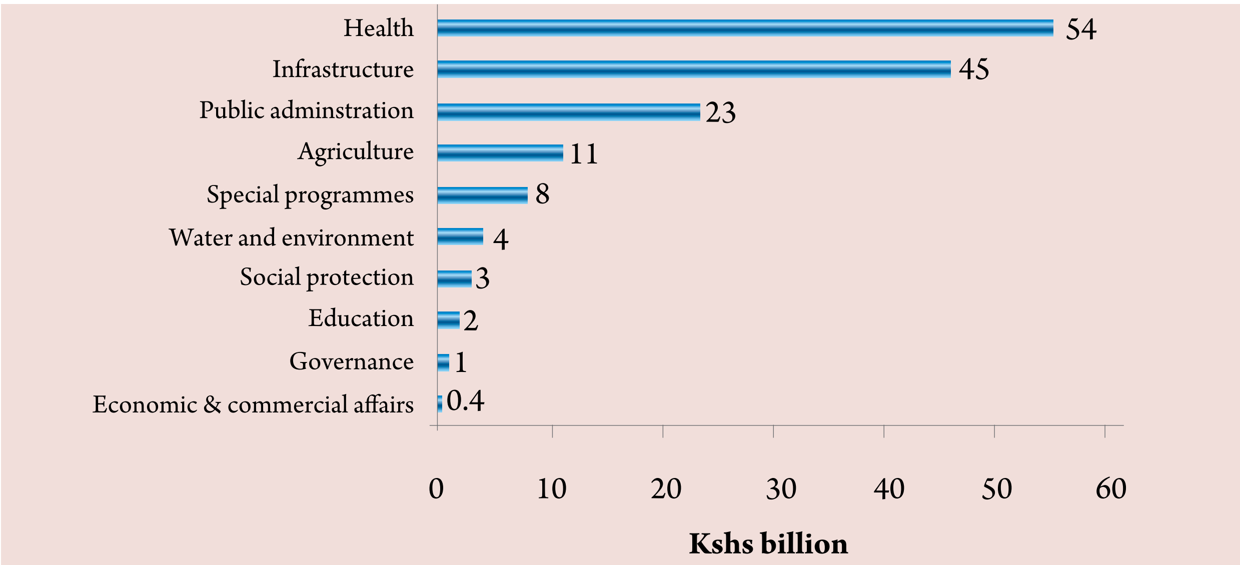
On one hand, further disaggregation of 2014/15 recurrent expenditure reveals that 33.5 per cent, 19.9 per cent, 37.0 per cent and 1.3 per cent was on personnel emoluments, operations; use goods and services; acquisition of non-financial assets; and acquisition of financial assets, respectively (Table 17.4). Disaggregation of counties development expenditure shows diverse development activities, which reflect the diversity of the 47 counties. However 41 counties spent most of their development expenditure on infrastructural projects. The allocations to compensation of

Figure 17.10: County governments revenue and expenditure as % of GDP 2013/14



Source: World Bank, (2015)

Figure 17.11: Budget allocation for devolved functions, 2013/14



Sources: IFMIS data 2013/14

Table 17.3: County expenditures by functional classification, Ksh millions

	2013/14	2014/15	Percentage change between the two years (%)	Functional Share as a percent (%) of total expenditure, 2013/14	Functional Share as a percent (%) of total expenditure, 2014/15
General public services	135,187.00	108,744.00	-19.6	83.80	35.90
Economic affairs	11,086.63	77,922.53	602.9	6.90	25.70
General economic affairs	1312.91	811.30	-38.2	0.01	0.30
Agriculture	2876.45	23277.85	709.3	0.02	7.70
Transport	5930.08	40231.59	578.4	0.04	13.30
Other economic affairs	967.19	13601.79	1306.3	0.01	4.50
Environmental protection	873.72	9184.35	951.2	0.01	3.00
Housing and community amenities	3532.56	18121.89	413.0	0.02	6.00
Health	8492.22	58639.60	590.5	0.05	19.40
Recreation, culture and religion	924.64	3515.80	280.2	0.01	1.20
Education	1228.71	25024.19	1936.6	0.01	8.30
Social protection	71.95	1665.36	2214.6	0.00	0.50
Total	161397.47	302817.34	87.6		100.00

Source: Government of Kenya (2015)

Table 17.4: County expenditure by economic classification

	2013/14	2014/15	Percentage change between the two years	Percentage, 2013/14	Percentage, 2014/15
Compensation of Employees	64,262.36	101,562.40	58.0	39.8	33.5
Use of goods and services	35,353.92	60,380.47	70.8	21.9	19.9
Acquisition of non-financial assets	42,423.74	111,894.15	163.8	26.3	37.0
Acquisition of financial assets	1,912.56	3,928.13	105.4	1.1	1.3
Other expenses	13,733.85	25,052.19	82.4	8.5	8.3
Debt repayment and pending bills	3,711.04			2.3	
Total	161,397.47	302,817.34	87.6	100.0	100.0

employees fell from 39.8 per cent to 33.5 per cent. The increased allocation to acquisition of non-financial assets implies that counties are gradually increasing expenditure on development activities.

17.5.4 County revenue and expenditure

An analysis of 2014/15 county level budgetary resources shows that most of the county governments' local revenue shares were below 10.0 per cent of total county government resources (Figure 17.14). Nairobi recorded the highest local revenue share standing at 51.0 per cent, followed by 31.0 per cent share for Mombasa and 28.0 per cent for Narok. Only 13 counties had local revenue shares of at least 10.0 per cent. Meanwhile, Mandera, Marsabit, Wajir, Garissa and Tana River counties each recorded low shares of about 1.0 per cent. Another 21 counties have shares of between 2.0 and 5.0 per cent. Clearly, county revenue performance is low across the country, contributing to over-reliance on CRA's equitable shares of national revenue. This situation partially reflects the unequal development resulting from years of inequitable public spending that have compounded the adversities of agro-ecological heritage, especially in the arid and semi-arid lands of northern Kenya.

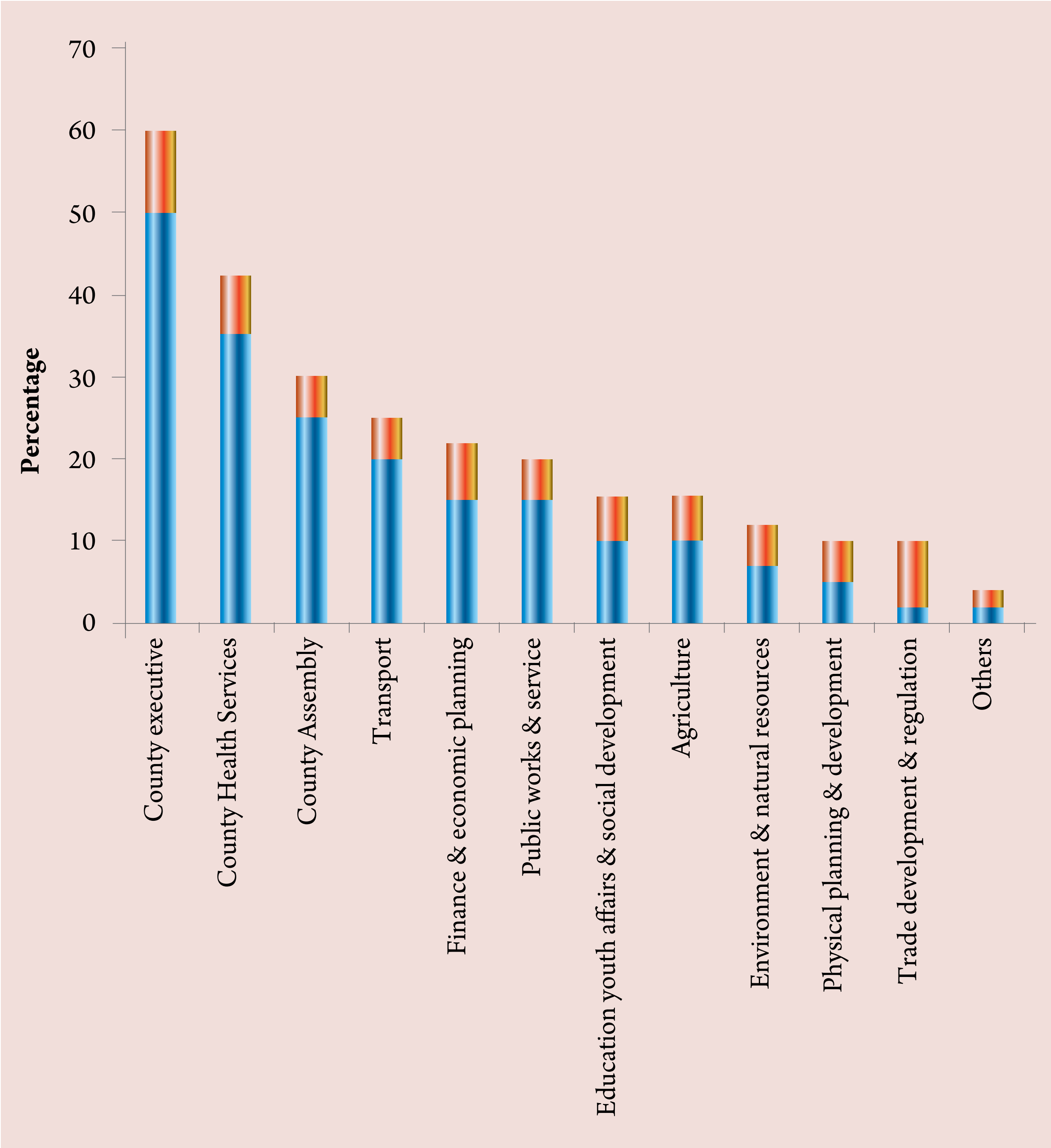
It is clear that most county governments will continue relying on resources from national level transfers, with CRA's equitable shares ranging from Nairobi's 49.0 per cent to Mandera's 94.0 per cent. The data also shows that the shares of conditional grants are quite uneven across counties, with the share for four counties above 20.0 per cent, while six counties have 5.0 per cent or less. Surprisingly, neither of the four counties with shares above 20.0 per cent have a Level 5 Hospital. Finally, the figure also illustrates the disparities in re-voting; for nine counties, re-voting reflected a zero share, while for one county, it stood at a 7.0 per cent share. These very modest re-voting returns are interesting in light of government concerns that county governments have a weak absorptive capacity over voted resources.

