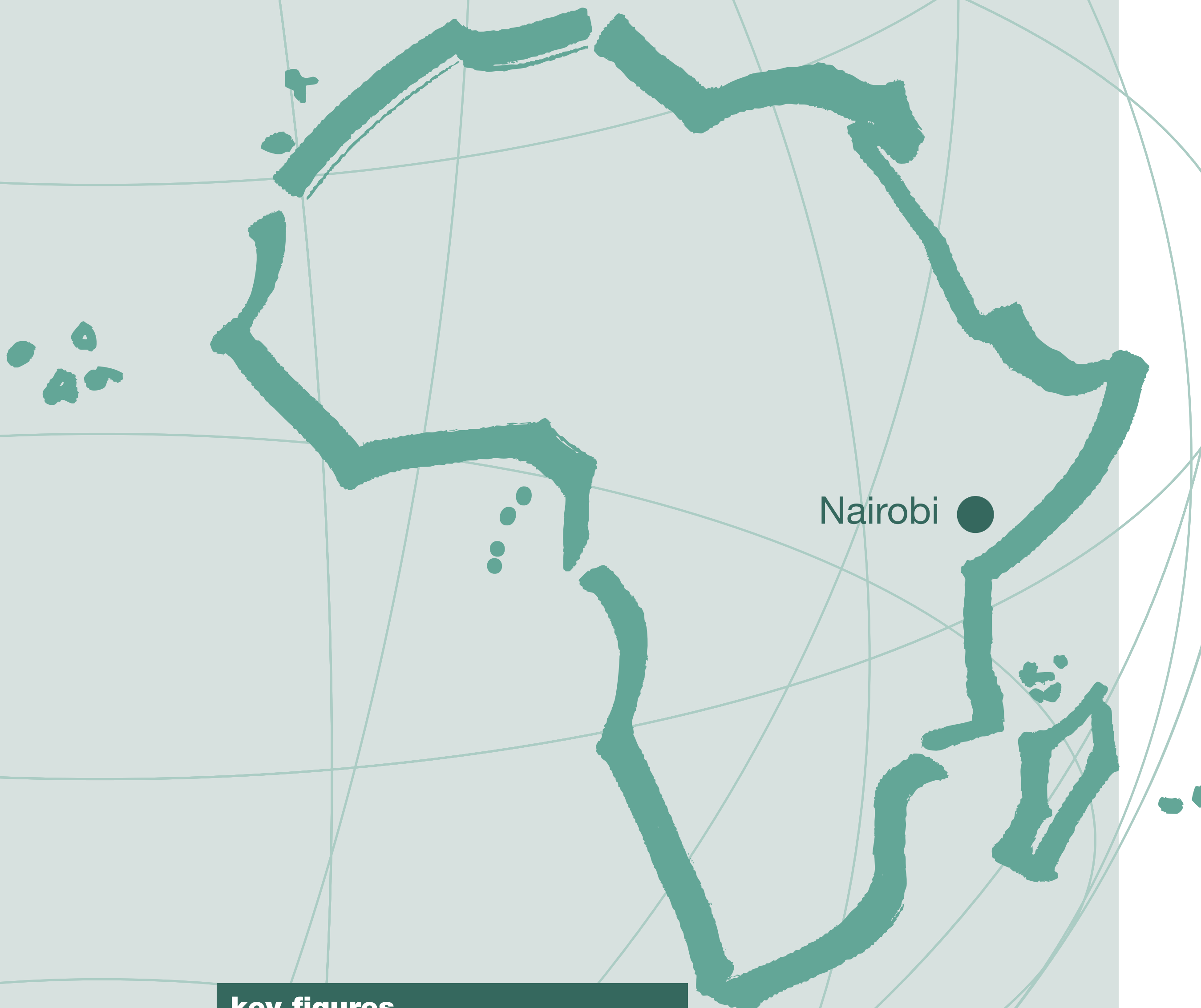
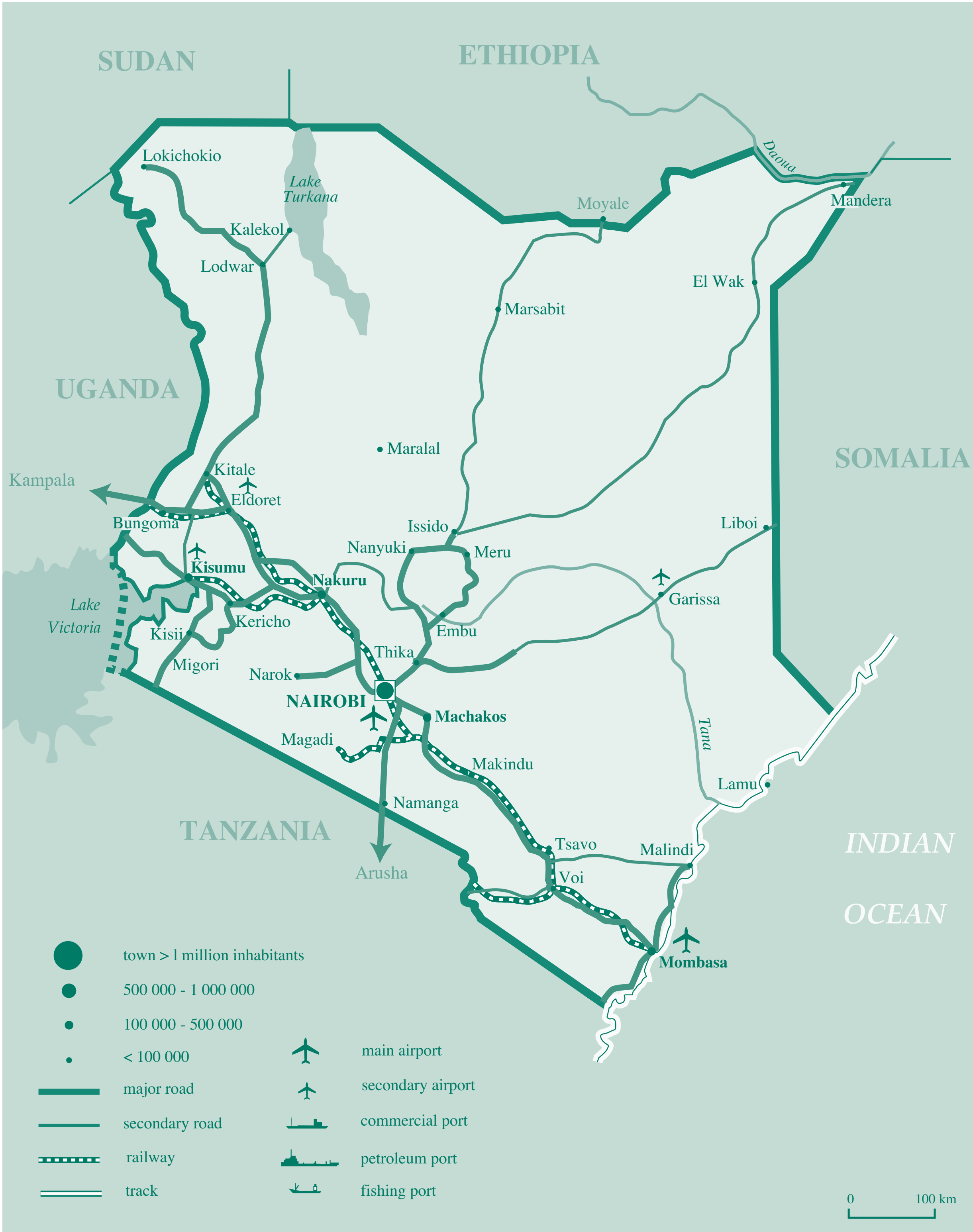
Kenya



key figures

• Land area, thousands of km²	580
• Population, thousands (2007)	37 538
• GDP per capita, USD at constant 2000 prices (2007)	456
• Life expectancy (2007)	54.1
• Illiteracy rate (2007)	11.8

