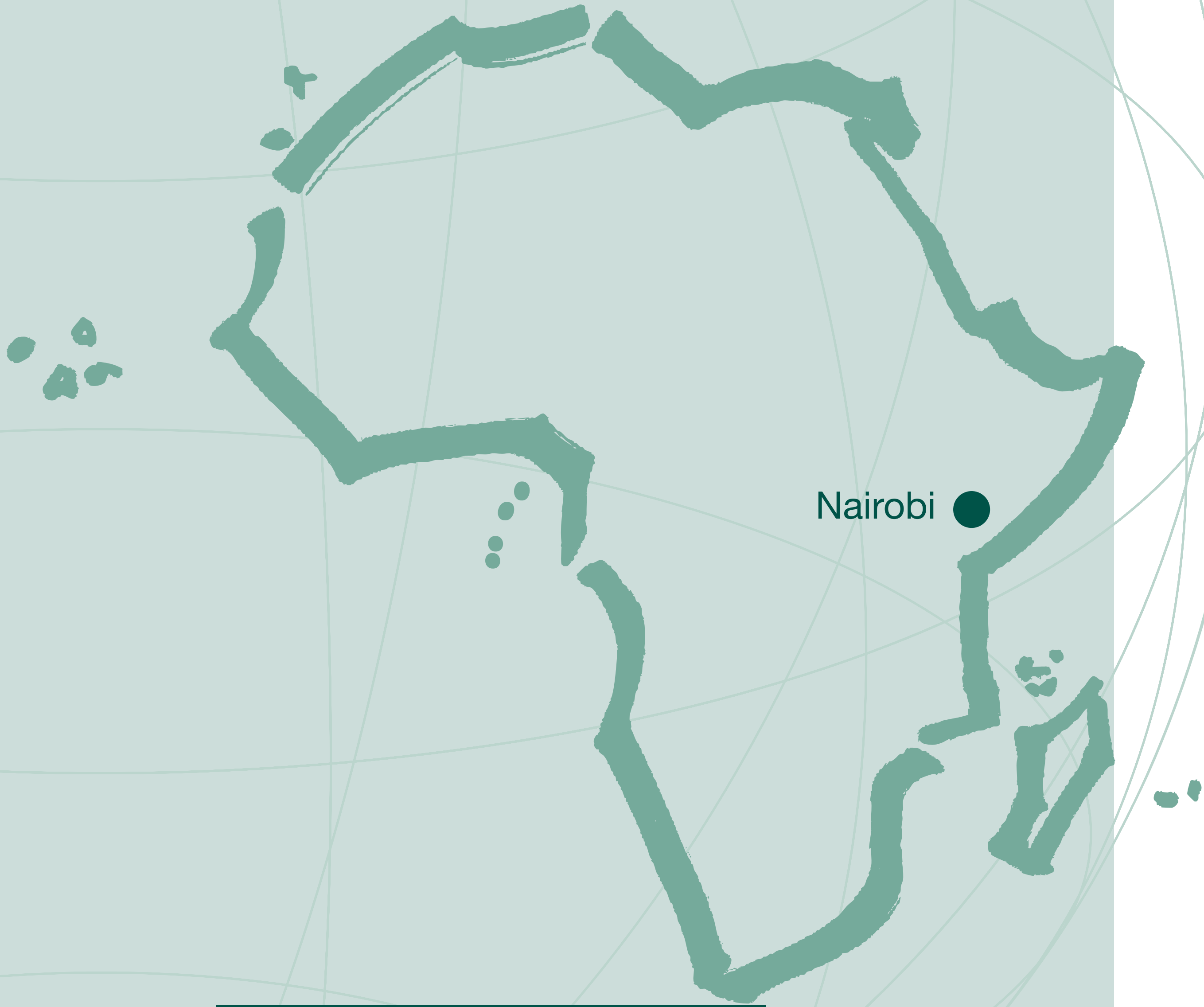
# Kenya




**key figures**

| | |
|---|---|
| • Land area, thousands of $km^2$ | 580 |
| • Population, thousands (2005) | 34 256 |
| • GDP per capita, $ PPP valuation (2005) | 1 144 |
| • Life expectancy (2000-2005) | 47 |
| • Illiteracy rate (2005) | 13.1 |