The local revenues constituted about 54.4 per cent of Local Government resources during the period prior to devolution. This share dropped to just over 11.7 per cent and 10.6 per cent during 2013/14 and 2014/15, respectively. A partial explanation for that growth is obviously in the changed service delivery roles of the national and county levels of government. Figure 17.15 shows county expenditure disaggregated by county for 2014/15.

17.6 Lessons from Other Countries

Under this sub-section, we present lessons from selected comparator countries that have decentralized fiscal systems. These are Australia,

Figure 17.12: County approved budget (%) by functions, 2013/14



Source: IFMIS Data, 2013/14

Figure 17.13: Aggregate county government budget resources, 2014/15

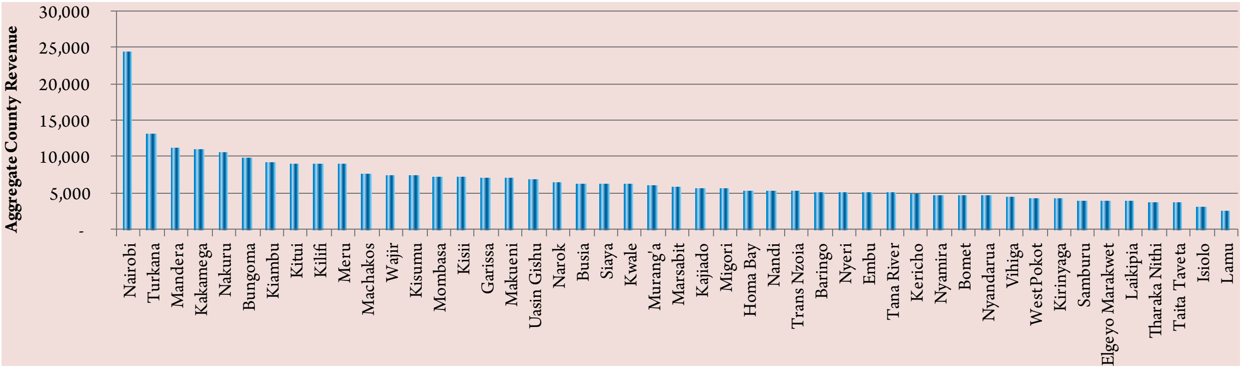
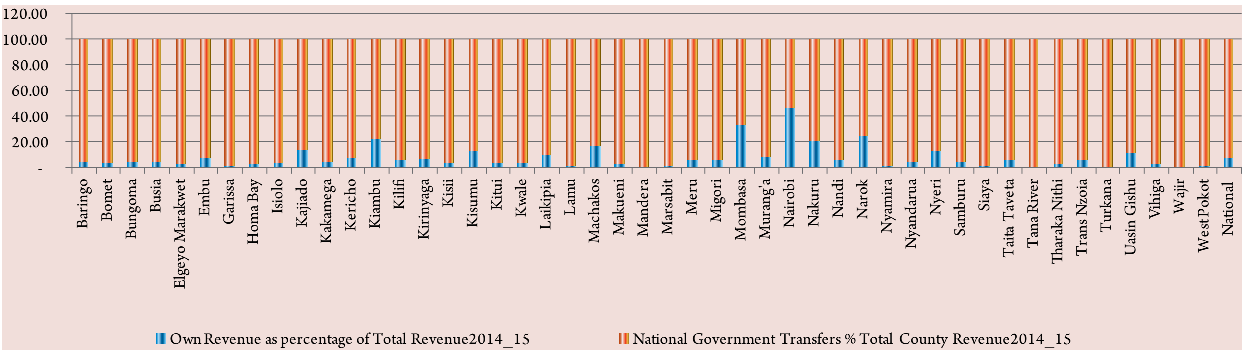


Figure 17.14: Sources of aggregate county government budget resources, 2014/15



Germany, Ghana, and South Africa. Specifically, we draw lessons from their fiscal transfer arrangements.

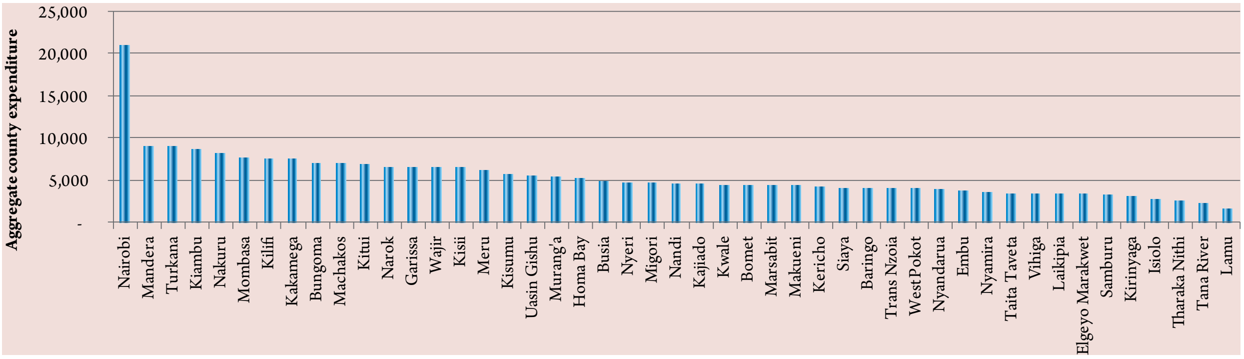
Australia

Australia is a federal country where the central government has the responsibility for the main taxes, but States and territories have the responsibility for almost half of government spending. Central government transfers are still an important method of funding the States and territories. The layers of devolution in Australia show that the Australian federation comprises of six States and two inter self-governing territories. There are also some 565 local authorities.

The central government or the commonwealth is the only level of government that raises revenue from income tax, corporation tax, excise duty and levies and taxes on international trade. While the State and territorial governments are free to set tax rates and receive revenue from land taxes, financial and capital transaction taxes, taxes on gambling, taxes on insurance, taxes on activities and the use of goods (such as motor vehicle tax) and mining loyalties (except for offshore oil and gas). They also have the responsibility for collecting most payroll tax (the commonwealth receives three per cent of total payroll tax collected through the superannuation guarantee charge). Local authorities receive revenue from municipal rates and user charges (with the latter growing in importance of late).

State governments have no borrowing ceiling. The Australian Loan Council has an oversight and monitoring role but arrangements emphasize transparency rather than limits and operate on a voluntary basis. Most States have modest borrowing, which is undertaken through Treasury Corporations (their own borrowing agencies) using a range of debt instruments issued directly in financial markets (including foreign borrowings).