Kenya


SUDAN
ETHIOPIA
UGANDA
SOMALIA
TANZANIA
INDIAN
OCEAN
Lake
Turkana
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Victoria
Daoua
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Lokichokio
Kalekol
Lodwar
Moyale
Mandera
El Wak
Marsabit
Maralal
Kampala
Kitale
Eldoret
Bungoma
Kisumu
Issido
Nanyuki
Meru
Liboi
Nakuru
Garissa
Kericho
Kisii
Embu
Migori
Thika
Narok
NAIROBI
Machakos
Magadi
Makindu
Lamu
Namanga
Arusha
Tsavo
Malindi
Voi
Mombasa
town > 1 million inhabitants
500 000 - 1 000 000
100 000 - 500 000
< 100 000
major road
secondary road
railway
track
main airport
secondary airport
commercial port
petroleum port
fishing port
0
100 km

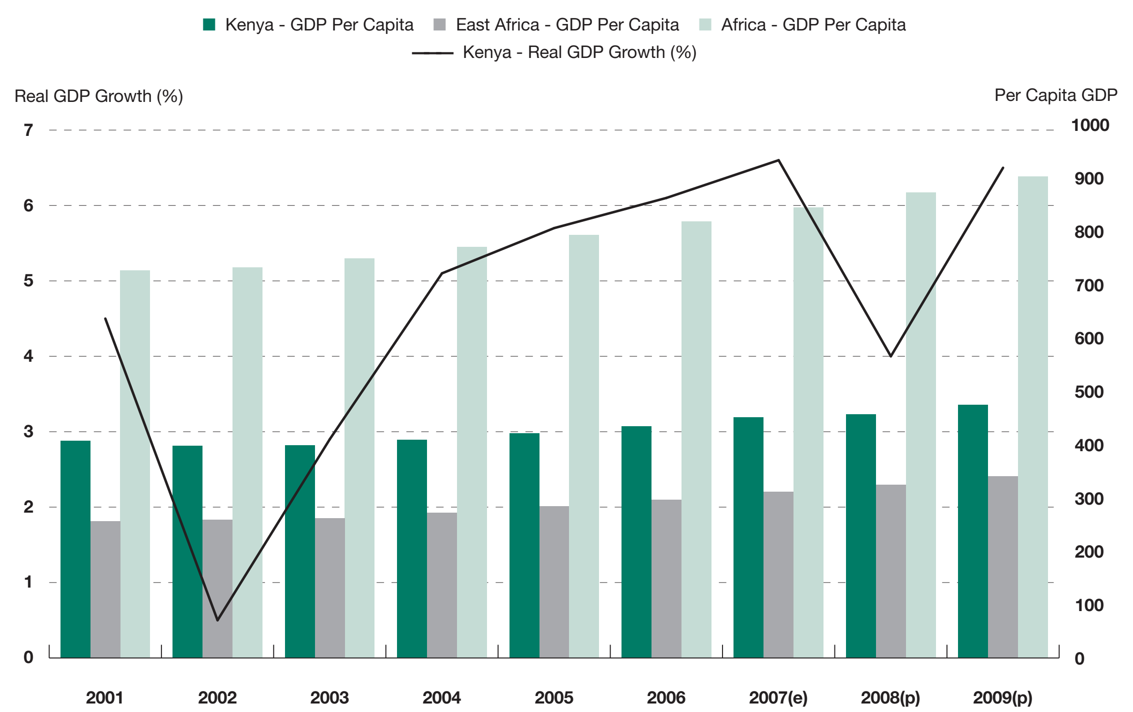
Kenya

THE KENYAN ECONOMY GREW at an estimated rate of 6.6 per cent in 2007, up from 6.1 per cent in 2006. This reflects broad-based economic growth in most sectors. Under the Economic Recovery Strategy (ERS) which ended in 2007, investor confidence was restored, farm prices improved, and rural electrification proceeded in many parts of the country. Before the eruption of the current crisis following the disputed presidential elections, the economy appeared to be on track to maintain or improve upon its performance in 2007. However, it now appears likely that growth will be much less than expected in 2008. Assuming that the crisis is short-lived, the impact is expected to be modest, followed by a small increase in growth in 2009. The implementation from 2008 of Vision 2030 — a strategy comprising successive five-year plans, the first of which provides for increased investments in infrastructure and other key sectors — is expected to provide continued impetus to growth.

The political crisis could drive two million Kenyans into poverty, reversing economic gains.

During the period May 2005 to May 2006, overall poverty was measured at 46 per cent, compared to 56 per cent seven years earlier, with a significant 35 per cent reduction in rural poverty. Access to clean water and affordable healthcare services also improved during ERS, and school enrolments increased.

Figure 1 - **Real GDP Growth and Per Capita GDP**
(USD at constant 2000 prices)



Source: IMF and National Bureau of Statistics data; estimates (e) and projections (p) based on authors' calculations.

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Recent Economic Developments

The growth of real gross domestic product (GDP) is estimated to have been 6.6 per cent in 2007, compared to 6.1 per cent in 2006. This growth was supported by the agriculture, manufacturing, wholesale and retail trade, tourism, transport and communications, and financial services sectors, as well as increased efficiency in the economy's management. Per capita income increased to USD 456 in 2007, up from USD 439 in 2006. Prospects for 2008 have been dampened somewhat by the recent crisis. Tourism receipts are likely to be depressed. Exports are likely to have been affected by disturbances in the port city of Mombasa, and both private consumption and private investment are likely to slow. A recovery is expected to ensue, resulting in higher growth in 2009 (Table 1)[1]. Real GDP is projected to grow at 4 per cent in 2008 and then accelerate to 6.5 per cent in 2009 (Figure 1).

The agriculture sector, which accounted for 27.1 per cent of GDP (Figure 2), recorded a better performance in 2007 than in 2006, largely due to recovery from the drought that was experienced in late 2005 and the first quarter of 2006. However, food supply remained satisfactory following increased harvests of maize, beans and millet due to adequate rainfall received in most parts of the country. In 2007, the sector grew by 12 per cent during the first quarter, compared to 0.3 per cent recorded in 2006, and by 5.8 per cent in the third quarter, compared to 7.8 per cent in 2006, with all major crops recording growth in production. This was the result of a recovery from the drought experienced in the first quarter of 2006. The tea sub-sector is growing, albeit slowly, partly as a result of good rains. However, tea prices have been gradually declining due to excess supply. In 2007, the horticultural, coffee and sugar cane sub-sectors posted positive growths, both in value and quantity.