All tables and graphs in this section are available in Excel format at:
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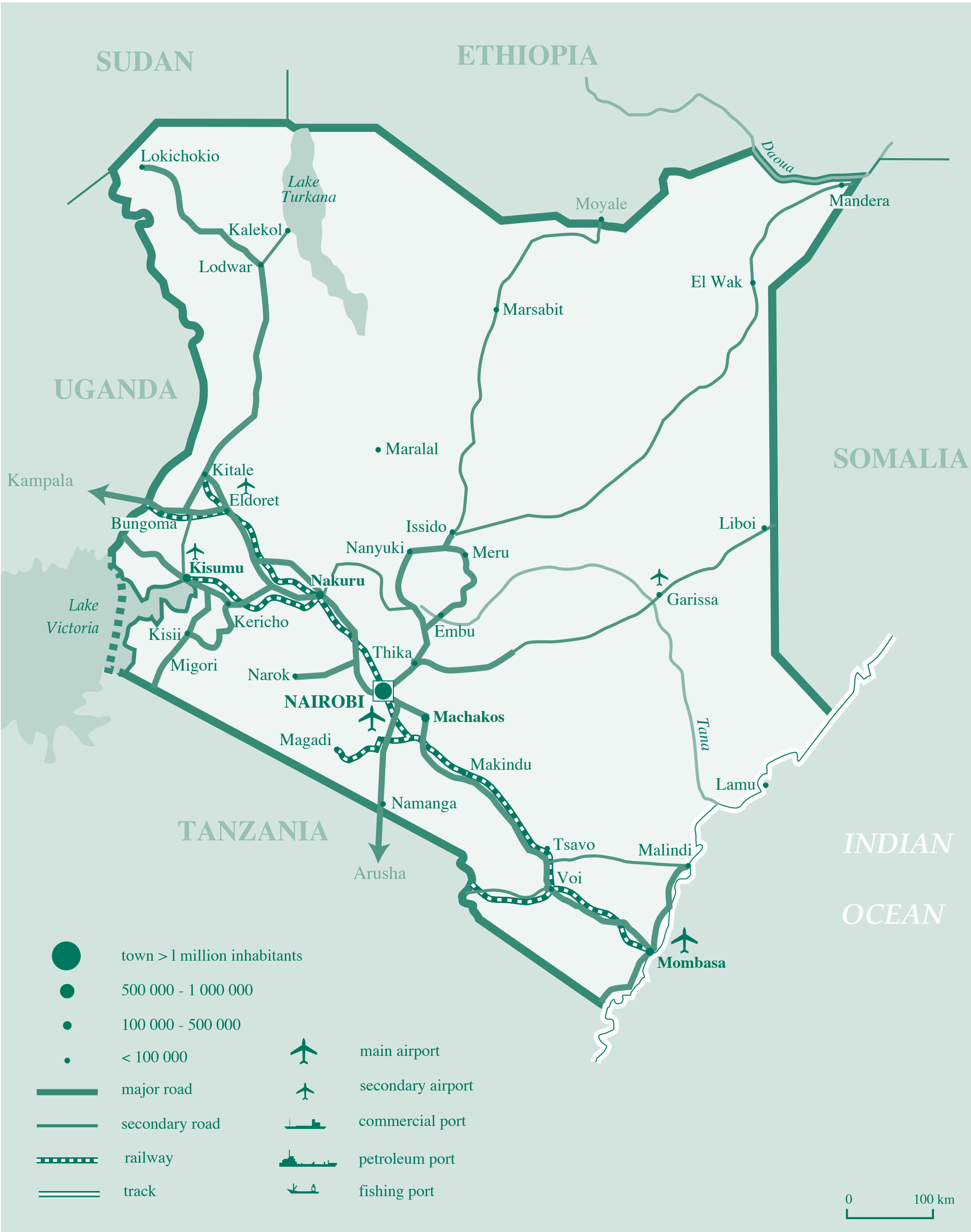
# Kenya



# Kenya

The Kenyan economy has begun to exhibit accelerating economic growth after reversing the poor performance of the last decade in 2003. Real GDP growth rose to 4.3 per cent in 2004 from 2.8 per cent in the preceding year in spite of a resurgence of drought that negatively affected the agricultural sector. Other sectors, especially transport and communications and manufacturing, have shown signs of renewed growth in response to new incentive structures put in place by the government. Similarly, tourism has continued to recover from the adverse effects of terrorism.

While fiscal reform is by no means complete, reforms in tax administration have begun to yield increasing domestic revenues. The government's expenditure management programme, however, continues to suffer from the huge public sector wage bill. The monetary authorities have achieved some success in reducing the growth of monetary aggregates. The impact of this on inflation has been minimal with the rate of inflation maintaining an upward trend as a result of high oil prices and drought-related shortages of some food staples. Interest rates have also risen in line with inflation as is to be expected. Nonetheless, the foreign exchange market has remained calm since the IMF gave a positive assessment of the economy in September 2004 which reduced the run on the Kenyan shilling. Kenya's external trade balance has deteriorated, in spite of a resurgence in exports, mainly as a result of the high oil price.

**Stronger adherence to structural reforms is necessary if the current upswing based on improved economic management is to be sustained.**

The government has combined its programme of economic recovery with steps to improve governance, yet strife within the government itself is affecting the country's democratic dispensation negatively. Kenya's structural reforms remain slow with several aspects of the reform process delayed by government inertia.



Economic performance continues to be hampered by the poor transport infrastructure which has deteriorated significantly in the last decade. The government's concerted effort at rehabilitating transport infrastructure will need to address the poor performance of the public enterprises that manage the networks

Figure 1 - **Real GDP Growth and Per Capita GDP**
($ PPP at current prices)


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

and also mobilise adequate resources for maintenance, rehabilitation, construction and expansion of the infrastructure itself.

## Recent Economic Developments

In 2004, in spite of the negative effects of a resurgence of drought, the high price of oil and a sharp deterioration in the terms of trade, real GDP growth rose to 4.3 per cent from 2.8 per cent in 2003. The economy has continued to improve with real GDP growth estimated at about 5 per cent in 2005, the highest level achieved in several years, mainly driven by private and public sector investment. The improving economic performance is also due in part to sound economic management. The main sectors contributing to the improving growth performance include tourism and transport and communications. The economy's performance is also underpinned by recovery in manufacturing, trade and building and construction.