Figure 17.15 County expenditure performance, 2014/15(Ksh millions)



Fiscal transfer arrangements

According to the Scottish Information Centre (2014), States and territories in Australia raise just over half their spending in revenue (58% from state own sources on average over the past decade), with the central government transfers providing the remaining funding. Horizontal fiscal equalization is undertaken through the distribution of revenue from Goods and Services Tax (GST) as untied grants. It aims to equalize the capacity of all States and territories to raise revenues and provide services to a national average standard. In addition, there are fiscal transfers provided to the States and territories which have to be spent on a particular sector or programme as agreed with the central government.

All revenues collected under the Australian GST are distributed to States and territories as untied grants, based on the principle of horizontal fiscal equalization. It is intended that each State and territory should receive transfers so that each uses its revenue bases to the same degree and operate at the same efficiency in providing public services to the same standard. The Commonwealth Grants Commission (an independent body which makes recommendations on the distribution of VAT revenues among States and territories) plays a central role in the equalization. It undertakes a comprehensive assessment of state and territory revenue raising capacities and expenditure needs. The factors that are taken into account include: population size, age structure, income geography, presence of indigenous people, and capacity of various tax bases. It is in this assessment of both expenditure needs and revenue raising capacity that makes the Australian approach to fiscal equalization unique internationally (Fraser Institute, 2013). Around a third of equalization transfers arise from differences in assessed revenue capacities and the remaining two-thirds arise from differences in expenditure needs. The process is dynamic, and periodic reviews of methods and annual updates are designed to keep the relativities up to date.

The common wealth also makes conditional fiscal transfers to the States, which are intended to support the implementation of particular national priorities. These include national specific payments, national partnership payments, and health and school funding. This makes around half of commonwealth funding to the States and territories. Majority of this funding is accompanied by conditions to ensure that national objectives are met.

Germany

Germany is a federal republic. The fiscal powers of each sphere of government follows the constitutionally-assigned competencies. Decentralization focuses on tax assignment rather than the devolution of major tax powers, and there is a tax rate uniformity across the sub-counties. The sub-counties also rely on grants and borrowing. There is a process of fiscal equalization to ensure uniformity of living conditions. In Germany, there are three layers of government – the Federal, States and Local Municipalities.

The Federal government has exclusive jurisdiction over tariffs, indirect taxes (including mineral oil tax, tobacco tax, spirits tax, sparkling wine tax, intermediate good tax, coffee tax and electricity tax), capital transaction taxes, insurance taxes and surcharges on income taxes. The sub-counties or States have exclusive rights to obtain revenue from wealth tax, the inheritance and gifts tax, motor vehicle tax, transaction taxes not in the power of the Federal government (including real estate purchase tax, betting and lottery tax and the beer tax), and fire protection tax. However, the bases and rates of these taxes are set jointly by the Federal government and the State governments. There must be no differences in taxation across the States, with the exception of real estate purchase tax, for which the State have tax rate autonomy.

Income tax, interest rebate, corporation tax and VAT are joint taxes, with revenue shared between the Federal government, the State governments and to a lesser extent the local jurisdictions. Income tax laws are federal, but require the consent of the State government. The individual State government receives their shares of income tax and corporation tax revenues according to the place of residence of the individual taxpayer/location of the firm. About 75.0 per cent of the VAT revenues due to the State government are allocated on a per capita basis, which distributes in favour of economically weaker States. The local governments have the power to set the tax rates in relation to local business and real estate taxes.

The State governments use borrowing to finance shortfalls in revenue. There are no credible federal restrictions on state borrowing. However, the State governments have their own constitutional statutory provisions that restrict them from borrowing more than the outlays for investment purposes projected in the budget. This restriction is not enforced by the Federal government, and there are several provisions that soften it. For example, borrowing can exceed investment spending if the Federal government declares a disturbance of the macroeconomic equilibrium.

Fiscal transfer arrangements

There is strong emphasis on equality of living conditions and public services in Germany, which has brought about the cooperative model of fiscal federalism. Fiscal equalization adjustments serve to support fiscally weaker states and are a central part of Germany's sub-central financing arrangements. There are four main stages to fiscal equalization across Germany: tax revenue assignment, VAT revenue sharing with the poorest state, fiscal transfers from the richer to the poorer state, and a federal adjustment for the poorest state.

Tax revenue from different sources is assigned to the State. Secondly, 25 per cent of the State VAT revenue is used explicitly as an equalization tool. A measure of fiscal capacity for each land is made, which incorporates yields from personal income tax, corporation tax, and the few taxes levied at the State level. Any State measured as less than 97 per cent of the average receive payments to bring them closer to the average.

The third stage is unique, consisting of direct, horizontal redistribution from richer to poorer States. Where other Federal systems provide for horizontal equalization, redistribution is carried out by the Federal level. For this to be done, a notional assessment of the fiscal capacity of each State is made, which takes into account the use of city services from individuals from neighbouring States for the three major city regions (Berlin, Bremen and Hamburg). Those national fiscal capacities are then compared and those that are above the national per capita average are obliged to make equalization payment.

The final process of horizontal fiscal equalization is made directly at the Federal level, where if after the above processes, a State still has a fiscal capacity of less than 99.5 per cent of the national average, 77.5 per cent of this is compensated through Federal supplementary allocations. In addition to these supplementary allocations, specific allocations are made to reflect certain needs of the State.

Ghana

The Ghanaian 1992 Constitution and various other legislative instruments have long been committed to decentralization. The goals of decentralization programme are strengthening and expanding local democracy; promoting local social and economic development; and reducing poverty and increasing the choices of the people. The comprehensive decentralization policy framework objective is to deepen political, administrative and fiscal decentralization in Ghana and reaffirm the government's commitment to the policy of decentralization in conjunction with the people's participation.

Inter-governmental fiscal decentralization focuses on the financial component of the larger decentralization programme. The Ghanaian Constitution prescribes a devolved form of decentralization where there is transfer of authority for decision making, finances and management from the central to the local governments. However, the central government still performs many functions that should be moved to the district level, and controls the majority of regional and district financial resources. As a result, the framework provides clarification on various issues.

The goal of the framework is to provide a comprehensive road map with broad-based support for the vision of fiscal decentralization as well as the strategies to meet that vision. The framework addresses the functions between the central and sub-national levels of government, the resource gaps at the sub-national levels, and the financial accountability capacity issues at the sub-national levels.

The framework defines the relationships under the fiscal decentralization vision between the different layers of government, the functions assigned to each layer, and the authorities granted to the sub-national governments by the central government. The goals for functional assignment are guided by the principles of devolution and subsidiarity, where responsibilities are transferred to the lowest level of government, which can most efficiently provide the goods and services.

In general, however, broad responsibilities of each level of government include: setting national standards and guidelines by the central government; harmonization, coordination and monitoring and evaluation by the regional coordinating councils; and providing services to the citizens of their Districts by the Metropolitan, Municipal and District Assemblies (MMDAs). A further break down is provided of the intended functional relationships and levels of autonomy assigned to the different levels of government for organization structure, policy and planning, budgeting, financial management, revenue generation and staffing.

The framework also includes all aspects of MMDA taxing authority and mobilization, all central governments transfers to the Regional Coordinating Council (RCC) and MMDAs including District Assemblies Common Fund (DACF), development partner support and borrowing authority. To achieve devolution as defined under the Constitution, the RCCs and MMDA must be responsive to the citizens of their jurisdictions. To this end, they must have adequate financial resources to fulfill their assigned responsibilities and functions as well as the ability to plan and manage those recourses. Other goals for revenue and funding arrangements include clear assignment of revenues; alignment of revenue with RCC and MMDA functional responsibilities; transfer system, which is harmonized and simple, with performance-based triggers to promote accountability and transparency; and the ability of

MMDAs to access credit or financial markets within defined risk limitations.

The framework covers a broad range of financial management areas, including planning and budgeting, procurement, internal and external audit, payroll, accounting, financial reporting and monitoring and evaluation of finances and programmes. Local governments operating in a decentralized environment have integrated financial management systems, which are transparent, responsible and accountable to provide citizens and tax payers with the assurance that public funds are safe and being used prudently.

One of the priorities of the inter-governmental fiscal decentralization programme is the consistent focus on continued progress and deepening the level of understanding of the issues. The institutional issues need to be structured to enhance the ability of the government to meet these priorities.

South Africa

South Africa has a unitary but decentralized system of government. It is not a federal system. The 1994 post-Apartheid system created three tiers ("sphere") of government: national, provincial and local. The Constitution assigns functions to the three spheres. The national and provincial governments are concurrently responsible for functions such as school education, health, welfare and housing. In practice, this means that the national government determines the policy and provincial governments are responsible for implementation. Exclusive functions for provinces are not significant in budgetary terms, with the notable exception of provincial roads.