The manufacturing sector, accounting for 11.5 per cent of total GDP, continued to be robust, recording higher expansion in 2007 than in 2006. This was a result of strong growth in various sub-sectors, including food, beverages and tobacco that registered an improved performance. In addition, favourable weather conditions led to an improved supply of raw materials to a number of agro-based industries, especially the dairy and grain-milling sub-sectors. Strong growth was also recorded in cement, textiles, clothing and footwear.

Table 1 - **Demand Composition**

	Percentage of GDP (current prices)		Percentage changes, volume			Contribution to real GDP growth		
	1999	2006	2007(e)	2008(p)	2009(p)	2007(e)	2008(p)	2009(p)
Gross capital formation	**15.6**	**19.4**	**10.1**	**5.7**	**10.0**	**2.3**	**1.3**	**2.4**
Public	4.6	5.0	45.0	7.0	10.0	2.6	0.6	0.8
Private	11.1	14.4	-2.0	5.0	10.0	-0.3	0.8	1.6
Consumption	**89.6**	**93.0**	**4.5**	**3.8**	**4.9**	**4.1**	**3.3**	**4.3**
Public	16.0	16.3	3.9	4.0	3.7	0.6	0.6	0.5
Private	73.6	76.7	4.6	3.7	5.1	3.5	2.8	3.8
External demand	**-5.3**	**-12.4**				**0.2**	**-0.7**	**-0.2**
Exports	21.3	25.1	7.6	1.2	4.0	2.5	0.4	1.3
Imports	-26.6	-37.5	4.9	2.4	3.3	-2.3	-1.1	-1.5
Real GDP growth	-	-	-	-	-	**6.6**	**4.0**	**6.5**

Source: National Bureau of Statistics data; estimates (e) and projections (p) based on authors' calculations.

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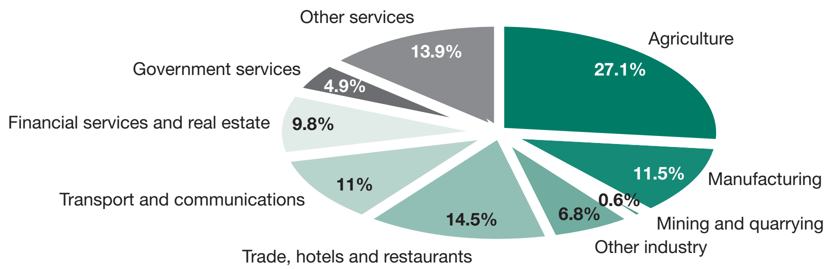
1. Gross investments as a percentage of GDP rose from 18.4 per cent in 2006/07 to 21.6 per cent in 2007/08, of which the share of public investments doubled from 4.2 per cent to 8.2 per cent during the period, while that of private investments declined marginally from 14.2 per cent to 13.2 per cent during the period, as reflected in Table 1.

Figure 2 - **GDP by Sector in 2006** (percentage)



Source: Authors' estimates based on National Bureau of Statistics data.

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Cement consumption, which is a key indicator of activity in the construction sector, is estimated to have increased by 14.1 per cent in 2007, compared to 12.3 per cent in 2006. The growth was mainly caused by increased government investments in infrastructure and the initiation of several Constituency Development Fund (CDF) projects and increased budgetary allocations for road construction, maintenance and rehabilitation activities. Loans and advances from commercial banks to the sector increased by 23.1 per cent in 2007, compared to 28.5 per cent in 2006.

The total electric power generated increased by 8.9 per cent from 4 808.9 million (KWH) in the first ten months of 2006 to 5 236.5 million (KWH) in the first ten months of 2007. Consumption of electricity increased by 8.5 per cent from 3 921.4 million (KWH) in the first ten months of 2006 to 4 253.3 million (KWH) in the first ten months of 2007, in line with increased economic activity. The price of imported crude oil increased by 1.4 per cent from USD 65.7 per barrel in the first ten months of 2006 to USD 66.6 per barrel in the first ten months of 2007.

During the first ten months of 2007, tourist arrivals increased by 13 per cent compared to a similar period in 2006, while earnings rose by 27.6 per cent from USD 688 million to USD 878 million during the same period. This compares with growth of 14.9 per cent in 2006. However, tourist arrivals fell drastically by more than 80 per cent during January 2008, due to the crisis in the country. Hotel bed-night occupancy in the first and second quarters of 2007 increased by 19.6 and 36 per cent respectively, when compared to corresponding periods in 2006. Similarly, visitor arrivals increased by 13 and 15.9 per cent in the first and second quarters of 2007. This growth has been supported in part by increased marketing campaigns and tapping of markets in Eastern Europe and the Asian subcontinent, together with improved diversification strategies.

Growth in the transport and communications sector was driven by road transport and communications, and the continued buoyancy of the tourism sector. In 2007, fuel products transported through the Kenya Pipeline Company (KPC) pipeline system increased by 5.1 per cent, from 3.2 million m^3 in the first ten months of 2006 to 3.3 million m^3 in a similar period of 2007. This compares with growth of 9.2 per cent in 2006. In a similar period, cargo throughput at the Port of Mombasa increased by 9.9 per cent, from 12 million tonnes to 13.1 million tonnes. In the telecommunications sub-sector, the growth momentum continued in 2007 with the mobile subscriber base increasing by 27.4 per cent, from 7.3 million in December 2006 to 9.3 million in July 2007. This compares to 36.5 per cent in 2006. Similarly, fixed telephone lines rose from 286 729 in June 2006 to 297 888 by March 2007, an increase of 3.9 per cent.

Macroeconomic Policies

Fiscal Policy

The government is committed to pursuing prudent fiscal policies over the medium term, focusing on strong revenue collection underpinned by deepening tax administration reforms and modernisation. It plans to contain the growth of total expenditures, thus creating the fiscal space to shift resources from recurrent to capital expenditures. In particular, the government plans to shift resources significantly towards Vision 2030 priority economic and social sectors, and to contain the growth of domestic debt to sustainable levels so as to ensure that private-sector borrowing is not crowded out.

The government budget, which was 24.8 per cent of GDP in 2005/06, is estimated to have declined to 22.9 per cent of GDP in 2006/07, and is projected to rise to 25.6 per cent in 2007/08 (Table 2), mainly due to increased development budget to support the infrastructure development. The overall fiscal balance on a commitment basis (excluding grants) for 2006/07 recorded a deficit equivalent to 1.7 per cent of GDP, against a target deficit of 5.6 per cent of GDP. This compares to a deficit equivalent to 3.3 per cent of GDP in 2005/06. The fiscal balance on a commitment basis, including grants, recorded an estimated surplus equivalent to 0.6 per cent of GDP, against a target deficit equivalent to 3.7 per cent of GDP. Expenditures are projected to be 25.6 per cent and 24.6 per cent of GDP in 2007/08 and 2008/09 respectively, with recurrent expenditures declining and development expenditures increasing, as compared with 2005/06.