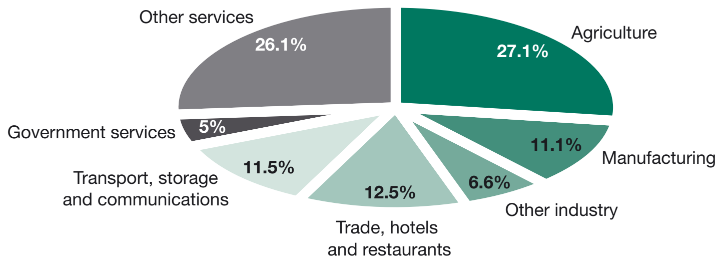
Agriculture remains a major sector in the Kenyan economy though its performance has been subdued in the last three years. In 2004, the agricultural sector contributed about 23.7 per cent of GDP. Growth of the sector decelerated from 2.7 per cent in 2003 to 1.4 per cent in 2004 owing largely to drought that affected maize, coffee and pyrethrum production. With near to normal rains in some parts of the country during 2005, the sector's performance improved as output growth reached an estimated 2.5 per cent, with output expanding mainly in wheat, tea, horticulture, sisal, sugar cane, cotton and rice. In 2005, the agricultural sector also benefited from tax concessions and other incentives introduced by the government during the year. These included increased budgetary allocations for credit facilities to farmers, through the Agricultural Finance Corporation, and targeted spending to boost cotton production. In addition, the government removed import duties for some categories of agricultural equipment. The production of tea benefited from the resolution of a trade dispute between Kenya and Pakistan, a major importer of Kenyan tea. Furthermore, the amendment of the Coffee Act to allow direct sales of coffee outside the auction system seems to have provided an incentive to boost coffee output. Nevertheless, in the medium to long term, the coffee sub-sector can only be restored to profitability by a reversal of the low prices due to the glut in international markets. Also, major restructuring, including putting an end to the persistent mismanagement of the coffee co-operatives, would provide an incentive to some farmers to return to coffee production.

The government has introduced tax incentives in the past three years in an effort to promote industrial growth. These incentives include waivers of import duties on some categories of capital goods and increasing the investment allowance from 60 per cent to 100 per cent. In 2004/2005, the government further abolished some 17 trading licences to simplify the licensing regime and reduce the cost of doing business. Similarly, the harmonisation of tax regimes across the East African Community has been expected to boost industrial growth in Kenya.

The manufacturing sector appears to be responding positively to these incentives as well as to rising domestic and external demand. In 2004/05, manufacturing output increased significantly by 4.1 per cent compared with 2.7 per cent in the preceding year. Major output expansions were recorded in cigarettes, beer, soda ash, processed milk and cement in response to increased domestic demand. Manufacturing output also gained from increased trade with Uganda, Tanzania and the Common Market for East and South African (COMESA) region, especially in agro-industrial products, plastics and engineering goods. The textile sub-sector also recorded significant expansion, especially within the Export Processing Zones, owing to increased exports to the United States under the African Growth and Opportunities Act (AGOA).

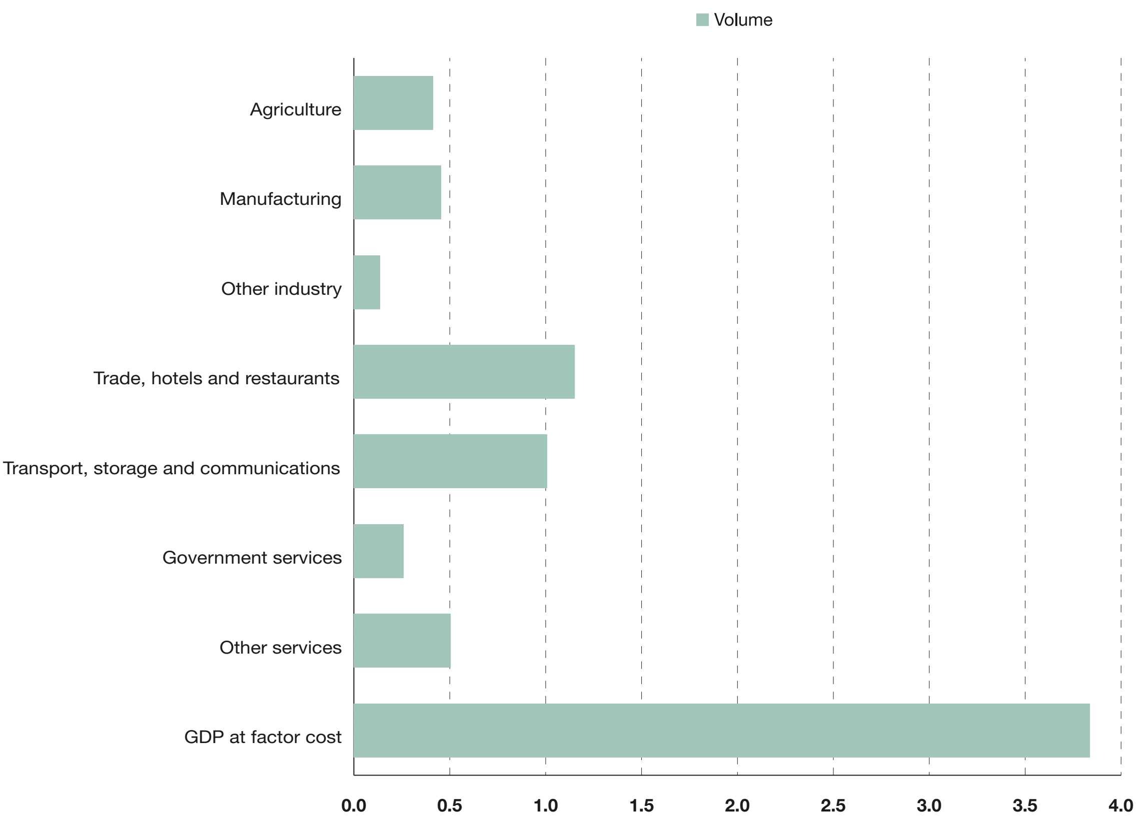
Manufacturing output is anticipated to expand further in response to increasing demand for Kenyan products from Sudan and Somalia following the recent end of civil war in both southern Sudan and Somalia. Kenyan manufacturers, however, continue to face major obstacles, particularly the high cost of power, the slow progress in rehabilitating critical transport infrastructure

Figure 2 - **GDP by Sector in 2004** (percentage)




**Source:** Authors' estimates based on domestic authorities data.

Figure 3 - **Sectoral Contribution to GDP Growth in 2004** (percentage)




**Source:** Authors' estimates based on domestic authorities data.



such as roads and railways and the lengthy customs clearing procedures at the Port of Mombasa. On the one hand, until the ongoing Sondu Miriu Hydro-power plant and the Olkaria Geothermal extension projects are completed it is rather difficult to anticipate any increase in electricity generation sufficient to keep pace with the growing energy demand. On the other hand, the recent granting of concessions to private South African operators to manage the Kenya and Uganda Railways is likely to improve the pace of cargo handling especially from the Port of Mombasa.