While the division of powers changed for national and provincial governments after 1994, the local government's sphere was left with similar powers and functions as the previous white local authorities. Approximately two-thirds of local functions (in budgetary terms) involve user fee services such as electricity, water and sanitation, while the remaining third involves the provision of public goods such as municipal and household infrastructure, streets, streetlights and garbage collection.

The South Africa Constitution entrenches the important principle of cooperative governance. This obliges the three spheres of government to cooperate and legally enforce negotiation, rather than litigation, to solve political (and budgeting) problems between them. Numerous inter-governmental forums have been established as a result, including the Budget Council and Budget Forum, which facilitate cooperation and consultation in the budget process. The Council comprises the national and provincial ministers of finance, while the Forum consists of members of the Budget Council and the national and provincial chairpersons of local government association in each province.

Two aspects of decentralization in South Africa must be noted: Firstly, public servants employed by national and provincial governments comprise one single public service (with similar remuneration for similar ranking, irrespective of function). Provinces employ the majority of public servants. Municipal employees are not part of this public service, nor any uniform municipal service, but employees of their respective municipalities only. Secondly, there is a high level of unionization, and collective bargaining. This reinforces the uniform nature of the public service, not only at the national and provincial level, but also drives municipalities to converge towards similar conditions of service and salary structure.

Fiscal transfers arrangements

South Africa's fiscal system is based on a revenue sharing model, with provinces totally dependent on transfers from the national government, while municipalities are only marginally dependent. Provinces cannot impose corporate income tax, VAT, excise levies or property taxes. Though they cannot impose a personal income tax, they may impose a surcharge on personal income tax and on the fuel levy. However, in terms of the Constitution, the right to impose a tax or surcharge is subject to national legislation and national economic policy objectives.

South Africa allows provincial and local governments to borrow for capital and bridging purposes only. Local governments have traditionally borrowed for capital investments. However, given the poor state of local government finances, and uncertainty generated by the many policy changes since 1994, long term borrowing has largely dried up. This is because the previous system of national government was forced to borrow on their own merits. Proposed legislation to facilitate long term borrowing for municipalities reinforces the approach of not providing central guarantees for sub-national borrowing. This legislation allows for a form of judicial intervention in the event of defaults, clarifying the rights of lenders.

Provinces and local governments have different fiscal capacity. Local governments have significantly more revenue-raising powers than provincial governments, rising over 90 per cent of their own revenue, while provinces raise only 4 percent of their own revenue. Local governments have traditionally been allowed to borrow for both capital and bridging purposes, while provinces only borrow for bridging purposes.

Under the South African revenue sharing system, nationally raised revenue is divided among the three spheres after national debt servicing needs and a contingency reserve for emergencies are taken into account. Allocations are made for three years under the multi-year budgeting system in South Africa. The Constitution requires ten factors to be taken into account to help determine this division. These include fiscal capacity and expenditure efficiency of the provincial and local spheres, their development needs and backlogs and provision for emergency funding. Before proposing its final allocations to Parliament, the national Cabinet discusses its proposals with provinces and local government at the inter-governmental forums, the Budget Council and the Budget Forum. It also takes into account any recommendations from the Financial and Fiscal Commission (FFC). In addition, provincial premiers are invited to the Cabinet meeting where the final allocations between the three spheres are decided.

The consultations use as their starting point a baseline allocation (which includes the implicit percentage shares allocated to each of the three spheres), which reflects three year allocations from the last budget. As a result, it is only the additional resources that have to be allocated. This division between the three spheres reflects priorities determined by the national Cabinet after the above consultations. It is a political judgment, and depending on the programme or sector prioritized, more resources are made available to the implementing sphere. Thus, if school education is identified as a new or higher priority, the provincial share increases over the baseline allocation from the current three year allocation; if policing is a priority, the national government share is increased.

Given the high demands facing South Africa and the need to prioritize, it is unlikely a formula-driven approach can be used to improve on this process for the vertical division among the three spheres. The political judgment approach does not make the budget process ad-hoc, given the baseline allocations (and the implicit baseline percentage share) of each sphere. The provincial and local spheres are (implicitly) guaranteed their baseline three year allocations. Furthermore, Parliament (and particularly the second house, and the national council of provinces) subjects such allocations and shares to rigorous scrutiny, where the FCC (and provincial and local) comments are taken into account.

The political judgment thus only involves allocations on the margin, and the additional allocations indicate the new priorities determined by the national executive. It is also not an unfettered political judgment, as the baseline percentage share between the three spheres is an important factor when new priorities are taken into account. It would be incorrect, as well as unrealistic, to make the resource allocation process a mechanistic one determined by a formulae. A formulae approach for the vertical division is not necessarily any more certain or less ad-hoc. For instance, a formula will be subject to annual changes as policy priorities change or better information becomes available.

17.6 Emerging Issues and Implications for Policy

Kenya's adoption of the constitution in 2010 defines the public sector as comprising two tiers of government: a national government as well as county governments. Kenya's constitution sets an important framework for some minimum level of autonomy across the two tiers of government. In Article 174, the Constitution clearly outlines some of the broad objectives of enshrining devolution, including: to promote democracy and accountability; greater participation and empowerment; and improve access to public services. The Constitution also sets out the fiscal and other responsibilities and/or functions of the national and county governments. The public finance principles and framework are also articulated in Article 201 of the Constitution. An overriding theme is openness and accountability to guide all aspects of public finance, including public participation. This has provided a firm foundation on which to build fiscal decentralization.

The Public Finance Management Act gives effect to the principles set out in the Constitution. The Act creates a number of crucial public service entities such as the National Treasury and Parliamentary and Senate committees and outlines their functions.

Although the motivation behind fiscal decentralization and other forms of decentralization is greater effectiveness and efficiency, positive outcomes depend crucially on a set of basic elements accompanying the process of decentralization. Some of the basic elements that outline an effective fiscal decentralization system include: an adequate legislative and institutional enabling environment; assignment of an appropriate set of functions to devolved units; assignment of an appropriate set of local own-source revenues to county governments; the establishment of an adequate inter-governmental fiscal transfer system; and the establishment of adequate access of sub-national governments to development capital.

Adequacy of legislative provisions

A broad assessment is that there are indeed adequate legislative and institutional enabling environments for fiscal decentralization. Even so, there are a number of hiccups that relate to elements that are critical in establishing sustainable environments for fiscal decentralization. A few that are notable include:

(i) Political will, which ought to be adequate. Numerous push and pull factors between the national and county governments as well as other national agencies indicate that perhaps much more political will is required to meet the constitutional thresholds of fiscal decentralization. The problems Kenya faces in this area lean more on adherence to the rule of law and implementation of legislative provisions. Political will to pursue the rule of law would greatly improve outcomes in this area.

(ii) There are protracted delays in passing relevant legislation, such as the County Finance Acts. This has undermined the setting up of robust and clearly defined legal provisions to support decentralization. However, the delays could be part of the learning process associated with any transition.

(iii) The coordination of activities is still weak, as evidenced by turf wars across the governments and related agencies. There is also duplication of some services across the two tiers of government. Despite the existence of coordination arms at the national and county levels, there seems to be no appropriately empowered mechanism for coordinating the complex activities typically associated with decentralization. This has resulted in competing interests and agencies working against each other.

(iv) The country is also experiencing significant budgetary and human resource constraints, yet effective fiscal decentralization requires that adequate resources and capacity be decentralized.

Assignment of appropriate set of functions to national and county governments

The fundamental institutional framework of assigning services to devolved units follows the principles for assignment of services to sub-national governments. However, there are challenges to the national or county governments in the assignment of (or the process of assigning) appropriate functions. For example:

(i) The national and county government are prone to viewing each other as competitors. This results from the perception that the national government is slowing down the decentralization process. On the other hand, the devolved units have been perceived as wasteful.

(ii) The pace of decentralization has been too rapid. The process of decentralization of health services is a good example. Experiences from other countries indicate that if too many sectors are decentralized too rapidly, county governments would be likely to perform poorly. Central agencies hostile to decentralization can use poor local performance as an excuse for keeping the services centralized. Poor fiscal performance of devolved units does not necessarily prove that fiscal decentralization is inappropriate. It may simply mean that the fiscal decentralization or sub-national government reform programme is giving sub-national governments too much functional responsibility too rapidly and without appropriate capacity building and local governance development support from the central government.