The stock of pending bills declined from KES 18.3 billion (Kenyan shillings) in 2003 to KES 9.4 billion by end June 2007. The bulk of pending bills were for recurrent expenditures, accounting for

Table 2 - **Public Finances** (percentage of GDP)

	1998/99	2003/04	2004/05	2005/06	2006/07(e)	2007/08(p)	2008/09(p)
Total revenue and grants[a]	**23.0**	**22.3**	**22.3**	**21.5**	**21.3**	**21.2**	**20.5**
Tax revenue	20.0	19.0	19.2	18.4	18.5	18.0	17.6
Grants	0.6	1.3	1.1	1.3	0.8	1.3	1.0
Total expenditure and net lending[a]	**22.6**	**23.3**	**22.2**	**24.8**	**22.9**	**25.6**	**24.6**
Current expenditure	18.9	20.0	18.9	20.3	18.5	19.5	18.6
Excluding interest	*14.3*	*17.6*	*16.6*	*17.7*	*16.1*	*17.1*	*16.9*
Wages and salaries	7.2	7.9	7.7	7.3	7.0	6.5	6.1
Interest	4.6	2.5	2.2	2.7	2.3	2.4	1.7
Capital expenditure	3.6	3.2	3.3	4.4	4.4	6.0	6.0
Primary balance	**5.0**	**1.5**	**2.3**	**-0.7**	**0.6**	**-2.0**	**-2.6**
Overall balance	**0.4**	**-0.9**	**0.1**	**-3.3**	**-1.7**	**-4.4**	**-4.3**

a. Only major items are reported.
Source: Domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

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57 per cent during the period June 2002 to June 2006, while pending bills for development projects accounted for 43 per cent. The policies being undertaken to reduce the occurrence of pending bills include: implementation of a mandatory accounting system to ensure accurate recording of commitments; identification of the genuine stock of pending bills by the pending bills committee, with a commitment to clear them quickly; and termination of stalled projects that continue to add to the stock of pending bills.

The government wage bill rose from KES 108.7 billion in 2005/06 to KES 128.8 billion in 2006/07, accounting for 32.2 per cent of total revenue. Government policy in the medium term aims to reduce the growth of the wage bill to about 6.7 per cent of GDP by 2008/09, through public-sector management reforms.

Fiscal revenue collection increased from KES 311.3 billion in 2005/06 to KES 379.1 in 2006/07. This is projected to reach KES 487.3 billion in 2008/09. Despite the growth in revenue, performance has been below the targets set for the year by KES 12.9 billion. This under-performance was mainly attributed to lower-than-expected revenue from excise taxes and import duties. Ministerial Appropriation in Aid (AIA) also recorded a shortfall of KES 10.4 billion against the target of KES 41.9 billion. With further reforms, it is expected that revenue collection will be more closely aligned with the set targets.

Despite the steady rise in oil prices, this has had no impact on public finance. Oil dealers are usually very quick to make upwards adjustments of their pump prices, and hence a complete pass-through to the consumer occurs. In a move to address the public concern over the price hikes, parliament passed an Energy Bill (2006) which the government has been reluctant to enforce, since this would amount to a partial retreat from the recent liberalisation of the oil sector. However, the government has embarked on deliberate efforts to increase the number of outlets under the state-owned National Oil Corporation.

In line with the Poverty Reduction Strategy Paper (PRSP), the government identified core poverty projects and programmes in the budget which are given priority and cushioned from budget cuts. These are intended to have a positive impact on the lives of the poor, including: increasing incomes for the poor; improving the quality of life; enhancing security; empowering the poor; improving governance; and promoting equity and equality in society. The overall expenditure on these programmes by the end 2006/07 was KES 50.9 billion.

Kenya has a three-year Medium Term Expenditure Framework (MTEF) in place. The government has implemented an Integrated Financial Management System (IFMIS), and is now in the process of initiating an output-based expenditure programme to complement the MTEF budgeting process.

Monetary Policy

Monetary policy in Kenya is conducted mainly by the Central Bank of Kenya (CBK) in consultation with the monetary policy advisory committee and the Ministry of Finance. However there are plans to harmonise monetary concepts and definitions within the East African Community (EAC) (comprising Kenya, Uganda, Tanzania, Rwanda and Burundi) by the end of 2009. Kenya has already implemented the IMF's Monetary and Financial Statistics (MFS) 2000 manual, and subsequently introduced a parallel run in September 2007 before fully adopting the methodology under the General Data Dissemination System (GDDS) II programme. This is in line with EAC summit recommendation for fast-tracking the EAC towards a customs union, then a monetary union, and eventually a political federation by 2016.

The CBK pursues its monetary policy objectives through open-market operations (using Treasury bills and any other eligible securities to achieve a desired level of money in the economy) and varying the cash reserve requirement (CRR) at the CBK. The CRR has been maintained at 6 per cent of commercial bank deposits since July 2003. The CBK also engages in foreign-exchange market operations, in order to discourage speculation rather than to influence domestic liquidity.

Monetary policy seeks to contain end-period inflation to the government's objective of 5 per cent. In 2007 it aimed to limit the growth in both reserve money and broad money to 12.7 per cent, in line with the estimated growth in real GDP. However, both money supply and reserve money expansion continued to remain well above the desired level, following a significant build-up in the net foreign assets (NFA) and net domestic assets (NDA) of the banking system. Money supply, M3, grew by 18.8 per cent in the year to June 2007, compared with 16.1 per cent in June 2006 — above the target growth of 14 per cent for the June 2007 quarter — while M2 grew by 16 per cent in June 2007. Monetary policy has since been tightened in order to achieve inflation of 5 per cent by the end of June 2008. While there are concerns over the volatility of international oil prices, the stability in the shilling exchange rate (which is expected to be sustained) will help contain inflation pressures, particularly in the transport and energy sectors. So far, there is no evidence that the oil price increase has generated any decrease in reserves. On the contrary, the Kenya shilling has continued to appreciate against the US dollar.

In 2007, the headline inflation rate was 9.8 per cent, compared to 14.5 per cent in 2006. However, the core inflation rate (excluding food and energy) remained close to the 5 per cent target, largely due to prudent fiscal and monetary management and the strengthening of the Kenya shilling against the US dollar. Inflation is projected to rise to 10.1 per cent in 2008 before declining to 7.4 per cent in 2009.

The Central Bank Rate (CBR) was lowered from 10 per cent to 8.75 per cent on 15 June 2007, to align it with other short-term money-market interest rates. There was also a narrowing of interest rate differentials among notes of different maturities. Thus, the interest rate of the 91-day Treasury bill increased during the period January-June 2007, from an average of 5.73 per cent in December 2006 to 7.6 per cent in October 2007. The average 182-day Treasury bill rate, however, declined over the same period, from 8.87 per cent to 7.8 per cent in June 2007. Commercial banks' average lending rates declined from 13.74 per cent in December 2006 to 12.56 per cent in October 2007. The spread between lending and deposit rates declined from 9.63 per cent in December 2006 to 8.53 per cent by October 2007. Interest rates are expected to remain stable in the medium term as they move towards the CBR.

There are potential short-term risks to the outlook for inflation. In particular, further volatility in world crude prices would have an impact on domestic prices through increased energy prices, and through spillover effects on the prices of other goods and services.