The services sector continues to be the mainstay of the Kenyan economy accounting for 60 per cent of total GDP in 2004 with a similar contribution estimated in 2005. Tourism, the main service industry, exhibited rapid growth in 2004 and 2005 as it continues to recover from the adverse effects of terrorism and tribal clashes in tourist areas. In 2004, the government strengthened the Tourist Police Unit to improve security in tourist areas. Also, following the reversal of negative travel advisories by the United States and the United Kingdom, tourist numbers from these countries rose significantly. Furthermore, Kenya appears to be attracting increasing numbers of tourists from non-traditional markets such as China, Japan and India following the government's campaign in those countries. In addition, the government's effort in broadening tourism offerings, by opening up new circuits in the western and northern parts of the country to complement the traditional beach and wildlife areas, appeared to have had some success. Tourist arrivals rose by nearly 19 per cent in 2004 and are estimated to have increased by 30 per cent in 2005. Tourism receipts increased by 51.9 per cent in 2004, implying increased spending in real terms per tourist given the relative low rate of inflation in the country.

The transport and communications sector has remained one of the fastest growing sectors of the Kenyan economy since 2000. In 2004, the sector contributed about 10.3 per cent to GDP exhibiting a growth rate of 8 per cent. A similar performance is expected in 2005. Expansion in the sector has followed extensive investment in telecommunications, particularly in mobile phone services, internet services provision and radio and television operations. These have generated many new support businesses, including public mobile pay phones commonly referred to as *simu ya jamii,* and increased numbers of subscribers, in addition to the enlarged geographical coverage. Growth in the telecommunications sector is exemplified by the more than doubling of mobile phone subscribers from about 2.2 million in 2004 to 4.6 million in 2005.

Table 1 - **Demand Composition** (percentage of GDP)

| | 1997 | 2002 | 2003 | 2004 | 2005(e) | 2006(p) | 2007(p) |
|---|---|---|---|---|---|---|---|
| **Gross capital formation** | **15.1** | **16.3** | **17.4** | **18.2** | **19.3** | **20.6** | **21.0** |
| Public | 5.4 | 4.3 | 4.2 | 4.0 | 4.5 | 4.8 | 4.9 |
| Private | 9.7 | 12.0 | 13.2 | 14.2 | 14.8 | 15.8 | 16.0 |
| **Consumption** | **91.0** | **90.8** | **89.6** | **90.9** | **87.8** | **85.8** | **84.2** |
| Public | 15.5 | 16.7 | 17.8 | 17.0 | 16.4 | 15.9 | 15.1 |
| Private | 75.5 | 74.1 | 71.8 | 74.0 | 71.4 | 69.9 | 69.1 |
| **External sector** | **-6.2** | **-7.1** | **-7.0** | **-9.1** | **-7.1** | **-6.4** | **-5.2** |
| Exports | 22.7 | 24.3 | 24.6 | 28.0 | 28.4 | 27.4 | 26.0 |
| Imports | -28.8 | -31.4 | -31.6 | -37.1 | -35.5 | -33.9 | -31.2 |

**Source:** Authors' estimates and projections based on IMF data.



In sharp contrast, poor performance continues to persist in fixed-line telephone services with declining connections leading to tele-density (telephones per 100 persons) falling from 1 in 2003 to 0.9 in 2004. The decline partly reflected inefficiencies of Telkom Kenya, the monopoly provider of fixed-line services. It is noteworthy, nonetheless, that Telkom Kenya upgraded its services with the introduction of CDMA wireless service in parts of the country to improve efficiency in 2005. The transport sub-sector gained from new investments in major projects including the Northern Corridor highway and the government's Roads 2000 programme which was implemented in 34 districts in 2004 and 2005. Kenya's new road transport rules and regulations introduced in 2004 also encouraged the private passenger transport business leading to a substantial increase in newly registered private passenger vehicles in 2004 and 2005. Moreover, the granting of concessions to a private South African consortium to manage the Kenya and Uganda railways led to new investment in railways. These developments in various economic sectors also reflected, and sometimes contributed to, an increase in the growth rate of private consumption in both 2004 and 2005. A similar pattern was observed for private investment. A reversal of the fiscal stance from expansionary to restrictive exerted a counter-cycle influence in 2004 but the fiscal position became expansionary once again in 2005. Meanwhile the balance of payments on goods and non-factor services expressed in constant prices worsened in 2004, also dampening growth, but improved somewhat in 2005 reinforcing growth in that year.

## Macroeconomic Policies

In 2004, the government revised the macro-economic framework originally envisaged in the Economic Recovery Strategy (ERS). The revision was necessitated by declining external development assistance, deterioration in the terms of trade and capacity constraints. The revised framework emphasised consolidating and strengthening macroeconomic performance through greater emphasis on promoting national savings to increase national investments.

### *Fiscal Policy*

The government's medium-term fiscal strategy is built around three pillars: *i)* a revenue policy framework that aims at maintaining domestic revenue at above 21 per cent of GDP; *ii)* an expenditure strategy that gradually reduces the level of expenditure to GDP, while allowing for expansion in poverty reduction programmes and capital expenditure; and, *iii)* reducing the budget deficit to less than 3 per cent of GDP. The authorities have been relying on increasing revenue collection by improving the quality of tax administration rather than raising tax rates in order to attain the revenue objective.