Assignment of appropriate own-source revenues to sub-national governments

Assigned revenues are almost never adequate to meet the local expenditure requirements. This means that national government transfer programmes are inevitably required. The three years of revenue generation across counties indicate that the county governments often use too many unproductive revenue sources that barely cover the costs of collecting them. One of the most critical international lessons of local tax reform is that sub-national governments should focus their energies on systematic development of a few local sources of revenue that can provide substantial yields and establish a better link between the taxes local residents pay and the benefits they receive.

Assignment of appropriate revenues to sub-county levels

Further, there is no clear legal framework for transferring resources and functions from the county level to sub-county levels, or and micro units within the counties. This has led to concentration of resources at county headquarters, while the sub-county units remain either under-resourced and or under-supported. There is also need to strengthen coordination between national government transfers to counties, service delivery and constituency resource allocations and spending across all counties.

Developing an appropriate inter-governmental fiscal transfer system

Inter-governmental transfer programmes serve multiple often-interrelated purposes. First, they help to cover sub-national government fiscal imbalances, supplementing inadequate local own-source revenues to improve the ability of sub-national governments to meet their expenditure responsibilities.

Second, they can be used to meet national redistribution objectives, helping to offset fiscal capacity differences among sub-national governments.

Third, they can be used to encourage local expenditure on particular goods and services that exhibit positive externalities or are considered to be basic needs that should be distributed less unequally than the ability to pay for them. Most transfer systems are intended, at least officially, to meet these objectives, and they use a variety of types of mechanisms to do so.

There are several typical issues and problems involved in designing transfer systems and programmes.

(i) Too many transfer programmes with different allocation criteria create an administrative burden for local officials and provide incentives for unproductive competition and strategic behaviour.

(ii) In some cases, transfer programmes may substitute local tax effort rather than stimulate it.

Common reforms put in place to overcome these and other challenges include: moving towards consolidated programmes with more transparent allocation mechanisms; introducing incentives for good fiscal behaviour into the access criteria and distribution formulae; and starting new programmes incrementally.

Developing adequate local access by county governments to investment capital

Sub-national governments in many developing countries get much of their capital budget from inter-governmental transfers. Some decentralized governments, typically states, provinces, and large cities, are able to borrow in some countries.

There is an ongoing debate to allow counties to borrow. A key institutional design across countries is to develop and enforce credit limits. Also, access to capital markets can be structured to be direct in cases where decentralized governments are relatively strong.

There are additional basic elements of a successful decentralization process. These include:

Ensuring strong linkage between county and national plans and budgets

Despite the fact that most counties have developed County Integrated Development Plans, the plans are weakly linked to the national government plans. There is also inadequate monitoring and evaluation system, and effective data management systems. If not addressed, this situation will make it difficult for both national and county governments to assess impact of public spending by both levels of government and other stakeholders.

Capacity and institutional/devolution systems

Most counties face a risk of over-employment and duplication of functions by national government and county government employees. Across a significant number of counties, the former local authority staff were retained and additional workers employed without proper rationalization of the staffing requirements. This has led to over-employment and relatively large wage bills existing side by side with human resource capacity gaps.

Support public participation

Public participation primarily assesses whether governments provide for direct engagement between the public and the government during formulation, execution and implementation of national budget process (IBP, 2015); in other words, the extent to which stakeholders outside government are able to participate and influence the rules that guide financial governance, set the agenda, policies and shaping execution. Granted that the sovereign power is tied to citizenry, public participation is the determining variable in any policy formulation at both national and county level. Devolution laws provide a framework that allows citizens to participate in the budget process, including monitoring expenditure and assessing service delivery performance (KSG, 2015). The County Government Act outlines the principles upon which public participation must be anchored on. Such principles include reasonable access to the process of formulating and implementing policies, laws and regulation, including the approval of development proposal, projects and budget, the granting of permits and the establishment of specific performance standards.[7] Furthermore, the county government is mandated to establish structures for citizen's participation in budget preparation and validation forums, among others.

According the draft OCOB County Revenue Baseline study, 89 per cent of the 47 counties had an established County Budget Economics Forum (CBEF) as provided in the PFM Act. The CBEF comprises the Governor, members of the County Executive Committee and Governor Appointees. The purpose of the forum is to provide a means for consultation by the county government on county plans, budget-related documents, including the economy and financial management. The forum is an opportunity for citizen participation with a broad mandate. Seemingly, the aforementioned statistic is quite high but further disaggregation of the statistic reveals a different and ineffective system. For instance, the frequency of meetings of annual, biannual and quarterly are 8 per cent, 18 per cent and 37 per cent, respectively with 13 per cent dormant (OCOB-KIPPRA, 2015). Furthermore, the law is silent on whether the appointment process of members of the forum is representative of the public in general.

In another survey conducted in 2014 by CIC, public participation on budget making process registered a composite index of 67.8 per cent. The index constitutes several indicators of public participation based on access to the public gallery, petitions to the County Assembly, memorandum, press adverts, stakeholders' consultation and others such as website, radio stations, and churches ward offices (CIC, 2015). In view of the public participation test in the aforementioned legal analysis, both surveys are lacking facilitation element.

Inclusiveness of revenue governance reflects executive consultation with the public to determine budget priorities. Although there was no evidence on public consultation of budget priorities 2013/14, some counties conducted consultations in 2014/15. Such consultations included information dissemination on proposed projects by the County Executive Committees and Members of County Assembly. Granted that the proposed projects were predetermined, the consultation was mere informative rather than participatory (IEA, 2015).

Transparency and accountability

This reflects the extent to which the process of governance is transparent with regard to sharing documents and information that the public need in order to exercise its accountability role. Transparency entails disclosure and timely publication of budget documents relating to formulation, execution and implementation of the budget process (IBP, 2015). Openness is anchored in the Constitution and the statutory laws. Information accessibility is a fundamental right[8] for State-held information especially on public financial matters. In addition, such information must be timely and accurate. Privately held information that has bearing with the execution of a fundamental right does not enjoy constitutional protection. In addition to reiteration of information accessibility rights, the statutory laws provide for information accessibility channels[9] with the widest public reach, and which may include the following: television station, information communication technology (ICT) centres, website, radio station, public meeting, and traditional media, among others.

The transparency of budget government entails easy and timely accessibility of key budget documents. Such accessibility calls for publication of documents such as circulars for citizen participation, county fiscal strategy paper, and budget review and outlook paper, including a citizens' budget.

Openness of revenue governance embodies taxpayers' awareness of liabilities and obligations. Based on the County Revenue Baseline Survey, 86 per cent of local revenue collectors reported taxpayers' resistance to pay taxes. The distribution of reasons for non-payment resistance in order of magnitude includes 40 per cent, 27 per cent and 17 per cent of high rate, non-value of money, and corruption, respectively. Such resistance may have an impact on local revenue generation. The local revenue constituted 56.0 per cent of the total resources available for the then local government's prior devolution. Subsequently, the share dropped to 10.6 per cent and 11.0 per cent of total resources available to county governments during 2013/14 and 2014/15, respectively (OCOB-KIPPRA, 2015). Such significant drop is attributable, first to county governments' over-reliance on vertical equitable allocation from the national government, which is distributive in nature.

Second, a survey on the revenue collectors reveals possibilities of revenue leakage. For instance, 69.0 per cent of collectors believed that their respective jurisdictions were adequately mapped. Twenty (20) per cent and three (3) per cent believed that their respective jurisdictions were too big to allow a possibility and guarantee non-collection, respectively.

Third, the mode of revenue collection has a bearing on the effectiveness of revenue collection. About 79.0 per cent of collectors were paid in receipted cash compared with a more secured mode of payment such as cheque, bank deposit slips, and E-mobile banking, which were 4.6 per cent, 10.0 per cent and 2.0 per cent, respectively.

Fourth, 43.0 per cent and 43.2 per cent of revenue collectors deposited their collections to cashier or cash office, and direct banking through Mobile-banking, respectively. Eleven (11) per cent of collectors keep their collection in their respective offices while 2.4 per cent manage their collections in other different ways, including taking them home. Such management creates loophole for further leakages.

Oversight (MCAs, Auditor General)

The oversight measures the effectiveness of Parliament and other audit institutions to provide effective oversight. Such effectiveness embodies financial and administrative independence from the Executive arm of government (IBP, 2015). Accountability is enshrined as one of the objects and principles of devolved government[10] and public finance.[11]

The Office of Controller of Budget (OCOB) has duly and timely fulfilled its constitutional mandate to report on the implementation of budgets of county governments. For instance, the Annual County Governments Budget Implementation Review Report of 2014/15 provides an analysis of revenue and expenditure that identifies key challenges as well as recommendations. However, there is no evidence that the county governments have met their statutory obligations[12] of maintaining internal auditing arrangements.