External Position

The duty- and quota-free access to EU markets under the Cotonou Agreement lapsed on 31 December 2007. In anticipation, the Customs Union of the East African Community (EAC) and the EU signed an Interim Framework Agreement on 27 November 2007 in Kampala, Uganda. The Agreement is to act as a stepping stone towards an Economic Partnership Agreement (EPA) that will cover trade in goods, market access, development co-operation and fisheries.

The Agreement, to be applied provisionally from 1 January 2008, provides a mechanism for the continuation of negotiations beyond 31 December 2007. This gives the EAC members duty- and quota-free access to the EU market, with transitional arrangements for rice and sugar. It also provides for the liberalisation of 81 per cent of EAC imports from the EU, with a transitional period of 25 years.

In 2007, the current account deficit was estimated at 1.5 per cent of GDP, compared to 2.3 per cent in 2006. This is projected to reach 2.6 per cent of GDP in 2008 before returning to 1.6 per cent in 2009 (Table 3). However, services recorded a surplus in 2007 equivalent of 4.4 per cent of GDP, due to increased

Table 3 - **Current Account** (percentage of GDP)

	1999	2004	2005	2006	2007(e)	2008(p)	2009(p)
Trade balance	-7.6	-10.0	-11.2	-14.3	-12.7	-13.4	-12
Exports of goods (f.o.b.)	13.7	16.7	18.1	15.4	13.6	12.5	11.7
Imports of goods (f.o.b.)	21.3	26.8	29.3	29.7	26.3	25.9	23.7
Services	2.8	3.8	3.9	4.5	4.4	4.3	4.4
Factor income	-1.2	-0.8	-0.6	-0.3	-0.3	-0.3	-0.3
Current transfers	5.3	6.2	6.5	7.8	7.2	6.7	6.2
Current account balance	**-0.7**	**-0.8**	**-1.4**	**-2.3**	**-1.5**	**-3.3**	**-1.6**

Source: Domestic authorities' data; estimates (e) and projections (p) based on authors' calculations.

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earnings from tourism and unilateral private transfers, which also increased during 2007.

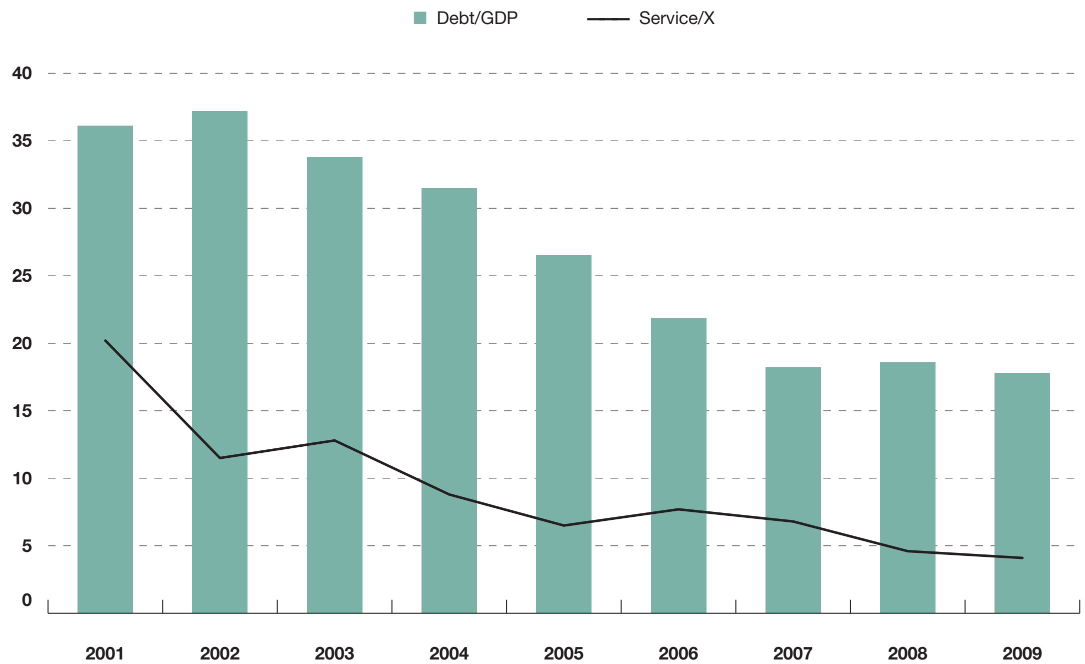
Horticulture, tea, articles of apparel and clothing accessories, and coffee continue to be the leading merchandise export earners, collectively accounting for 53.4 per cent of total domestic export earnings in 2006. Horticultural earnings increased by 9.2 per cent in 2006, while tea earnings increased by 11.7 per cent; coffee earnings increased by 0.8 per cent, and earnings from articles of apparel and clothing accessories — mainly from the Export Processing Zones (EPZ) — by 11.4 per cent. During the year to October 2007, merchandise exports increased by 17.4 per cent compared with the same period in 2006, as a result of the increased export value of coffee, tea, horticulture, oil, manufactured goods and raw materials. Tea, horticulture and coffee collectively accounted for 37 per cent, while manufactured goods accounted for 12.5 per cent of the value of exports, in the year to October 2007.

The value of imports, including machinery and transport equipment, manufactured goods, chemicals and oil, increased by 26.6 per cent during the year to October 2007 compared with a similar period in 2006. Machinery and transport equipment accounted for 32.2 per cent, and petroleum products for 21 per cent, of the total value of merchandise imports.

The capital and financial account recorded a surplus of USD 1 572 million in the year to October in 2007, up from USD 1 153 million in the year to October in 2006. This was mainly driven by increased inflows of capital transfers and direct investment short-term capital.

Kenya's public and publicly guaranteed debt increased from KES 789.1 billion at the end of June 2006 to KES 801.3 billion at the end of June 2007, equivalent to 40 per cent of GDP. This represented an increase of KES 12.2 billion, or growth of 1.5 per cent, during the

Figure 3 - **Stock of Total External Debt** (percentage of GDP) **and Debt Service** (percentage of exports of goods and services)



Source: IMF.

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fiscal year 2006/07. The increase in the stock of debt during the fiscal year was attributed to an increase of KES 46.9 billion in domestic debt, which was partly offset by a decrease of KES 34.7 billion in external debt. However, domestic debt as a percentage of GDP has been consistently on the decline, and stood at 18 and 18.2 per cent at the end of June 2006 and end of June 2007 respectively. The stock of domestic debt in absolute terms increased by 13.1 per cent, from KES 357.8 billion at the end of June 2006 to KES 404.7 billion at the end of June 2007.

Total external debt as a proportion of GDP declined from 21.9 per cent in June 2006 to 18.2 per cent in June 2007. In absolute terms, Kenya's external debt has been on a downward trend since June 2004, due to reduced access to external financing and strengthening of the Kenya shilling. The external debt stock was estimated at USD 6.1 billion at the end of September 2007, which reflected an increase of 2.3 per cent from the June 2007 position of USD 6 billion. Loans from multilateral agencies constituted a larger portion of Kenya's external debt due to their concessionary lending terms (low interest rates and long-term repayment periods). Overall, external debt comprises 60 per cent of multilateral and 35.2 per cent of bilateral, while commercial banks' and export suppliers' credit accounted for 0.1 per cent and 4.7 per cent respectively. Japan is Kenya's leading development partner, as evidenced by Japanese ODA to Kenya amounting to USD 1.1 billion in September 2006.