The government faces several challenges in implementing its fiscal strategy. These challenges include: *i)* reducing the large variations between budgeted allocations and actual expenditures; *ii)* enhancing the low absorption capacity in the development portion of the budget and reducing the volume of recurrent expenditures in the development budget; *iii)* reducing the high civil service wage bill which amounts to more than 8 per cent of GDP; *iv)* reducing the level of transfers to public enterprises; *v)* providing adequate financial resources for priority programmes; and *vi)* reducing the high levels of expenditure arrears and numbers of stalled projects.

Nonetheless, the government has made some progress towards fiscal objectives. In response to improvements carried out in tax administration, including computerising a number of operations of the Kenya Revenue Authority (KRA) in 2004/05, the declining trend of Kenya's domestic revenue to GDP ratio has been reversed. Also, in 2004/05, the authorities integrated the Income Tax and VAT departments into an integrated Domestic Tax Department and simplified customs processing procedures for imports and exports. Further administrative reform at the KRA, curtailing tax exemptions, and introducing Electronic Tax Registers (ETRs) are being carried out in 2005/06.



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

| | 1996/07 | 2001/02 | 2002/03 | 2003/04 | 2004/05(e) | 2005/06(p) | 2006/07(p) |
|---|---|---|---|---|---|---|---|
| **Total revenue and grants** | **21.3** | **19.4** | **20.3** | **22.2** | **21.9** | **21.8** | **21.7** |
| Tax revenue | 17.7 | 15.8 | 16.4 | 16.7 | 16.0 | 15.7 | 15.6 |
| Grants | 0.8 | 1.1 | 1.5 | 1.0 | 1.3 | 1.4 | 1.4 |
| **Total expenditure and net lending** | **23.6** | **21.5** | **22.7** | **22.0** | **23.7** | **23.1** | **22.6** |
| Current expenditure | 19.5 | 19.0 | 19.6 | 19.3 | 20.3 | 19.4 | 18.7 |
| *Excluding interest* | *14.7* | *16.1* | *16.3* | *17.0* | *18.0* | *17.6* | *17.3* |
| Wages and salaries | 3.6 | 8.0 | 8.2 | 8.4 | 8.5 | 8.1 | 7.7 |
| Interest on public debt | 4.8 | 2.9 | 3.3 | 2.3 | 2.2 | 1.9 | 1.5 |
| Capital expenditure | 3.7 | 2.5 | 3.1 | 2.3 | 3.3 | 3.6 | 3.8 |
| **Primary balance** | **2.5** | **0.7** | **0.9** | **2.6** | **0.5** | **0.5** | **0.6** |
| **Overall balance** | **-2.3** | **-2.1** | **-2.4** | **0.3** | **-1.8** | **-1.3** | **-0.9** |

**Source:** Authors' estimates and projections based on domestic authorities' data.

As a result of the reforms, the domestic revenue to GDP ratio rose from 20.3 per cent in 2002/03 to 21.9 per cent in 2004/05. At the same time spending was restrained to less than the amounts budgeted in the face of delayed disbursement of budgetary support pledged by donors. This tightened fiscal stance in 2004/05 enabled net repayment of domestic debt to the banking sector equal to 0.3 per cent of GDP instead of a programmed domestic borrowing equal to 2.3 per cent of GDP.

### Monetary Policy

Kenya's monetary policy aims at maintaining core inflation below 5 per cent, although this has been difficult to attain. The inflation objective has been pursued by controlling the amount of reserve money, with broad money supply as the intermediate target. In 2005, the monetary authorities were successful in reducing the growth of broad money supply (M3X) from 12.9 per cent in the preceding year to 11.3 per cent. Much of the expansion in the money supply in 2005 was owing to a strong expansion of credit to the private sector, in response to the increase in domestic economic activity.

Inflation has continued to exhibit a rising trend since 2003, when the rate of inflation was 2 per cent, and has remained substantially above the government's target. In 2005, in spite of the slowdown in the rate of expansion of the monetary supply, the average annual rate of inflation rose to an estimated 14 per cent from 11.1 per cent in 2004. The government's difficulty in bringing down inflation is a result of the increase in oil prices and drought-related shortages of food commodities. The government has allowed the prices of oil and food items to adjust fully to market prices with appropriate safety nets to protect the poor.

Interest rates in Kenya have risen in line with inflation. The rate on the benchmark 91-day Treasury bills, which had declined to below 1 per cent in September 2003, rose to about 8 per cent in December 2004 before stabilising at 8.5 per cent in June 2005. The rapid increase in the 91-day Treasury bill rate reflects the expected domestic borrowing required to finance the government's budget in 2005/06.

Kenya maintains a flexible exchange-rate system to complement its trade reforms and to ensure appropriate economic incentives for producers. In nominal terms, the shilling depreciated against the US dollar following fears of increased demand for foreign currency to cover the rising import bill, owing to the increased oil price and food imports to mitigate the supply shortage occasioned by drought and hence speculation that delayed donor inflows for budgetary support would put pressure on the exchange rate. This obliged the central bank to intervene periodically to smooth out volatility. Speculation on the Kenyan shilling eased from September 2004 following a positive assessment of the economy by the IMF. In 2005, the shilling appreciated by 4.9 per cent against the US dollar as a result of strong export receipts and capital inflows in response to the relatively high domestic interest rates.