Oversight on revenue governance entails comprehensiveness of audit activities. The County Assembly has a constitutional oversight duty[13] over the County Executive with the power separation doctrine.

Link between policy, planning and budgeting processes

While most counties submit their budget estimates to county assemblies by 30th April as required by law, many counties do not adhere to the timelines for submitting other budget documents that are integral to the proper preparation or execution of county budgets. In the short run, therefore, the tight budget calendar will undermine the credibility of the budget particularly for county governments. Counties prepare and approve their County Fiscal Strategy Papers (CFSPs), which set out proposed expenditure ceilings for each sector based on a resource envelop that they are unaware of. This is because the statutory deadline for approval of division of revenue bills (which sets out the horizontal and vertical sharing of revenue) is 30th March. Due to overlapping national and county budget calendar, counties currently prepare their CFPS without aligning them to the annual budgets.

Fiscal risks

County governments have two systems operating concurrently: Integrated Financial Management Information System (IFMIS) for expenditure management, and Local Authorities Integrated Financial Operations Management System (LAIFOMS) for revenue management in some counties or locally designed revenue management systems. These two systems are incompatible, with no integration between the two. LAIFOMS is a computer-supported financial management tool and IFMIS is a web-based system. Delays in integration of these two systems have caused some counties to procure integrated systems to handle this function. IFMIS is perceived to be contrary to Article 190 of the Constitution and section 12 of the PFM Act. Limited use of PFM systems is also attributed to limited staff capacity to operate IFMIS, insufficient budgetary allocations for computers, poor internal connectivity systems, and budget system being stand alone with different accounts. The limited use of PFM systems creates loopholes through use of manual systems that undermine recording and reporting.

Transparency and public access to budget information

Section 7 of the County Government Act 2012 provides for the membership of the County Assembly whose role is: (i) legislation; (ii) representation, and (iii) approval. In public finance management (PFM), the County Assembly is vested with the role of oversight, which includes approving the budget and expenditure of the County Government. The mandate of the County Executive is to implement the functions of the County Governments as provided under Schedule 2 of the Constitution. In addition, the Executive is expected to implement National and County Government legislation as well as provide regular reports to the County Assembly on matters such as budget implementation.

County Assemblies and the Senate are the legislative arms of the county governments, thus have an oversight and accountability mandate. Quite often, these roles are undermined by political economy issues, which often manifest into misunderstandings on two fronts; first between Senators, and Governors on one hand and secondly between Governors and Members of the County Assemblies. These misunderstandings delay the passing of key bills including supplementary budget estimates, the finance bill, among others, all of which affect budget execution.

Internal revenue and expenditure control systems of control

The PFM Act 2012 enshrines a number of fiscal responsibility principles:

i) Development expenditure should be a minimum of 30 per cent of the national or county government budget.

ii) Wages and benefits should not exceed a specified per cent of revenue.

iii) Debts limits as set by Parliament or County Assemblies shall not exceed and in any case not exceed levels specified in the medium term debt management strategy.

iv) Level of tax rates and bases should demonstrate a reasonable degree of predictability and stability.

v) Deviation from financial objectives can only be a temporary basis and only when such deviation is caused by a major natural disaster, or other significant unforeseen event.

vi) National and county governments are prohibited from deviating from fiscal principles.

The above requirements may be too stringent particularly for county governments with limited capacity. Neither the national nor the county governments are adhering to the fiscal responsibility principles relating to the recurrent development expenditure ratios. In the case of county governments, this is for a number of reasons related to inherited costs and new administrative structure, transfer formula and information asymmetry on the cost of devolved functions, and lastly limited capacity in revenue forecasting and administration.

Transfer of functions and the related challenges

In some counties, the wage bill consumes a significant share of the transfer from the national government. County governments have four categories of employees: (i) those inherited from the former local authorities; (ii) those seconded from the national government; (iii) newly recruited into county executives; and (iv) newly recruited in the legislative arm, i.e. County Assemblies. This administrative structure has seen a rapid increase in administrative costs.

The current transfer formula was designed to 'equalize' and redress historical injustices in resource allocation process, but was formulated without data on the cost of devolved functions, thus does not take into account other considerations such as (i) inherited recurrent costs; (ii) the minimum package for service delivery; (iii) the capacity to generate own revenues; and (iv) the creation of incentives for fiscal responsibility. The formulae, which would achieve the equalization objective, leaves some counties with limited fiscal space to deliver the devolved services. This has led to counties spending less on services such as health compared to actual spending before devolution.

17.8 Conclusions and Recommendations

17.8.1 Conclusions

The national government has continued to support the devolution as evidenced by subsequent increase of vertical allocation beyond the minimum threshold of 15 per cent. However, assessment of counties' public financial management reveals some weakness. Based on recent studies, the evaluation of budget and revenue governance indicators gives a mixed results.

From the counties' perspective, public participation in the budget process is based on the statutory compliance of establishing county budget economic forums. However, further disaggregation on the operation of these forums show some weakness based on the frequency of meetings held. In addition, the measure of public participation based on the CBEF underestimate the participation because membership to these forums tends to be county executive appointees, which might not be representative. Furthermore such outcome would fall short of the newly established threshold that encompasses both participation and facilitation as per recent case law.

As for transparency of budget governance, there is no evidence that budget documents are transparently available to citizens in an effective ways.

Institutional oversight was provided as evidenced by the OCOB's annual budget implementation reports. The County Assembly oversight may be presumed because appropriation finance bills has been enacted in most counties. However, there is no evidence that the county governments have met their statutory obligation of maintaining internal auditing arrangements.

Further analysis shows a 2014/15 improved budget utilization rate compared to 2013/14, which is supported by equally better absorption rate in the same review period. These improvements are conjecturally attributable to the effectiveness of OCOB's oversight role and other factors such as legal requirement of at least 30 per cent development spending. Furthermore, the interest of being re-elected may have incentivized the counties to devote more resources on development projects.

Evidently, some counties conducted consultations on revenue governance in 2014/15, which included information dissemination on proposed projects by the County Executive Committees and Members of the County Assembly. Granted that the proposed projects were predetermined, the consultations were merely informative rather than participatory. Transparency assessment of revenue governance reflects the reluctance of the citizens to pay taxes as reported by the collectors. Such reluctance is manifested in financial leakages.

The counties' sources of revenue in 2014/15 include the vertical allocation, conditional grant, local revenue, donor grant and unutilized balance. The vertical allocation for the last two financial years reflects an increment above (about 20%) the constitutional 15 per cent of sharable revenue. Conjecturally, this is attributable to the national government's commitment to pursue devolution agenda. Moreover, to pacify the Council of Governors, there are calls for constitutional amendments to increase the allocation.

17.8.2 Recommendations

Fiscal decentralization is a relatively new entrant in the realm of fiscal management even in the global arena. This section highlights recommendations and the way forward for Kenya in its efforts to fully implement the requirements of the Constitution of Kenya 2010"

(i) Ensure full implementation of legal and legislative frameworks and enhance adherence to the rule of law. All arms of government should ensure that Chapter 11 of the Constitution on devolution and principles of governance are adhered to. Particularly, Article 174 provides for ensuring equitable sharing of national and local resources and promoting democratic and accountable exercise of power.

(ii) The Commission on Revenue Allocation should allocate revenue sharing based on historical allocation and expenditure of ministries, agencies and departments. However, this should only be done after costing of both national and county governments functions has been comprehensively undertaken. Proper costing will enhance equity in revenue sharing between the two levels of government.

(iii) Systematically assign appropriate sets of functions to counties. Any assigned functions should not be rapid and should pay attention to existence of appropriate capacity.

(iv) Revenue sharing between levels of government in a decentralized environment require consultation. In addition, there is need to strengthen the transparency and accountability oversight systems.

(v) Deepen effective coordination for efficient service delivery, and link county and national plans and budgets. Due to low technical capacities at the county levels, there is poor adhereance by counties to deadlines set in the Constitution and the PFM Act, due to lack of the necessary expertise to prepare the required documents. This is particularly the case in regard to preparation of Programme Based Budget. Poor budget implementation has been attributed to delayed appointment or inadequate staffing in the relevant departments.

(vi) Ensure that all counties access development capital and deepen public participation on the budget making process and implementation of budget plans.

(vii) Ensure adequate capacity building and sustainable institutional/devolution systems. The Controller of Budget reports raise particular concerns relating to inadequate technical capacity to support County Assemblies on budget preparation and legislation.

(viii) To enhance own-source revenue and service delivery link, counties should collect revenue from a few (rather than many) local sources. Counties have two PFM systems operating concurrently: IFMIS and LAIFOMS for revenue management.