Structural Issues

Recent Developments

The authorities have continued to make progress in implementing structural reforms, despite delays in passing key legislative reform bills by the last parliament. The Governance Action Plan (GAP) for the Governance Strategy for Building a Prosperous Kenya (GSPK) is being implemented as scheduled, with the enactment of the Miscellaneous Act (which amends various pieces of legislation and contains important governance reforms). The last parliament approved the Political Parties Bill 2007 in September 2007, the enforcement of the Witness Protection Act 2006, and the establishment of a Public Complaints Standing Committee in June 2007 so as to increase transparency and public access to government information. The government continued to deepen public financial management reforms during 2007, while scaling down the role of the state in the economy. The ten targeted benchmarks of the Public Expenditure Management Assessment and Action Plan have been met; also, the risk-based audit approach has been rolled out and the IFMIS is now operational in the headquarters of all 24 ministries. In addition, the Public Procurement Oversight Authority (PPOA) is now operational, as required under the Public Procurement and Disposal Act.

During 2007, the government further moved to improve the business environment in order to enhance private-sector development, by eliminating 205 business licences and simplifying another 371 under the new Licensing Laws (Repeals and Amendment) Act, 2006. The number of licences that have been removed and simplified since 2006 now stands at 315 and 379 respectively, out of a total 1 325. In 2007, Kenya was ranked among the top ten global reformers in the ease of doing business by the World Bank's *Doing Business Report 2008*. In 2007, Kenya was awarded the UN Public Service Award in the category of "Improving Transparency, Accountability and Responsiveness in the Public Service" for introducing comprehensive performance contracts across all cadres in the public service and introducing a requirement that all ministries deliver on services to the public in 100 days. In addition, the Ash Institute for Democratic Governance and Innovation at Harvard University's John F. Kennedy School of Government nominated the Kenyan government for an international award for improved performance in the public service. In September 2007, the Standard and Poor's Ratings Services maintained its sovereign credit rating for Kenya of "B+" for foreign currency and "BB-" for local currency long-term sovereign debt.

In 2005, the government enacted the Privatisation Act to ensure transparency in the privatisation of state-owned enterprises and thereby strengthen accountability. The Act creates an independent Privatisation Commission mandated to oversee the government's divestiture programmes. The Privatisation Commission of Kenya was gazetted in December 2007 with 1 January 2008 as the commencement date of the Act. This brings to an end a protracted controversy over the absence of a regulatory framework to oversee the disposal of state-owned enterprises, such as the recent sale of KenGen (Kenya's electricity generating company), Mumias (a sugar-producing company) and the Safaricom Initial Public Offering (IPO)[2], which was rescheduled for early 2008.

In January 2007, the government launched the Kenya Private Sector Development Strategy (PSDS), which set out a road map that would help the country build a strong, thriving private sector over the next five years. The PSDS seeks to increase the co-ordination of activities across the government, and to improve the harmonisation of activities by the government, development partners, the private sector and civil society through appropriate institutional and management structures. A PSDS Implementation Plan (PIP) has been developed; this focuses on: fast-tracking existing and new government initiatives by addressing constraints to public services delivery through specific catalytic activities; supporting the accelerated implementation of macroeconomic reforms in key areas such as trade, deregulation and access to finance; and funding specific initiatives to fast-track the growth and competitiveness of small and medium-sized enterprises (SMEs).

In 2007, the government continued to rehabilitate and expand investment in physical infrastructure in order to support the productive sectors and thereby contribute to poverty reduction. Infrastructure — comprising roads and public works; water and sanitation; energy; transport and housing; and also, strengthening local government — is envisaged as a key pillar for economic growth in Vision 2030.

The Public Procurement and Disposal Act, 2005 became operational on January 1, 2007. The Act creates an autonomous Public Procurement Oversight Authority (PPOA). The PPOA is expected to make the public procurement system in the country more transparent, ensure accountability and reduce wastage of public resources.

Key financial-sector reforms include: enacting the Banking (Amendment) Act, 2006, ceding supervisory powers to the CBK and capping accrual interest on non-performing loans; the Insurance (Amendment) Act, 2006; and amendments in the Finance Act, 2006. Following the enactment of the Microfinance Act, 2006, the CBK has prepared a set of prudential regulations that will implement the Act once the effective date is gazetted by the Minister, taking into consideration the unique features and characteristics of microfinance, as distinct from traditional commercial banking. These regulations have been based on international best-practice recommendations. The Insurance (Amendment) Act, 2006 has provided for the establishment of an Independent Insurance Regulatory Authority that will further strengthen regulation of the insurance industry and improve insurance penetration.

The Nairobi Stock Exchange (NSE) is now well established, with 20 member firms. The number of listed firms on the NSE is currently 58, out of which 52 are equities and 6 are corporate bonds.

The value of private pension funds grew by 21.6 per cent to KES 148 642 billion in 2006. During this period, the value of assets held by the National Social Security Fund (NSSF) also increased, to KES 63 661 billion. The growing size of the pension funds along with their preference for investing in long-term instruments has enabled the government to launch longer-term bonds. It is expected that pension funds will invest significant amounts in 15-year treasury bonds launched in November 2007.

The National Environment Management Authority (NEMA) was established under the Environment Management and Co-ordination Act (EMCA) of 1999, which came into force on

2. The government plans to sell 25 per cent of its 60 per cent stake in Safaricom, in a transaction estimated to be worth KES 34 billion.

14 January 2000. The Authority is mandated by the Act to exercise general supervision and co-ordination over all matters relating to the environment, and to be the principal instrument of the government in the implementation of all environmental policies. At the beginning of 2005, NEMA issued a requirement that all industrial establishments, including existing enterprises, have to carry out an Environmental Impact Assessment.

There have been a number of recent reforms in the agricultural sector. The dairy industry sub-sector and its management have been restructured. This has seen milk delivery go up by 125 per cent between 2001 and 2005, while the price increased by over 100 per cent over the same period. The regulatory capacity of the Coffee Board has also been enhanced. Direct sales of coffee are now allowed alongside the auction system. Coffee co-operative debts worth KES 4.2 billion were written off by the government, and rice irrigation schemes in western Kenya and coastal regions were rehabilitated. Governance in the co-operative sector has been improved, thus making credit more easily accessible to farmers. A draft Savings and Credit Co-operatives (SACCOs) Regulatory Bill is expected to be tabled in parliament and be enacted into a SACCO Regulatory Framework. Finally, a draft land policy was completed in 2006, and comments from different stakeholders are now being incorporated in the document.

Technical and Vocational Skills Development

The government has developed a national policy on Technical and Vocational Education and Training (TVET) which was formalised in Sessional Paper No. 1 of 2005, *Policy Framework for Education, Training and Research.* Among other things, the government has embarked on gender parity in TVET promotion activities and is committed to increasing female enrolment from the current 5 per cent to 30 per cent.