### External Position

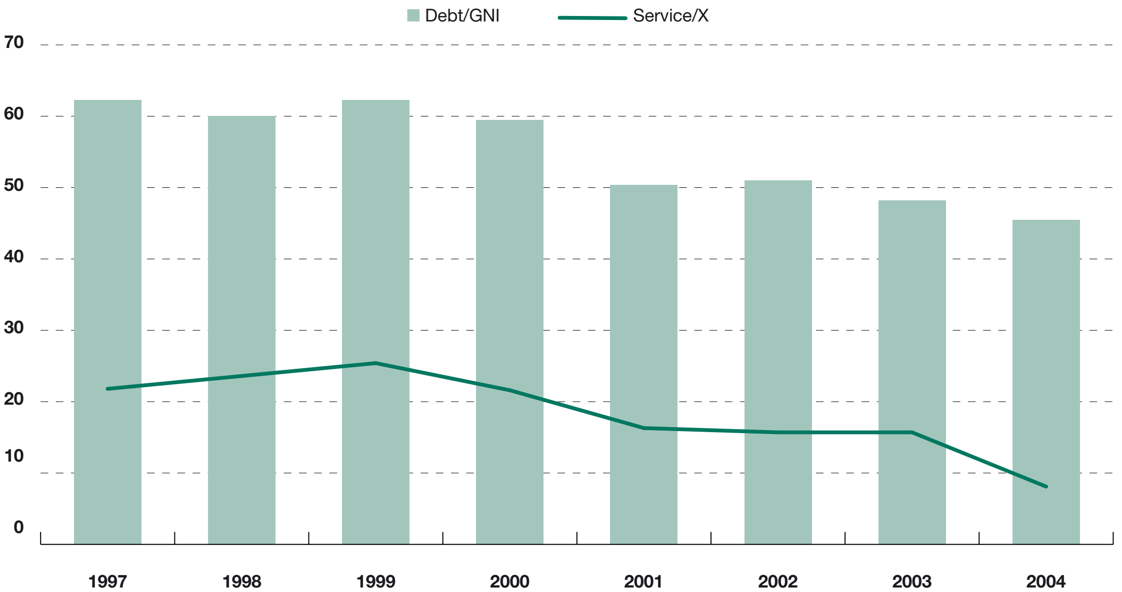
The implementation of the Common External Tariff (CET) binding the maximum tariff rates of

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

| | 1996 | 2001 | 2002 | 2003 | 2004(e) | 2005(p) | 2006(p) |
|---|---|---|---|---|---|---|---|
| Trade balance | -6.8 | -7.6 | -7.6 | -9.9 | -10.5 | -9.8 | -8.4 |
| Exports of goods (f.o.b.) | 15.7 | 16.4 | 16.1 | 16.9 | 15.7 | 15.3 | 14.5 |
| Imports of goods (f.o.b.) | -22.5 | -23.9 | -23.7 | -26.8 | -26.3 | -25.1 | -22.9 |
| Services | 0.7 | 2.5 | 3.2 | 4.2 | | | |
| Factor income | -1.3 | -1.1 | -0.6 | -0.7 | | | |
| Current transfers | 3.9 | 4.8 | 5.4 | 4.0 | | | |
| **Current account balance** | **-3.4** | **-1.3** | **0.5** | **-2.3** | | | |

**Source:** Authors' estimates and projections based on domestic authorities' data.

Figure 4 - **Stock of Total External Debt** (percentage of GNI) **and Debt Service** (percentage of exports of goods and services)




**Source:** IMF and World Bank.



Kenya and its partners in the East African Community (EAC) began in January 2005. Under the CET, the maximum tariff rate of Kenya was lowered from 35 per cent to 25 per cent. The EAC customs union is designed to facilitate increased trade between the member states, while protecting their individual infant industries and attracting FDI.

The current account balance of Kenya has worsened mainly owing to deterioration in the trade account. In 2004, the current account showed a deficit equivalent to 2.3 per cent of GDP thus reversing the small surplus of 0.5 per cent of GDP recorded in 2003. The deficit in 2004 followed deterioration in the trade account as a sharper rise in imports of over 29 per cent outweighed an increase in exports of 17.3 per cent. The rise in imports was owed mainly to increased domestic activity and the higher price of oil. A similar situation was observed in 2005 as exports rose significantly by about 25.4 per cent but was outweighed by a sharper increase in imports of about 40.4 per cent. Kenya's exports in 2005 gained from the resumption of peace in the horn of Africa as well as robust growth in Kenya's COMESA trading partners enhanced export performance. Imports continued to rise in 2005 as a result of the higher oil bill and larger intermediate goods imports in response to increased economic activity.

The outstanding external debt of Kenya stood at $5.1 billion at end-2004. This was equivalent to 31.6 per cent of GDP. The debt service ratio declined from 15.7 per cent in 2003 to 8.1 per cent in 2004 as a result of debt rescheduling and improvements in export performance. In January 2004, the Paris Club of Creditors rescheduled $350 million of arrears and scheduled interest and principal falling due between January 2004 and December 2006. Multilateral organisations continued to be the leading creditors, accounting for 63.4 per cent of the total debt, while bilateral creditors accounted for 31.3 per cent. The remaining 5.3 per cent of the total debt was owed to commercial creditors. On the one hand, Japan remained the major creditor of Kenya amongst the bilateral donors accounting for 40.9 per cent of the total bilateral debt. On the other hand, IDA /IFAD were the leading creditors among the multilateral creditors, accounting for 83.4 per cent.

To ensure a sustainable external debt position, Kenya's debt management strategy focuses on external borrowing on concessional terms, lengthening the term structure and reducing servicing costs, currency diversification to mitigate exchange rate-risk, and refinancing to replace expensive debts with less expensive ones.