Endnotes

1. PFMA section 125(1)
2. PFMA section 125(2)
3. Article 209
4. PFMA section 109
5. Article 207
6. PFMA section 107(2)(b)
7. The County Governments Act, 2012
8. Constitution article 35
9. County Government Act section
10. Constitution article 174
11. Constitution article 201
12. PFMA section 115
13. Article 185
14. Article 228(6)
15. Republic of Kenya (1965).
16. See Institute of Economic Affairs (2007)

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Annex

Annex Table 3.1: Education public spending by economic classification (2011/12-2013/14) (Ksh millions)

	Approved			Actual				
	2011/12	2012/13	2013/14	2011/12	2012/13	2013/14	% budget execution (2013/14)	Actual % (2013/14)
Recurrent expenditure	160,572.49	216,475.20	237,963.22	188,650.49	215,715.28	229,387.86	96	96
Compensation of employees	115,209.98	142,753.00	157,062.36	147,449.98	142,521.91	156,795.89	100	66
Use of goods and services	4,097.08	4,973.50	4,017.60	4,078.85	4,819.26	2,961.75	74	1
Current grants and transfers	18,492.90	46,595.80	50,449.32	14,308.40	46,234.37	48,739.74	97	20
Other recurrent expenditures	22,772.53	22,152.90	26,433.94	22,813.26	22,139.74	20,890.48	79	9
Development expenditure	7,675.20	16,704.10	19,207.40	5,324.20	13,556.80	9,505.50	49	4
Acquisition of non-financial assets	965.70	1,205.70	8,278.74	654.60	1,059.50	2,775.39	34	1
Grants and transfers	3,624.90	13,417.00	6,606.98	1,688.30	10,467.90	4,324.52	65	2
Other development expenditure	3,084.60	2,081.40	4,321.68	2,981.30	2,029.40	2,405.59	56	1
Total expenditure	168,247.69	233,179.30	257,170.62	193,974.69	229,272.08	238,893.36	93%	100%

Source: Education Sector Report (2015)

Annex Table 3.2: Literacy and gross enrolment ratios for selected countries, 2014

	Literacy			Gross Enrolment Ratios				
Country	Adult	Youth	Population with at least some secondary education	pre-primary	Primary	Secondary	Tertiary	Primary school dropout Rates
	(% ages 15 and older)	(% ages 15-24)	(% ages 25 and Older	(% of children of pre- school age)	(% of primary school age population)	(% of secondary school-age population)	(% of tertiary school age population)	(% of primary school cohort)
Norway	-	-	97.1	99.0	99.0	113.0	73.0	0.7
United States	-	-	95.0	73.0	99.0	94.0	95.0	6.9
Germany	-	-	96.6	112.0	101.0	102.0	57.0	3.4
United Kingdom	-	-	99.9	85.0	107.0	97.0	61.0	-
South Korea	-	-	82.9	118.0	104.0	97.0	101.0	1.0
Japan	-	-	86.4	87.0	103.0	102.0	60.0	0.1
Indonesia	92.8	98.8	44.5	42.0	109.0	81.0	27.0	12.0
Botswana	85.1	95.2	75.5	18.0	106.0	82.0	7.0	7.0
Egypt	73.9	89.3	51.2	27.0	109.0	76.0	29.0	1.1
South Africa	93.0	98.8	74.3	77.0	102.0	102.0	-	-
Kenya	72.2	82.4	28.6	51.0	112.0	60.0	4.0	..
Rwanda	65.9	77.3	7.7	13.0	134.0	32.0	7.0	64.4
Nigeria	51.1	66.4	-	13.0	81.0	44.0	10.0	20.1
Tanzania	67.8	74.6	7.4	34.0	93.0	35.0	4.0	18.6
Uganda	73.2	87.4	28.8	14.0	110.0	28.0	9.0	75.2

Source: UNDP (2014)

Annex Table 3.3: Distribution of health facilities in Kenya, 2014

County	Population 2012	No. of hospitals level 4-6	Hospitals per 100,000 population	No. of health centres and dispensaries (level 2-3)	Health centres and dispensaries per 100,000 population
Kenya	40,700,000	512	1.3	8,104	19.9
Baringo	593,840	6	1.0	182	30.6
Bomet	782,105	5	0.6	113	14.4
Bungoma	1,473,458	12	0.8	134	9.1
Busia	796,646	7	0.9	74	9.3
Elgeyo Marakwet	396,663	8	2.0	113	28.5
Embu	550,438	8	1.5	131	23.8
Garissa	457,068	14	3.1	105	23.0
Homa Bay	1,033,941	14	1.4	201	19.4
Isiolo	206,306	5	2.4	42	20.4
Kajiado	732,356	14	1.9	224	30.6
Kakamega	1,781,528	17	1.0	232	13.0
Kericho	799,515	14	1.8	162	20.3
Kiambu	1,734,694	27	1.6	391	22.5
Kilifi	1,179,956	10	0.8	227	19.2
Kirinyaga	564,022	5	0.9	239	42.4
Kisii	1,234,634	20	1.6	137	11.1
Kisumu	1,030,986	21	2.0	145	14.1
Kitui	1,061,296	15	1.4	290	27.3
Kwale	69,412	3	0.4	96	13.8
Laikipia	417,538	7	1.7	96	23.0
Lamu	106,877	3	2.8	41	38.4
Machakos	1,174,587	8	0.7	293	24.9
Makueni	946,292	13	1.4	175	18.5
Mandera	1,005,003	6	0.6	73	7.3
Marsabit	312,325	4	1.3	83	26.6
Meru	1,448,606	24	1.7	369	25.5
Migori	981,319	15	1.5	170	17.3
Mombasa	995,334	15	1.5	275	27.6
Murang'a	1,013,325	8	0.8	299	29.5
Nairobi	3,324,894	54	1.6	599	18.0
Nakuru	1,693,008	21	1.2	318	18.8
Nandi	802,347	6	0.7	169	21.1
Narok	908,597	6	0.7	147	16.2
Nyamira	640,844	7	1.1	126	19.7
Nyandarua	631,034	3	0.5	119	18.9
Nyeri	832,877	10	1.2	401	48.1
Samburu	239,416	3	1.3	70	29.2

County	Population 2012	No. of hospitals level 4-6	Hospitals per 100,000 population	No. of health centres and dispensaries (level 2-3)	Health centres and dispensaries per 100,000 population
Siaya	902,753	11	1.2	154	17.1
Taita Taveta	297,579	7	2.4	72	24.2
Tana River	258,261	2	0.8	62	24.0
Tharaka Nithi	389,731	8	2.1	96	24.6
Trans Nzoia	875,697	7	0.8	91	10.4
Turkana	868,209	6	0.7	139	16.0
Uasin Gishu	940,112	12	1.3	165	17.6
Vihiga	594,457	6	1.0	75	12.6
Wajir	566,454	10	1.8	102	18.0
West Pokot	525,970	5	1.0	87	16.5

Source: Kenya Health Policy (2014)

Annex Table 3.4: Health service outcome indicator results, 2013/14 communicable conditions