Entrepreneurship has been integrated with TVET to the extent that it is now being referred to as TIVET (Technical, Industrial, Vocational and Entrepreneurship training). The current reforms being undertaken aim at improving skills to meet the needs of the economy in line with the changes in technology.

There are four national polytechnics located in Nairobi, Kisumu, Mombasa and Eldoret and one Technical Teachers Training College located in Nairobi that offer technical education. The national polytechnics offer courses ranging from certificate to higher national diplomas, while those in Mombasa and Nairobi have been empowered to offer technology degrees. Other TVETs, which are spread across the country include: 17 institutes of technology; 21 technical training institutes; over 600 youth polytechnics; and close to 1 000 commercial colleges. Altogether, there were 71 167 students enrolled in TVET programmes in 2006, out of which 4.87 per cent were female.

Although quality assurance systems are inadequate, the legal framework is presently being developed by the government. One of the quality assurance processes in place is that examinations are conducted by one central examining body (Kenya National Examinations Council). In addition, a student attached to an employer is usually placed under a knowledgeable supervisor who has to give an independent report on that student's abilities.

A total of 123 institutions have been participating in the industrial attachment pilot project. To date, 2 012 students have participated, out of which 313 have been university students, 1 699 from other training institutions, and 23 lecturers/instructors from technical training institutions. Extensive sensitisation has been undertaken with over 350 employers, of whom 136 are participating in the pilot project. Standardised guidelines plus monitoring and evaluation instruments for industrial attachment have been developed and are in use. A National Industrial Training Council approves a token financial support to the attached students under the pilot project.

The country largely focuses on certificates and diplomas offered at the technical institutes. However, the existing capacity at the various levels of youth polytechnics, middle-level colleges and universities is inadequate to absorb most of the primary and secondary school graduates. There is need for skills development for these graduates through a well-harmonised, flexible and demand-driven TIVET system to meet the market demand.

Important skills shortages exist due to multiple deficiencies of the TVET system, including: inflexible TVET curricula; mismatch of skills learned and those demanded by industry; inadequate mechanisms for quality assurance; inadequate physical facilities for training, coupled with a lack of sufficient modern equipment; expensive training materials and textbooks; and low participation of the private sector in curriculum design. The higher up one goes in the hierarchy of technical-training levels, the less one finds emphasis on manipulative and practical skills. TVET systems do respond considerably to the overwhelming skills-training needs of the informal economy: apprenticeship is practised on a large scale, especially in urban areas for self-employment.

The TVET investment programmes are managed by steering committees under the Director of Technical Education. Priorities are set for the period 2005/06 financial year through 2009/10, with a total investment of about KES 2 747 billion, in terms of new students, equipment, tools, upgrading, rehabilitation, and maintenance of existing structures and equipment. The main actors in financing are the government, private-sector non-governmental organisations (NGOs), individuals, and foreign governments and agencies.

TVET financing is mainly through training levy and state budget. The TVET institutions are financed in part by parent-teacher associations (PTA) through annual PTA subscription fees. For its part, the government supports the teachers' monthly salaries, while support staff depend on the fees paid by students for their pay. The institutions can also meet capital expenditures through grants and funding by the government or donors. The funds acquired in this case can be for specific projects, meeting budgetary deficits or for giving bursaries to needy students. Real public and private/donor expenditures excluding operational costs on education and training have increased strongly over the last five years (Table 4). However, in 2006/07,

Table 4 - **TVET Real Public and Private/Donor Expenditure 2002/03-2006/07**
(million KES)

Financial Year	2002/03	2003/04	2004/05	2005/06	2006/07
Public	260	300	350	405	465
Private	100	150	205	260	304

Source: Domestic authorities' data.

StatLink http://dx.doi.org/10.1787/323382868640

allocation to TVET accounted for 0.7 per cent of the total budget and 2.7 per cent of the education budget.

The lessons learned from an assessment of the existing TVET system are that existing capacity and capability in middle-level colleges and youth polytechnics are inadequate to absorb the primary and secondary school graduates who are left out of the universities or colleges. The implementation of Free Primary Education (FPE) has exerted great pressure on the existing facilities by producing a large number of primary graduates prepared to move into the TVET system. These, and other deficiencies described above, are challenges that require to be addressed.

Political Context

The ruling party National Rainbow Coalition (NARC) and the former ruling party, Kenya African National Union (KANU) disintegrated further in 2007, leading to the formation of the Party of National Unity (PNU), the Orange Democratic Movement (ODM) and ODM-Kenya. The original ODM campaigned against the proposed new constitution, and the government side lost the constitutional referendum in the November 2005 referendum. During the December 2007 general elections, ODM had Raila Odinga as its presidential candidate while ODM-Kenya had Kalonzo Musyoka, both of whom served as cabinet ministers under President Kibaki. President Mwai Kibaki ran for a re-election on a PNU ticket. PNU affiliate parties include KANU, Safina, Democratic Party of Kenya (DP) and NARC-Kenya among others. The Leader of the Official Opposition during the ninth parliament, Uhuru Kenyatta, and the former President, Daniel Arap Moi, supported the incumbent President, Mwai Kibaki for re-election.

General elections in Kenya are held every five years for the Presidential, Parliamentary and Civic positions. The 27 December 2007 elections attracted the highest number of parliamentary aspirants, with 2 548 candidates vying for the 210 parliamentary seats, compared to 1 033 in 2002, and 15 332 civic candidates contesting 2 486 seats. The elections also attracted the largest number of women candidates, with 269 seeking parliamentary seats, compared to 44 in the 2002 General Elections, while another 1 478 vied for civic seats. Nine parties fielded presidential candidates, including the front-runners, President Kibaki (PNU), Raila Odinga (ODM) and Kalonzo Musyoka (ODM-Kenya). A record 108 political parties sponsored candidates to vie for parliamentary seats, while 117 parties fielded civic candidates. At the constituency level, some seats had as high as 33 parliamentary candidates; there were very few seats with only two or a very small number of candidates.The Electoral Commission of Kenya (ECK) accredited 4 000 observers and 2 000 local and foreign media representatives.

The 27 December 2007 elections had a voter turnout of 70.4 per cent of the 14 044 959 registered voters. The polls were closely contested, with Mwai Kibaki of PNU garnering 4 584 721 votes (47 per cent), and his closest challenger Raila Odinga (ODM) garnering 4 352 993 (44 per cent), while Mr. Musyoka had 879 903 (8.9 per cent) of the total votes cast. However, the credibility of the presidential-vote tallying was described as questionable by both domestic and international observers, with violent protests from the ODM supporters. The outcome of the presidential election sparked widespread and ethnically motivated violence resulting in over 1 000 deaths, more than 300 000 people displaced, and widespread destruction of property. The political crisis could drive an estimated 2 million Kenyans into poverty, reversing the gains made over the last few years, and could have an impact on business confidence if this political stalemate is not resolved. The African Union has appointed a team of eminent African persons as mediators, led by the former UN Secretary General Kofi Annan and assisted by former President Benjamin Mkapa of Tanzania and former First Lady Graça Machel of South Africa, to help solve the political crisis arising from the presidential election results dispute. Together with government and opposition representatives, they have constituted a Kenya National Dialogue and Reconciliation Team to resolve the crisis in the country.