## Structural Issues

### *Recent Developments*

Kenya places emphasis on the private sector for creating employment and wealth and reducing the spread of poverty. Towards this end, in 2004 the government began a number of initiatives aimed at supporting the private sector. These include the formulation of a Private Sector Development Strategy (PSDS) to provide the general direction and a medium- to long-term road map for the government to support private sector development. Moreover, an Investment Climate Action Plan (ICAP) was put in place to co-ordinate reform by government ministries and public agencies to provide immediate benefits to private enterprises. The ICAP focuses on a number of priority areas organised into clusters including: controlling rampant and escalating insecurity; addressing the poor state of roads; fast-tracking construction approvals; removing inefficient, unnecessary, unfriendly and cumbersome licensing procedures; improving business registration; improving land administration; updating the Company Law; and improving customs and tax administration.



Nonetheless, many of the government's own actions seem to run counter to its declared intention of fostering private sector development. For example, the failure by parliament to pass the Privatisation Bill since 2003 makes the government's intentions unclear. The government acknowledges publicly that poor performance of key enterprises earmarked for privatisation continue to undermine Kenya's competitiveness. The government appears to favour public-private partnerships and performance contracts in the reform of these enterprises. This approach, however, still requires the enactment of the Privatisation Bill that remains stalled largely as a result of government inertia.

The government continues to make limited progress with other aspects of its public sector reforms that focus on improving public financial and human resource management. The authorities have introduced a Results Based Management (RBM) System in the public service and in 2005 performance contracts were signed with some heads of parastatal organisations and top government officers on a pilot basis. Furthermore, the government has set a target for the civil service wage bill of 7.2 per cent of GDP by 2005. However, a court case by the Union of Kenya Civil Servants has slowed down the implementation of the Voluntary Early Retirement Scheme and hence the wage bill remains more than 8 per cent of GDP. Other reforms include the Public Officers Ethics bill and measures to strengthen the Anti-corruption Crusade.

The government has been pursuing financial sector reform to strengthen the financial system and to increase the predictability of the business environment in the financial sector. Towards this end, the government has prepared a comprehensive financial sector strategy aimed at improving efficiency in financial intermediation. As part of the strategy, the government expects to restructure and privatise state-owned banks. In 2005, a Bank Restructuring and Privatization Unit was set up in the Ministry of Finance to develop and implement the reforms in state-owned banks. Furthermore, efforts were made to strengthen the capacity to detect and prevent money laundering and financing of terrorist activities, through the drafting of the Anti-Money Laundering (AML) and Proceeds of Crime Bill. Other measures pursued include amendments to the Banking Act and the Central Bank Act to transfer all supervisory and regulatory roles from the Ministry of Finance to the central bank. Additionally, the Capital Markets Authority (CMA) that regulates the stocks and equities market was reinforced in 2005 to strengthen investor confidence.

### *Transport Infrastructure*

Kenya has experienced rapid growth in the transport industry since independence. This has proved to be essential not only for the domestic economy but also to serve the landlocked countries in Eastern Africa.

However, the transport infrastructure network has deteriorated significantly in the past decade owing in part to the suspension of donor funding to Kenya for this purpose. The network has also suffered from a long and cumbersome procurement process for construction, maintenance and rehabilitation of public infrastructure coupled with poor and compromised quality of work as a result of corruption. The quality and efficiency of the transport network have fallen leading to less predictable service delivery. Lengthy delays, breakdown of transport equipment, and closure of sections of the transport networks along the major transport corridors occur on a daily basis.

In recognition of the importance it attaches to addressing these problems, the government has identified transport infrastructure as one of the key pillars in its ERS and has developed an Integrated National Transport Policy Programme that seeks to develop the transport sector's infrastructure in a coherent and integrated manner. However, daunting challenges persist in the attempt to repair, modernise and expand the Kenyan transport infrastructure. Among the major challenges are how to turn around the poor economic performance of the public enterprises managing transport infrastructure facilities, and how to mobilise adequate resources for maintenance, rehabilitation, construction and expansion of the infrastructure itself.

The responsibility for road infrastructure is dispersed among different government ministries, departments and levels of government, with the Ministry of Roads and Public Works responsible for the classified roads, and the Ministry of Local Government, through various local authorities, responsible for urban and rural roads. The existing institutional framework has many players who are not linked optimally.

Kenya's road network has greatly deteriorated in the last decade. In addition to poor and deteriorating road conditions in the urban centres, there is a lack of other road infrastructure facilities such as footpaths for pedestrians to make walking safer, separate lanes for cyclists or non-motorised transport modes (NMTs), or flyovers and bypasses to ease traffic congestion. Although local authorities are expected to be responsible for the provision and maintenance of urban infrastructure, including roads, nearly all of them have been experiencing critical financial constraints, poor resource management and lack of quality personnel in specialised areas. The government is aiming to reduce the length of road network classified in bad condition by 23 per cent by 2007. The projected implementation activities include construction and rehabilitation of key road links and networks under the Roads 2000 Programme; rehabilitation of rural roads and reconstruction of 150 km of trunk roads per year, and concessioning of up to 1 200 km of trunk roads by 2007.

Current road infrastructure financing, which is a responsibility of the central government, is inadequate, arbitrarily allocated and does not allow for innovative ways for funding infrastructure development and maintenance. Furthermore, financing is fragmented between different ministries, departments and levels of government, which results in spreading the resources too thinly. Significant external funding for most of the proposed activities is made available from various donors and development partners. The government's contribution is made available through the Fuel Levy Fund that accounts for 24 per cent of the total budget and a share of the newly created Constituency Development Fund (CDF), with an estimated 16 per cent share of the total budget.