County	% of fully immunized infants	TB Treatment completion rate (2012 data)	% HIV + pregnant mothers receiving preventive ARV's	Number of eligible HIV clients on ARV's	% targeted under 1's provided with LLITN's	% targeted pregnant women provided with LLITN's	Under 5's treated for diarrheoa	% school age de-wormed reported in health facilities
Baringo	63.5	87.91	56.0	2,085	0.0	36.2	26.8	48.6
Bomet	60.2	91.99	46.2	3,764	3.0	49.1	27.6	13.4
Bungoma	54.3	86.2	37.2	13,680	0.0	39.6	9.6	13.4
Busia	98.7	82.93	48.1	18,071	0.0	85.2	25.5	12.6
Elgeyo Marakwet	69.1	83.44	20.3	1,546	0.0	46.2	41.9	37.8
Embu	70.1	90.40	61.6	4,693	0.0	37.7	16.5	44.0
Garissa	89.2	88.40	49.3	766	0.0	2.6	26.0	8.8
Homa Bay	65.3	83.57	67.2	46,251	7.8	65.0	16.2	17.0
Isiolo	81.6	84.36	28.8	1,486	0.0	72.8	35.0	9.8
Kajiado	62.7	90.55	56.1	5,310	0.0	67.1	34.6	44.3
Kakamega	64.3	90.40	61.7	19,879	0.0	48.2	12.8	19.6
Kericho	64.0	90.60	44.7	9,398	21.0	50.4	117.5	33.8
Kiambu	78.3	87.37	44.4	23,012	0.0	28.3	27.1	20.9
Kilifi	83.4	85.50	36.6	12,799	48.0	81.7	27.0	42.6
Kirinyaga	73.0	87.13	87.3	6,822	9.6	54.8	31.3	0.0
Kisii	63.1	87.28	62.4	15,775	31.9	52.9	13.8	13.9
Kisumu	63.9	85.08	83.4	52,288	0.0	97.1	19.2	8.8
Kitui	71.1	87.83	41.9	9,714	21.4	52.1	22.1	33.0
Kwale	79.6	83.80	59.7	3,945	0.0	75.9	19.5	3.5
Laikipia	77.2	84.33	55.9	5,184	0.0	0.2	18.6	52.1
Lamu	73.1	82.65	52.4	598	0.0	88.8	42.2	0.7
Machakos	67.8	86.59	65.1	14,349	0.0	45.2	22.5	54.2
Makueni	67.4	89.10	73.6	11,027	0.0	39.1	20.0	44.4
Mandera	34.9	89.13	22.5	201	0.0	0.1	7.7	0.4
Marsabit	86.8	94.81	35.1	749	0.0	5.5	34.3	11.4
Meru	63.5	83.62	43.4	10,345	0.0	36.4	12.4	23.2
Migori	79.4	89.77	67.0	39,405	2.6	74.2	16.7	27.4
Mombasa	59.3	88.03	46.3	31,449	5.8	44.0	21.7	9.6
Murang'a	61.8	90.74	72.0	11,287	0.0	47.4	22.8	35.3
Nairobi	94.5	84.69	69.1	94,264	0.0	1.0	25.7	10.7
Nakuru	75.9	85.97	58.6	22,188	0.0	1.2	22.7	21.2
Nandi	68.1	88.00	65.1	6,383	1.1	44.2	20.6	25.1
Narok	69.0	89.39	31.3	4,031	0.3	46.5	22.5	30.5
Nyamira	60.1	90.11	59.5	7,706	37.7	46.1	12.4	5.4
Nyandarua	73.4	89.66	70.5	4,452	0.0	0.4	15.3	80.7
Nyeri	63.8	87.58	41.6	12,369	0.0	0.8	18.7	27.9

County	% of fully immunized infants	TB Treatment completion rate (2012 data)	% HIV + pregnant mothers receiving preventive ARV's	Number of eligible HIV clients on ARV's	% targeted under 1's provided with LLITN's	% targeted pregnant women provided with LLITN's	Under 5's treated for diarrheoa	% school age de-wormed reported in health facilities
Samburu	71.7	87.12	42.9	556	2.2	0.8	40.6	35.5
Siaya	60.1	82.52	81.0	48,456	26.4	59.9	18.1	22.0
Taita Taveta	58.6	86.40	63.6	3,253	0.0	49.3	19.7	33.8
Tana River	64.1	85.71	45.6	521	0.0	47.7	31.0	0.7
Tharaka Nithi	52.2	89.16	46.8	5,221	0.0	44.0	14.3	34.1
Trans Nzoia	57.6	86.16	44.5	2,159	0.0	45.8	13.9	13.9
Turkana	46.8	91.06	29.4	3,581	0.0	5.1	18.7	7.7
Uasin Gishu	74.0	88.91	29.8	18,657	6.5	56.8	20.0	46.6
Vihiga	73.1	87.68	69.6	8,455	0.0	44.5	7.1	18.3
Wajir	80.8	90.65	13.6	230	0.0	0.3	22.1	22.9
West Pokot	59.1	88.43	37.7	1,408	0.0	48.5	28.5	24.9
Kenya	69.2	87.50	60.5	2,085	7.5	37.7	22.3	23.4

Source: Ministry of Health (2014)

Annex Table 3.5: Health service outcome indicator results 2013/2014, non-communicable diseases

County	% New outpatients with mental condition	% new outpatients with high blood pressure	% new outpatients with Diabetes	County	% New outpatients with mental condition	% new outpatients with high blood pressure	% new outpatients with Diabetes
Baringo	0.06	0.29	0.10	Marsabit	0.22	0.48	0.26
Bomet	0.08	0.39	0.09	Meru	0.23	1.67	0.51
Bungoma	0.11	0.79	0.17	Migori	0.05	0.38	0.15
Busia	0.06	0.67	0.12	Mombasa	0.16	1.76	0.79
Elgeyo Marakwet	0.13	0.25	0.11	Murang'a	0.40	3.89	0.93
Embu	0.28	0.69	0.49	Nairobi	0.33	1.85	0.76
Garissa	0.11	0.64	0.2	Nakuru	0.12	1.22	0.74
Homa Bay	0.05	0.27	0.11	Nandi	0.11	0.4	0.08
Isiolo	0.16	0.59	0.08	Narok	0.07	0.41	0.17
Kajiado	0.13	1.49	0.65	Nyamira	0.09	0.72	0.21
Kakamega	0.10	0.62	0.13	Nyandarua	0.39	3.17	1.13
Kericho	0.16	0.64	0.13	Nyeri	0.55	3.98	1.13
Kiambu	0.17	2.71	1.00	Samburu	0.12	0.23	0.04
Kilifi	0.16	1.12	0.23	Siaya	0.09	0.6	0.16
Kirinyaga	0.17	1.31	0.66	Taita Teveta	0.43	2.37	0.53
Kisii	0.11	0.67	0.33	Tana River	0.16	1.12	0.12
Kisumu	0.07	0.82	0.24	Tharaka Nithi	0.27	1.25	0.20
Kitui	0.14	1.48	0.29	Trans Nzoia	0.22	0.8	0.5
Kwale	0.13	1.12	0.20	Turkana	0.11	0.15	0.07
Laikipia	0.52	5.69	0.67	Uasin Gishu	0.27	1.02	339
Lamu	0.30	0.96	0.49	Vihiga	0.14	1.06	0.20
Machakos	0.18	2.18	0.59	Wajir	0.20	0.43	0.11
Makueni	0.22	1.92	0.40	West Pokot	0.11	0.09	0.06
Mandera	0.11	0.35	0.09	Kenya	0.18	1.32	0.41

Source: Ministry of Health (2014)

Annex Table 3.6: Violence and injuries indicators

County	% new outpatient cases attributed to other injuries 2012/13	% new outpatient cases attributed to other injuries 2013/14	Difference	County	% new outpatient cases attributed to other injuries 2012/13	% new outpatient cases attributed to other injuries 2013/14	Difference
Baringo	2.5	2.25	-0.25	Marsabit	1.6	1.78	0.18
Bomet	1.9	2.03	0.13	Meru	2.3	2.15	-0.15
Bungoma	2.7	2.23	-0.47	Migori	1.5	1.03	-0.47
Busia	1.5	1.18	-0.32	Mombasa	1.9	1.87	-0.03
Elgeyo Marakwet	4.0	3.12	-0.88	Muranga	2.2	2.44	0.24
Embu	2.4	2.33	-0.07	Nairobi	2.2	2.30	0.10
Garissa	1.7	1.52	-0.18	Nakuru	2.0	2.53	0.53
Homa Bay	1.5	0.87	-0.63	Nandi	2.4	2.15	-0.25
Isiolo	1.7	2.16	0.46	Narok	2.4	2.06	-0.34
Kajiado	2.6	2.53	-0.07	Nyamira	2.8	2.26	-0.54
Kakamega	3.2	1.77	-1.43	Nyandarua	2.4	2.90	0.50
Kericho	2.0	1.96	-0.04	Nyeri	1.5	2.88	1.38
Kiambu	2.5	2.76	0.26	Samburu	2.2	2.15	-0.05
Kilifi	2.1	2.22	0.12	Siaya	1.6	1.36	-0.24
Kirinyaga	2.4	2.53	0.13	Taita Teveta	2.0	2.66	0.66
Kisii	3.0	2.52	-0.48	Tana River	1.6	1.45	-0.15
Kisumu	1.3	1.23	-0.07	Tharaka Nithi	1.7	1.33	-0.37
Kitui	2.4	2.37	-0.03	Trans Nzoia	2.7	3.22	0.52
Kwale	1.6	1.36	-0.24	Turkana	1.6	1.45	-0.15
Laikipia	1.7	2.37	0.67	Uasin Gishu	2.9	3.05	0.15
Lamu	2.2	0.94	-1.26	Vihiga	2.5	1.43	-1.07
Machakos	3.3	4.06	0.76	Wajir	1.5	1.96	0.46
Makueni	2.9	3.26	0.36	West Pokot	2.3	2.35	0.05
Mandera	1.4	1.59	0.19	Kenya	2.2	2.18	-0.02

Source: Ministry of Health (2014)

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