The new parliament has also the highest number of women legislators — 15 in total — since independence. The poll's outcome saw over 60 per cent of the last parliament's members voted out, including 20 cabinet ministers and several seasoned politicians. The ODM emerged stronger, with 99 seats, while PNU had 43 seats, ODM-K 16 seats and KANU 14 seats. The opposition ODM and its affiliates have 104 seats, while PNU and government-affiliate parties have 103 seats. President Kibaki announced his appointment of Raila Odinga as Prime Minister of a coalition goverment on 13 April 2008. The new goverment is expected to put an end to the ongoing crisis.

To accelerate and deepen the reform agenda in the areas of governance and anti-corruption, the government developed a Governance Strategy together with its Action Plan, which sets out time-bound, specific and prioritised anti-corruption interventions in the broad areas of: prevention; investigation and recovery of corruptly acquired assets; strengthening prosecutorial capacity; and improving governance in priority sectors. The implementation of these measures is expected to result in a measurable improvement in the fight against corruption in the short- and medium-term. The Sexual Offences Act, 2006 was also enacted, and a convention to eliminate gender violence ratified.

Social Context and Human Resources Development

Besides the existing devolution systems such as the Constituency Development Fund (CDF), Local Authority Transfer Fund (LATF), Constituency Bursary Fund, and the Youth Enterprise Fund (YDF) aimed at generating youth self-employment, a Women's Enterprise Development Fund (WEDF) was established in 2007. The WEDF, amounting to KES 1 billion in 2007/08, seeks to empower women at the constituency level by way of facilitating enterprise development, and is to be tripled to KES 3 billion in 2008/09. The WEDF is to be channelled through 12 selected microfinancial institutions, while the Fund's committees have been set at the constituency level.

The government has successfully implemented a Free Primary Education (FPE) Programme and has taken measures to offer free tuition to secondary school students, beginning in 2008. Efforts are also being made to recruit more teachers so as to improve on the teacher pupil ratio. Budgetary allocations to the health sector have been substantially increased, since the government provides free antiretroviral drugs in hospitals throughout the country as part of the strategy of dealing with HIV/AIDS. As part of a "Marshall Plan" for the Arid and Semi-Arid Lands (ASALs), the government injected KES 11 billion for the drilling of boreholes and the rehabilitation of the Kenya Meat Commission, among other targeted policy interventions.

The government has increased investments in human capital development by 16.5 per cent, targeting education and health, to KES 147.6 billion in 2006/07, equivalent to 8.99 per cent of GDP. The FPE programme has improved access to primary education by 25.9 per cent, from a gross enrolment of 6 062.9 thousand in 2002 to 7 632.2 thousand in 2006. According to domestic sources both Gross Enrolment Rate (GER) and Net Enrolment Rate (NER) increased, from 107.2 per cent and 83.2 per cent in 2005 to 107.4 per cent and 84.2 per cent in 2006 respectively. Enrolment in secondary schools increased by 10.3 per cent, from 934.1 thousand in 2005 to 1 030.1 thousand in 2006. Participation at secondary-school level is still low, with GER and NER estimated at 32.4 per cent and 23.2 per cent in 2006 respectively. Enrolment in primary teacher-training colleges expanded marginally, to 17.7 thousand in 2006. Universities registered a 21.6 per cent increase in the student population, from 92.3 thousand in 2005 to 112.2 thousand in 2006. The number of educational institutions increased by 1 575 to 57 662 in 2006, mainly as a result of an increase of 1 078 pre-primary units and 476 primary schools.

Gross total allocation to the education sector increased by 18.8 per cent, from KES 92.4 billion in 2005/06 to KES 109.8 billion in 2006/07, equivalent to 6.69 per cent of GDP. Development expenditure on primary education increased almost fivefold, from KES 1.3 billion in 2005/06 to KES 6.4 billion in 2006/07. Technical and teacher education development expenditures declined from KES 185 million and KES 143.5 million in 2005/06 to KES 85 million and KES 50 million in 2006/07 respectively. Higher education development expenditure is expected to increase by 35.6 per cent, to KES 661.5 million in 2006/07.

The number of health facilities expanded by 5.3 per cent from 4 912 in 2005 to 5 170 in 2006, while that of registered medical personnel increased marginally from 65 914 in 2005 to 67 126 in 2006. The full immunisation coverage rate of children under one year improved from 63 per cent recorded in 2005 to over 70 per cent in 2006, following sustained national immunisation campaigns. Over 1 000 dispensaries have been built countrywide. Budgetary allocation for drugs has also increased, while over 4 080 additional health personnel have been deployed to rural and needy areas to scale up health services. In addition, the government has improved referral services by increasing the number of ambulances, and has also implemented financial management reforms to improve efficiency and service delivery countrywide.

Other measures undertaken include the provision of over 202 million treated mosquito nets and indoor residue spray campaigns. The training of community workers, and information, education and communication campaigns have also assisted in creating awareness. In 2005/06, the government introduced a new treatment policy on malaria, using Artemisinin-based Combination Therapy (ACT) to address the problem of resistance to sulphadoxine-pyremethamine.

Co-ordination in HIV/AIDS efforts resulted in a 50 per cent reduction in the prevalence rate from 13 per cent in 2001 to 6.7 per cent in 2003, with awareness at 98 per cent. The introduction of Voluntary Counselling and Testing (VCT) sites and centres has increased considerably, from 3 in 2000 to 105 in 2002 and then to over 700 VCT sites in 2005, spread across the country. In an effort to contain the disease, in June 2006, the government adopted a policy to give antiretrovirals (ARVs) for free. Current estimates indicate that HIV/AIDS infections have dropped from 5.9 per cent in 2005 to 5.1 per cent in 2006. The number of patients on ARV therapy has increased to 165 000 from 3 000 four years ago. However, about 430 000 adults and 23 000 children still require ARVs. In addition, 1.5 million pregnant women need counselling each year, while another 68 000 require treatment to prevent mother-to-child transmission. In 2007, the government budgeted to spend KES 500 million to purchase ARVs. However, there are still challenges that need to be addressed, including: improving the quality of life of those infected; investigating the socio-economic impact of the disease; and continued loss of life due to HIV–related illnesses and the increasing number of orphans.

Early in 2007, the country experienced a continuation of the Rift Valley Fever outbreak, mainly in the pastoral communities of North Eastern Kenya, although few isolated cases were reported in other parts of the country. There were also a few cases of cholera reported in parts of Nyanza Province.

The improved performance in the various sectors of the Kenyan economy is reflected in the creation of more jobs. Overall, the economy generated 496 000 jobs in 2006, equivalent to an improvement of 5.7 per cent over 2005 levels. A large proportion of this labour force was absorbed in the informal sector, which generated 418 000 jobs. The government continued to focus on the Micro and Small Enterprise (MSE) sub-sector for the creation of employment opportunities and poverty reduction. Labour laws have been reviewed for drafting into relevant bills, while the Employment Policy was approved by the Cabinet and passed on to parliament for legislation. The Cabinet has also approved the establishment of a National Employment Council to monitor employment trends and give advice. For the Jua Kali sub-sector, 60 Micro and Small Enterprise worksites have been rehabilitated across the country.