Rail transport is the second most important mode of transport in Kenya, after road transport, for both freight and passenger services. The railway system is under the parastatal management of Kenya Railways (KR) and comprises 2 765 km of track. In addition to provision of freight services within the country, KR also handles transit traffic to and from the landlocked countries in the East African region. KR has over time experienced financial, technical and operational problems as a result of poor corporate governance and inadequate investment. As a result the rail network continues to face operational problems because of rolling stock capacity constraints caused by inadequate funding.

The legal and institutional environment in which KR operates is not conducive to proper corporate governance. The KR Act, which governs the operations of the railways, limits the participation of other players in the railway transport business. The Act is silent on the participation of the private sector in the operations and development of railways. Moreover, the institutional management of the railway sub-sector combines the aspects of regulation and operation under one institution. In order for the government to enable the railway system to become competitive, it was necessary to review the KR Act. As a result of changes to the Act and the granting of a concession to a South African Consortium to manage the Kenya and Uganda Railways, the railway network may be expected to improve.

Kenya has a relatively well-developed air transport system. Many local, foreign and private firms as well as individuals operate services within the country. The Kenya Airports Authority (KAA), a public authority, oversees the management and administration of the airport infrastructure. The Meteorological Department and the Kenya Civil Aviation Authority (KCAA) provide essential support services to the aviation industry.

The current systems of Kenya's air transport infrastructure have a number of weaknesses, according to the Kenya Airspace Master Plan. These include ground communications that are persistently unsatisfactory by reason of the provider's (Telkom Kenya) technical problems; absence of essential equipment; the ageing and need for replacement of some of the technical equipment; and the lack of a Safety and Quality Management System (SQMS) among others. In order to handle growth in its international and domestic air traffic and maintain its status as an important hub in the region (East and Central Africa and the Indian Ocean), Kenya faces several challenges. These include sustaining sufficient budgetary allocations for rehabilitation and maintenance of airport facilities; reaching international safety and security standards; and improving and strengthening airport operational and management capability. To foster private sector participation (PSP) in the provision of infrastructure and services, the government has secured grants from the Public Private Infrastructure Advisory Facility and engaged a consultant to explore the possibilities and develop a PSP strategy.

The existing financing framework for airport infrastructure development and maintenance in Kenya is generally *ad hoc*. Financing is mostly by the government together with development partners. Currently, the ongoing airport modernisation is funded by the World Bank under the Northern Corridor Transport Improvement Project" (NCTIP).

Marine transport in Kenya consists of port facilities in Mombasa, shipping and inland water transport. The inland container depots at Nairobi, Kisumu and Eldoret, which are also managed by the Kenya Ports Authority (KPA), fall under this mode of transport. The recently established Kenya Maritime Authority oversees maritime activities in the country. Also, Kenya has inland water transport, but the potential for both rivers and lakes transport has not been fully exploited. Only Lake Victoria has significant transport activities.

## Political and Social Context

Kenya enjoys considerable participatory democracy and political pluralism amid continuing differences with the ruling NARC government. The government conducted a historical constitutional referendum in November 2005 which it lost. The constitution would have settled several controversial issues in the country, including electoral reform, the nature of presidential powers and the country's regional administration.

The government has maintained a strong commitment to the rule of law, peace and security and has continued to implement measures to reduce opportunities for corruption, deter corrupt practices and strengthen governance institutions as well as to enforce fully the anti-corruption laws and regulations. The government has prepared an Action Plan for a comprehensive anti-corruption strategy. The measures being implemented under this Governance Action Plan include enhancing the effectiveness of anti-corruption investigative agencies; building adequate prosecution capacity to handle corruption-related cases; making wealth declaration public in order to discourage abuse of public offices; and continuing to vigorously investigate economic crimes and to recover illegally acquired assets.



Additional reforms are being implemented to ensure that law and order is maintained. These reforms include improving capacity for crime prevention, investigation and prosecution; rolling out community policing to other urban centres outside Nairobi; and building housing facilities to improve the living conditions of police officers.

The government is taking some specific measures to reduce poverty in Kenya. These include the establishment of the Constituency Development Fund (CDF), the Local Authority Transfer Fund (LATF) and the Constituency Bursary Fund. Under the parliamentary act that established the CDF, it is required that 2.5 per cent of ordinary revenue generated by the government be transferred to this fund for disbursement to various poverty-reducing projects across the country. There is however concern that the establishment of many funds controlled by members of parliament may not achieve the desired target as the funds may not be subjected to the same control, reporting and accountability procedures as required for other normal budget outlays.

Progress in healthcare provision remains modest in Kenya. However, significant improvement is evident in the fight against HIV/AIDS. The HIV/AIDS prevalence rate has been reduced by 50 per cent in the last four years from 14 per cent to 7 per cent. The government has set new targets to maintain this momentum. According to the HIV/AIDS Strategic Plan 2005-2010, the National Aids Control Council (NACC) seeks to reduce the incidence of new infections, increase access to life-prolonging drugs and reduce the impact of AIDS on families. The new Plan also seeks to continue improving the quality of life for the country's 1.4 million infected people through access to anti-retroviral drugs and better medical care. The government has reduced the cost of anti-retroviral drugs to patients through a combination of factors, including enactment of the Industrial Property Act, which requires industrial establishments to make a financial contribution to government for the anti-retroviral drug programme. The government's education policy continues to focus on free primary school education. Since 2003, over 1 million children have joined the programme. The government has secured the future of these children in school by increasing budgetary expenditure on education. The government now allocates about 28 per cent of total government expenditures to the education sector. In 2004/05, the government focused attention on specific priority areas, such as ensuring equitable access to education by targeting disadvantaged areas, particularly those classified as Arid and Semi-Arid Land; vulnerable groups, such as street children and girls; reviewing implementation of the bursary scheme to ensure that only deserving children from poor households benefit; and improving quality and internal efficiency through teacher training and redeployment.

